

Captive Review January 2011

Not so simple life

Captives could be fooled into making a very expensive mistake by thinking tax compliance is becoming simpler

by *Mike Stalley, founder and CEO, FiscalReps*

The regulations covering the payment of insurance premium tax (IPT) across Europe are changing in a fascinating way right now. The long-established compliance mechanism, by which locally based fiscal representatives are legally required for insurers in the countries in which risks are being insured, is unwinding. However, tax authorities are arguably becoming more tenacious than ever before in their pursuit of revenue – and less forgiving too.

If you make a mistake with your IPT accounting in the future, do not expect a frown and a warning. Expect a penalty. And if you are the company's senior accounting officer, and if legislation already introduced in the UK is also enacted elsewhere, another fine might well be coming out of your own pocket.

So while, legally, the need for fiscal representation across Europe might be declining, the real need for expertise is actually increasing. If you do not have sufficient internal IPT expertise, and make an error with your tax filing, the punishment could be high. Ignorance is no excuse. If you do not calculate and pay your IPT correctly, the tax authorities are now far more likely than in previous years to condemn your complacency and penalise you.

Captives, and their owners, need to beware. Compliance costs (or the penalties for failing to comply) could be considerable in proportion to the business transacted by the captive.

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REVENUE & CUSTOMS BRIEF 47/09

Her Majesty's Revenue and Customs (HMRC) issued a brief confirming the action it would take following the high court judgment in the Homeserve IPT appeal. The brief summarised the case as follows:

“On 18 June the High Court released its judgment in the Homeserve Membership Ltd (Homeserve) Insurance Premium Tax (IPT) appeal (2009 EWHC 1311 (Ch)). Homeserve arranges domestic plumbing and electrical breakdown insurance for householders. In 2004 Homeserve restructured its arrangements so that it charged part of what would ordinarily be considered the insurance premium as an ‘arrangement and administration fee’ under a separate contract with the insured.”

The High Court found in favour of Homeserve, that is that the contract between Homeserve and the insured person fell outside the scope of IPT, being a separate contract to the tax-

able insurance contract.

In the brief, HMRC said it had decided not to appeal the judgement and confirmed that claims from businesses that have been accounting for IPT on fees charged under arrangements such as those adopted by Homeserve, “that is, charging fees under separate contracts with the insured parties and notifying the insured in writing that the fee is an amount so charged”, would be paid subject to the normal repayment, capping and unjust enrichment rules.

In HMRC's view, where fees are “artificially carved out of what would ordinarily be taxable insurance premium”, IPT is properly due. HMRC duly announced its intention to take action “to close the loophole exposed by the outcome of the Homeserve litigation”, consulting with the ABI and other insurance industry representatives to “ensure the proposed changes to IPT legislation are properly targeted”.

The changing environment

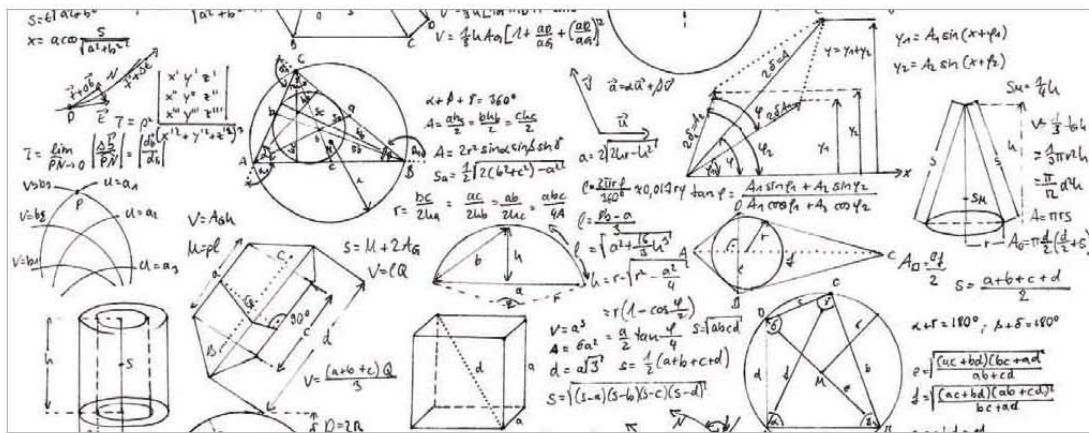
The spirit of the European Union, pursuing ‘Freedom of Services’, naturally encourages a level playing field for insurers. The principles of a single market demand that a UK-based insurer, for example, should be able to pay IPT in France without having to legally appoint a fiscal representative actually located in

France. We are seeing those principles become reality.

Leading the way, the requirement for a Belgium-based fiscal representative was dropped in January 2006 (as long as the insurer's head office was in the European Economic Area). In the UK, the equivalent requirement was abandoned in March 2009.

France and Italy are among the countries to have now joined this group, and the trend clearly indicates that a requirement for fiscal representation will be less and less common across Europe in the months and years to come. (The Netherlands' tax authorities, for example, have indicated a move to abolish the need for fiscal representation in 2011 and the European Commission has formally requested that the Spanish tax authorities drop the requirement.)

Of course, the freedom to act without



a fiscal representative when paying IPT should not be mistaken for the obligation to do so. Retaining a specialist tax agent to support your IPT process could 'insure' you against costly compliance errors.

More relaxed, more determined
As the IPT compliance mechanism becomes more relaxed, national tax authorities across Europe are becoming more determined. The pressure on these authorities to bring in as much money as possible has steadily intensified over the past two years, not least because governments are seeking to protect and steady themselves in the recession and 'eurozone' crisis.

Consequently, we have seen a sharp increase in the number of IPT rate rises in the past year. Governments are focusing on IPT as a means of repairing public finances. We have seen more IPT increases

TOP IPT TIPS FOR CAPTIVES

- Ensure your compliance requirements are focused on the business you underwrite
- Buy in expertise in niche areas where your knowledge is limited
- Look for opportunities to change your premium collection terms so that you are proactively reacting to changes in tax legislation
- Try to develop a simple and systematic approach to tax compliance built around annual premium renewals, so that any changes are identified as early as possible and can be addressed before the renewal date.

“Such frequent rate changes make it more difficult for captives to stay tax-compliant internationally”

announced in the past 12 months than in the previous two years combined.

Ireland, for example, increased the country's IPT rate to 3% in late 2009 and Finland's IPT rate rose to 23% (from 22%) in 2010. In 2011, the Netherlands and the UK will increase their rates (for the UK, the standard rate is up from 5% to 6% and the higher rate is up from 17.5% to 20%). In addition, Bulgaria will introduce IPT for the first time. Many governments clearly see IPT as an under-exploited revenue source.

Such frequent rate changes make it more difficult for captives to stay tax-compliant internationally and, furthermore, tax authorities are arguably pursuing revenues more aggressively than ever before. How do we know? Well, one example from late 2009 demonstrates how determined the UK tax authorities are to maximise revenues from IPT.

A company called Homeserve arranged home insurance contracts to provide cover for matters such as plumbing and drainage emergencies. For each customer, an insurance contract, on which IPT was paid, was issued alongside a separate contract for administration, on which IPT was not paid.

HM Revenue & Customs (HMRC) considered this arrangement to be an artificial avoidance tactic and sought IPT payments for both contracts. Initially, the

tribunal backed HMRC but Homeserve's appeal was successful. In March 2010, HMRC set about changing the law as part of the Budget. The Homeserve case, and specifically the consequent move to change the law, was a clear statement of intent from HMRC.

The UK's determination is not an isolated position. Germany and the Netherlands are the most vigilant IPT enforcers, regularly initiating tax inspections. Other European tax authorities could naturally follow any lead that proves successful in securing additional income from IPT. Avoidance, whether by accident or design, is likely to be punished.

Freedom of service

Where the legal freedom exists, any captive is of course perfectly entitled to calculate and pay IPT without fiscal representation. However, for captives' and captive managers' overstretched finance teams, maintaining a firm grip on the still-complex and regularly changing IPT regulations of multiple countries may prove, if you will excuse the pun, to be taxing. When choosing how to pursue watertight compliance in future, therefore, captives need to consider whether their internal resources are genuinely equal to the task. ☺