

## Market Turmoil Puts the Spotlight on Insurance Premium Tax Compliance

*There are now even more reasons to tighten up on IPT compliance, says Mike Stalley of FiscalReps*

One of the things we can be certain about after the recent dramas across financial markets is that regulation and compliance are moving even further up corporate and political agendas. While the greatest urgency may be to tackle banks' capital adequacy and incentive structures, financial compliance in general is sure to come in for greater scrutiny. For the insurance industry, this will likely see the topic of Insurance Premium Tax (IPT) compliance figure ever larger in discussions between client and insurer.

At the same time, a recent ruling by the UK IPT Tribunal has set a precedent that could make a wider range of insurance-related services subject to IPT payments. HM Revenue & Customs had argued before the Tribunal that Homeserve, the home emergency and insurance services group, should have paid IPT on the £14 arrangement and administration fee it charged its homeowner clients when they became insured by Inter Partner Assistance SA. For its part, Homeserve argued that its fees were covered under a separate contract from the insurance policy and were consequently IPT exempt. However, the Tribunal disagreed and found that, under the broader definition of a 'premium' created by 1997's amendments to the Finance Act 1994 - which includes services delivered 'in connection with' the provision of the insurance contract - Homeserve should indeed have paid IPT on its fees.

Not only is this ruling significant for Homeserve, which may now face a retrospective IPT bill of some £1 million, but it could affect other insurance intermediaries who are remunerated on a fee basis. For example, many brokers now to varying degrees have adopted service fees in place of commission income. In principle, there is of course no problem with this – the move away from traditional brokerage has been made in pursuit of transparency, not as a tax dodge. However, the Homeserve ruling, coupled with a climate of intensified regulation, means that intermediaries would be well advised to review the terms of their relationships to ensure that they are properly covered by either VAT or IPT. It is plain that HMRC will have no tolerance for business that, whether by design or mere oversight, falls between these two stools.

However, the ramifications of IPT do not stop there. It is an issue of which insurers, captives, risk managers and other professionals must now be far more circumspect than in the past.

For many years, the insurance industry regarded IPT as a side issue requiring minimal management attention. In today's climate, the situation couldn't be more different: IPT compliance is an important agenda item in contract negotiations, and brokers and insurers need to provide evidence of effective compliance systems before clients will consent to sign on the dotted line. This change has occurred because of the severe consequences that non-compliance can bring: fines, litigation and reputational harm can all result from unpaid taxes, a prospect that nobody would welcome.

An essential step is therefore to undertake a far-reaching audit of your existing IPT systems. This should investigate how IPT and parafiscal taxes are calculated, filed and documented, to establish how well these systems meet the demands of your business, your clients and the tax authorities. It is essential to approach the task with a critical – or perhaps independent – eye, to judge objectively how your arrangements compare to best practice. The task should be completely rigorously and transparently, and the findings shared with senior management, as they ultimately face the consequences of any inadequacies.

You should also consider the costs that your arrangements entail. Compliance is vital, but shouldn't become an overwhelming burden on your business. Around 95 percent of IPT compliance is administration, so it is important to consider ways in which systems can be streamlined or outsourced so as to save money.

The potential weaknesses and costs of your IPT compliance regime reflect the complexity of the issue, as amply demonstrated by the situation in the EU. Despite being a fairly homogeneous market in many ways, there is no harmonised IPT system in Europe – instead, there are 21 separate regimes, each with their own rates, rules and filing requirements. In addition, 13 separate currencies and 23 languages add further layers of difficulty. Even for major global carriers, complying with such a variety of regimes is a daunting task, and one that few could honestly say they are fully on top of. And if large firms are not confident, how do smaller, more specialised players feel? The truth is many are struggling and run the daily risk of fines or worse.

The consequences of non-compliance were worsened in 2001 by the European Court of Justice's ruling in the Kvaerner case. This gave EU national tax authorities the power to hold insurance buyers liable for premium tax unpaid by their insurers, an inconvenience and embarrassment sure to sour client relationships.

Not only is the level of regulation increasing, but so is the need of governments to collect unpaid premium taxes. In these times of declining tax revenues, administrations – always intent on exploiting new sources of income – are pursuing indirect taxes with growing fervour. IPT seems to be firmly in their sights: for example, the Netherlands increased IPT by 0.5% earlier this year, while compliance spot checks are now being carried out in Germany and Italy. The economic slowdown means similar actions are likely to become common across the EU, making IPT compliance an imperative, rather than an after-thought.

While Europe is particularly demanding when it comes to achieving compliance, IPT is also an issue with global ramifications. Corporates increasingly require worldwide insurance solutions, so many now expect insurers to maintain compliance systems that are similarly global. Compliance systems must therefore address the individual requirements not only of the EU, but also US states and other countries around the globe.

It all adds up to a very tall order: greater scrutiny, increasing risks of financial and reputational pain, and all this across a growing range of territories. The good news is that there are technological developments underway that promise to radically simplify matters, fortifying IPT procedures without emptying compliance purses. Insurers should soon be able to leave much of their compliance administration to reliable, automated solutions, and return to their core areas of expertise – the analysis, advice and service that really add value for clients.

However, with or without new technology, the core message is this: insurers and brokers must act now to protect themselves and their clients. Particularly in insurance, your reputation is invaluable. But reputations diligently built over decades can be quickly ruined through basic compliance errors. This is no longer a matter to be put off until tomorrow.

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