

A taxation storm

With the UK government expected to introduce tax regulatory changes that would effectively create our own 'Sarbanes-Oxley', Chris James warns of the major implications for all insurance company leaders.



Lost in the big headlines surrounding the Budget was an announcement that carries serious implications for the insurance industry and one that not enough people have woken up to. The news? Her Majesty's Revenue & Customs is in the advanced planning stage of a move to hold the senior accountants in larger firms personally liable for inaccurate tax reporting. If a company's accountant is found by the taxman to have made a "careless or deliberate" mistake, he or she could be fined and their employer could also face a financial penalty.

If implemented" and there is still, frustratingly, a lack of clarity here, which is only adding to anxieties" informed commentators view the new regulation as effectively a 'UK Sarbanes-Oxley'. That legislation, rushed through in the US in the wake of the Enron scandal, imposes hefty obligations on office holders of US corporations with respect to internal controls over financial reporting processes, as well as a raft of other compliance burdens.

There does appear a significant danger that Whitehall will force through 'Sarbox-style' compliance burdens on UK businesses, as well as creating a potential personal exposure for the senior accounting officer. At least one stakeholder, the Institute of Chartered Accountants, believes this is "a disproportionate response to the perceived problem. While we understand that it is not the government's intention to import US Sarbanes-Oxley style legislation into the UK, this is exactly what this provision will do".

Under the proposal introduced in this year's Budget, senior accounting officers of large UK companies will be required to personally certify that adequate accounting systems are in place to ensure the accuracy of their tax reporting. For this purpose, large companies are defined as those that meet at least two of the following three criteria for the financial year: a turnover exceeding £22.8m; a balance sheet total exceeding £11.4m; and more than 250 employees.

If the move goes ahead, a whole new area of risk opens up for any company not totally on top of key taxes issues, such as insurance premium tax; the only way to avoid heavy costs for businesses and insurers alike is to take immediate steps to ensure tax systems and processes are robust.

The risk is particularly acute in less well-known and indirect taxes, which include IPT. Achieving compliance remains a key challenge for insurers and insureds alike. This challenge is only magnified when considering global policy solutions, particularly for insurers writing multi-state cover, as European Union premium tax is difficult both to calculate and pay and insurers have to deal with each country on an individual basis. In the EU, the tax is calculated upon the location of the risk, rather than of the insurer or payee and is, therefore, as applicable to a US corporation or Bermudian captive as to a European insurance company.

For example, a US company's Irish subsidiary buying insurance in the London market for its Spanish distribution centre must charge Spanish premium taxes on the Spanish share of the total risk premium. It must collect the premium and taxes from the client in order to pay the Spanish tax authorities and, as an added complication, the insurer must appoint a tax representative in Spain to act on its behalf. This scenario is repeated in other member states with premium tax regimes.

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Added to this, tax rates and regulations vary widely between states, requiring specialist local knowledge and tailored filing arrangements. This is especially true in the EU, where there are 21 different insurance tax regimes, varying widely in terms of business classes liable and methods of payment. Add to this a dizzying selection of 23 official languages and 12 different currencies used in the region, and it becomes evident that water-tight compliance with IPT is a time-consuming, costly and highly complex task. And yet, in the eyes of tax authorities, the scale of the task is no excuse for non-compliance. Governments are keen to find additional revenue at the best of times" but in the current climate indirect taxes are a harvest ripe for the picking.

The importance of IPT compliance to insurance buyers has been underlined by Paul Hopkin, technical director of the Association of Insurance and Risk Managers, who said: "The complexity of European premium tax means there is ample scope for miscalculation and tax authorities can ultimately pursue the insured for any unpaid taxes. Given this financial and reputational exposure, insureds have a duty and right to demand evidence that insurers have appropriate measures in place to handle their premium tax obligations."

Insurers need to grasp the nettle of all forms of possible fiscal compliance coming down the line now so as to strengthen their companies and augment their efficiency to weather the ongoing storm. The verdict is clear. The economic and regulatory pressures on clawing back the money Whitehall has laid out to save UK banks mean insurers caught in the firing line could be facing increasingly costly litigation, extra auditory burden or worse" the destruction for probity of a reputation that may have taken decades to build, lost in hours.