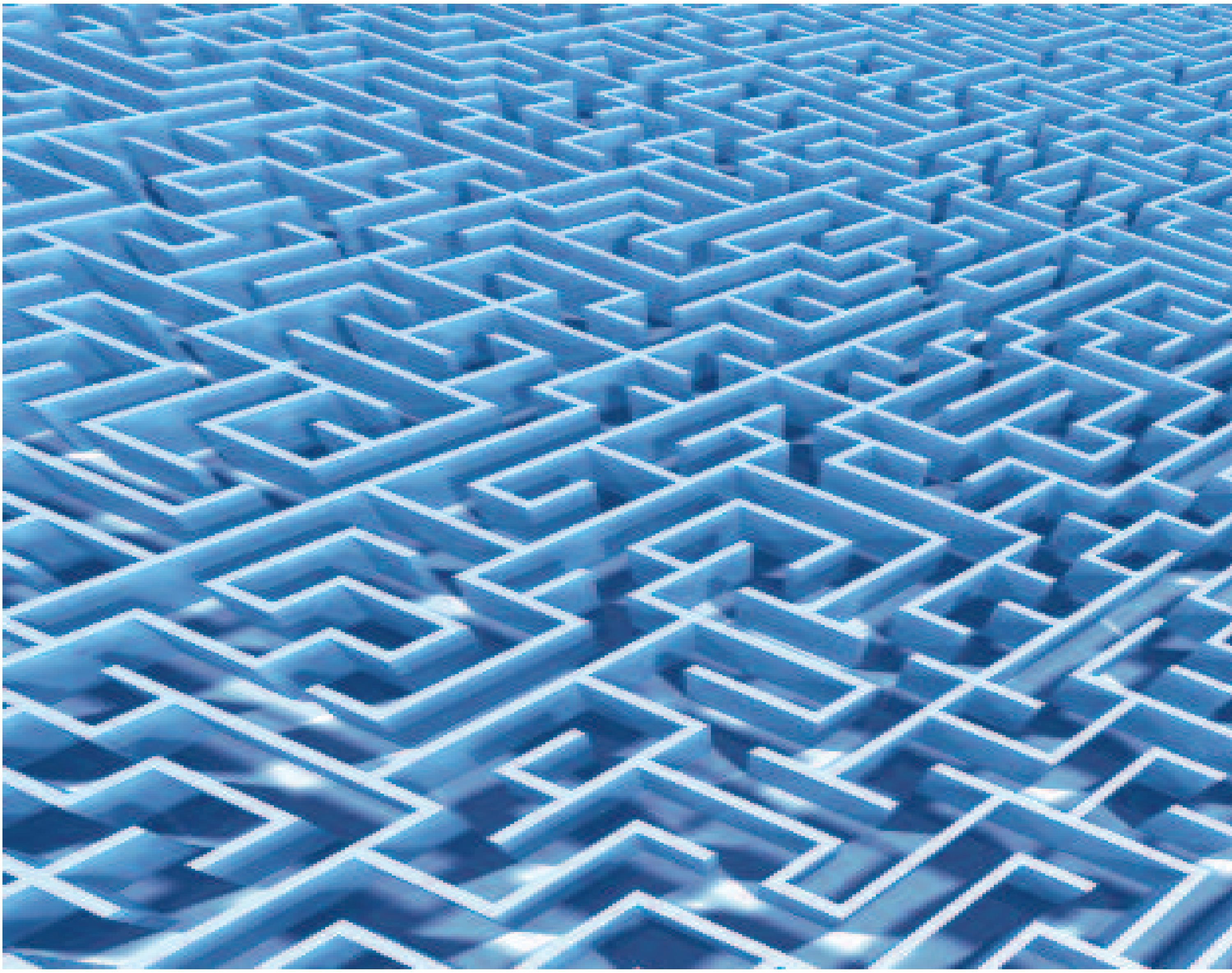
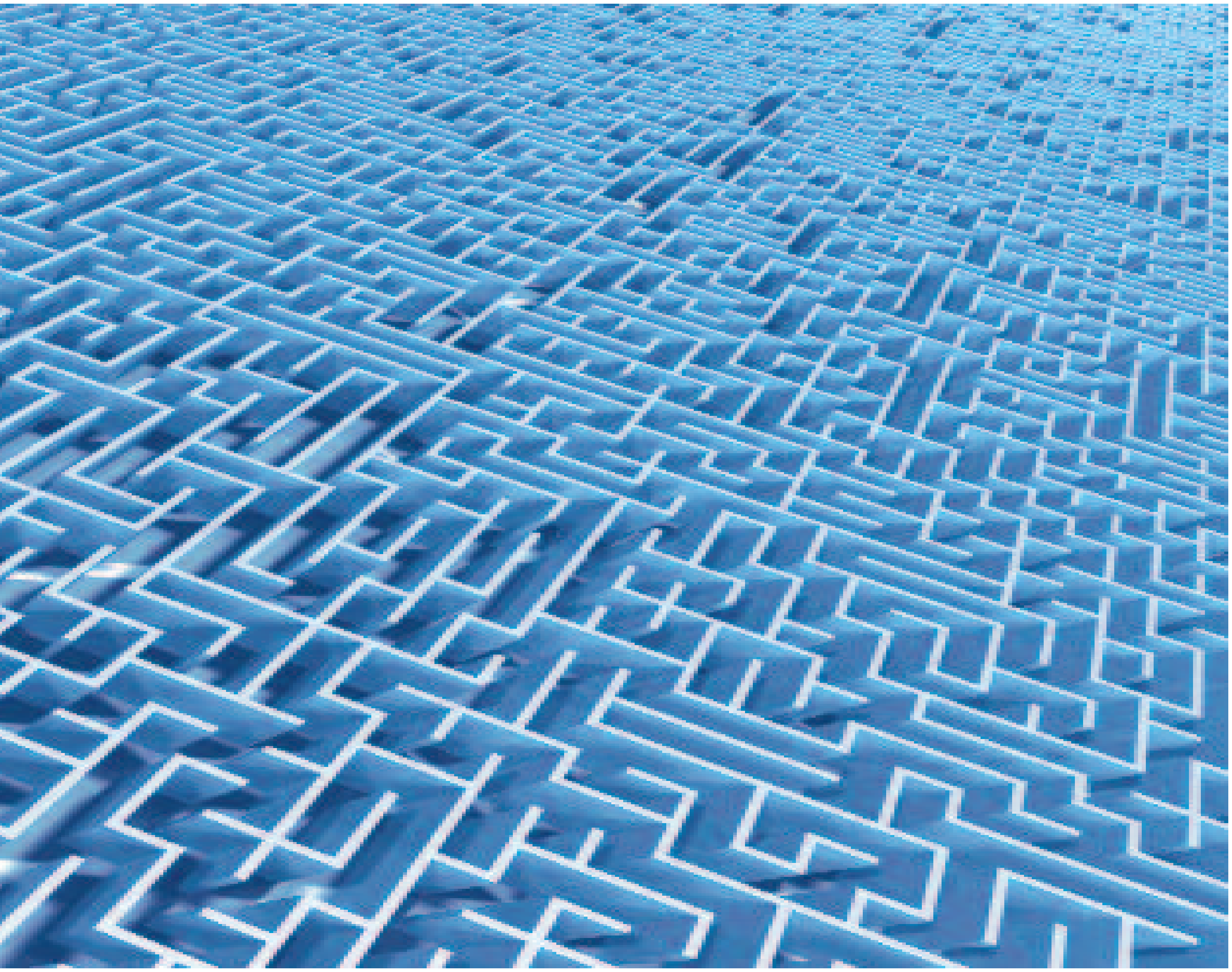


# Navigating the maze of IPT compliance



Some 200 jurisdictions around the world levy some form of tax on insurance premiums, and governments – always hungry for additional revenue – are increasing their enforcement activities. Compliance is an increasingly complex and critical issue. **By Lee Coppack**

In late 2007, the HM Revenue and Customs (HMRC) in the United Kingdom used a 1991 decision by the European Court of Justice (ECJ) to claim Insurance Premium Tax (IPT) from an overseas insurer, the Isle of Man company DSG International Insurance Services, which wrote extended warranty contracts for customers of the electrical retailing group, Dixons. This was the first such case the HMRC had pursued, but experts predict it will not be the last one, even though DSG won. It is evidence that the HMRC is prepared to chase foreign companies who insure UK risks for IPT, and captives could be particularly exposed.

## Increasing enforcement

The risk is primarily one of compliance, although failure could also mean

**"We have the ability to allocate a fair and reasonable part of the overall premium to each part of the risk. We know what insurer taxes are payable … there is a clear audit trail."** John Latter, Zurich

»» substantial penalties and interest in addition to back taxes. Under a growing number of corporate governance regimes, company directors need to be able to state that their companies are compliant globally with all relevant regulations. Insurers are in the front line, because the primary responsibility for paying insurance taxes is usually theirs.

The recent budget announcement that fiscal representatives will no longer be required for the payment of IPT in the United Kingdom means that an overseas insurer can choose to pay IPT due in the United Kingdom direct to HMRC. This is a positive sign and will help streamline trade involving overseas insurance companies operating on a cross-border basis.

Yet, the policyholder is still exposed. Even though the United Kingdom proposes to relax some liabilities for insureds, companies with complex international insurance programmes covering risks sited in many countries and involving a number of insurers may find it difficult to state confidently that all those insurers have the means to track, calculate and pay all the different taxes.

Although within the European Union, the single passport system allows insurers, including captives, regulated in one member state to underwrite risks in other countries with few restrictions, the premium tax still has to be paid where the risk is sited. For example, the 2008 budget also included an announcement that the United Kingdom will retain HMRC's power to assess the insured for IPT due in the United Kingdom in circumstances where the insurer is not based in a country covered by a mutual assistance agreement between the respective tax authorities.

In the 2001 ECJ case of *Kvaerner v Staatssecretaris van Financien*, the Dutch tax authorities had demanded tax on premiums paid by the UK company Kvaerner to cover its Dutch subsidiary. Kvaerner was the defendant because its insurer had no establishment or tax representative in the Netherlands. The ECJ ruled that Kvaerner was liable for the tax. The court also said it did not matter which part of an international group was legally the policyholder and neither did it matter if the subsidiary company paid none of the cost of the insurance. The tax was still due and if the insurer could not pay it, then the policyholder had to.

For a national business insuring risks in its home country with a locally admitted insurer, there should be few problems, although it may be possible to improve the effectiveness of the insurance budget, says Karen Gorman, Partner in Jardine Lloyd Thompson's Global Support Team. When it comes to multinationals with global or umbrella programmes, there can be major headaches. "It's fairly straightforward for property insurance," she explains, "but at the other end of the spectrum, how would you allocate the directors' and officers' liability exposure? There are many grey areas, but it is certain that tax authorities will look to claw back more money from insurance taxes."

## ARE YOU COMPLIANT?

- What is the risk?
- In what country or state is it?
- What part of a global or umbrella premium should be allocated to that risk?
- Where was the policy issued?
- Is the policy admitted or non-admitted?
- What is the right tax rate for that particular premium?
- Does the insurer have an effective system to calculate and pay the right tax?

## Mired in complexity

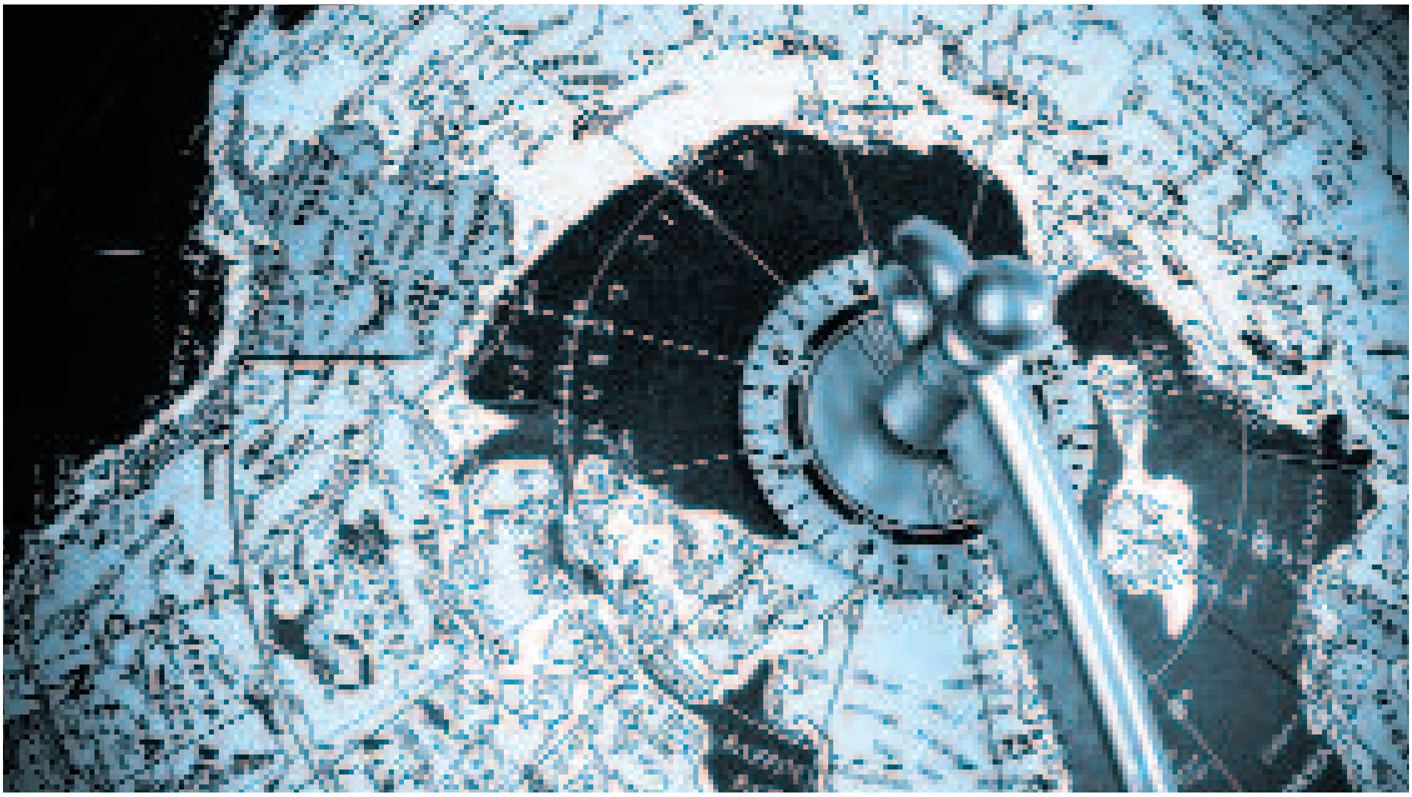
Only about 60 per cent of companies are compliant today according to Gorman's estimates and they are more likely to be businesses without complex insurance programmes. If captives and fronting arrangements are involved, an already complicated situation becomes more so.

In Europe alone, as Adrian Smith, Head of KPMG's IPT group and global network, explains, there are wide variations in insurance taxes. Seventeen of the 27 current member states of the EU have some form of premium tax, and each of them can set its own rates with the result that they vary wildly. The average is 10 per cent. Some countries also impose other parafiscal charges, such as a levy for the fire service. In the United States, taxes vary between states.

While brokers are not able to arrange tax payments, Gorman says they can help answer the key questions that policyholder and insurer need to establish (see box left) and work with the client to design programmes that keep the amount of tax due in proportion to the benefits from the insurance. For instance, Jardine Lloyd Thompson's specialist Global Support Team will work with the policyholder to:

- Decide how much risk to retain. It may be possible to increase deductibles and so reduce the tax liability without exposing the business to an unsustainable level of risk.
- Structure programmes for efficiency and transparency. The more easily you can identify the risk location or locations and show the process of premium allocation, the less likely you are to be on the wrong side of tax authorities.
- Advise on insurers' systems for tax payment or suggest alternative means of arranging payment, for example through fiscal representatives.

"We help our clients make sure they are compliant and maximise the value they get from their insurance budget," says Gorman.



## Proving compliance

KPMG's Smith believes "the compliance pressure on insurers is making them increasingly unwilling to write risks unless they are confident they have all the mechanisms in place in that jurisdiction to calculate and pay the right taxes".

He confirms that fiscal authorities are looking for compliance: "For example, the HMRC and the US Revenue have a reciprocal enforcement process which puts more pressure on insurers to think about their compliance," he says.

Zurich is one organisation that has invested a great deal of resources setting up its Multinational Insurance Application, a global database of legal, regulatory and tax data which also incorporates an insurer premium tax payment capability. This database underpins Zurich's Multinational Insurance Proposition (MIP), which it launched in October 2006 for new business and is continuing to roll out.

The global guidelines and standards that support Zurich MIP include very distinct rules for the allocation of premiums to risks based on the relevant regulations, and when it comes to cross-border business it takes into account how the insured structures its business. The UK DSG case, for example, turned on the issue of whether the subsidiary of Dixons, which DSG insured, was established in both the Isle of Man and the United Kingdom and if so, where did the policy relate.

"We have a range of business scenarios. We look at the customer's profile," says John Latter, Head of MIP at Zurich, "and we can adjust the framework. It's something we discuss with the broker and the customer. Then based on the customer's activities, we allocate the premiums according to the rules and the line of business."

Since tax regulations and rates change frequently, it is not surprising that maintaining the data contained in the underlying database is very demanding. The organisation employs four full-time lawyers, internal and external tax experts and a large network of local correspondents to make sure it is up to date.

Latter comments that even for businesses that feel they understand the insurance tax rules in European countries, as they develop globally, they may find they need to comply with completely different regimes in Japan or China, for instance. "Everyone realises there is an issue," he says. "The regulatory environment is tightening and it is tightening across the world." RS

i Karen_Gorman@jltgroup.com

**Lee Coppack** is editor of *Catastrophe Risk Management* and *InfoRM*, and former editor of *Global Reinsurance*; she writes widely on insurance and risk management.

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