

Take control to avoid a crisis

The ever-present threat of a hardening market has made the payment of insurance premium tax more important than ever before. Mike Stalley, founder and CEO of FiscalReps, explains how captive owners can reduce costs simply by reviewing tax calculations.

Taxes billed to corporate buyers of insurance during the purchase of global insurance policies must be accurate and paid to the correct tax authority in accordance with local tax legislation. Failure to do so, by using inefficient or incorrect processes, could hit captives and their owners hard financially, in both the short- and long-term.

In many countries, the burden of premium compliance falls on the shoulders of the policyholder, such as federal excise tax (FET) in the US and Canada. In areas such as the European Union (EU) where the policyholder does not have the primary legal liability for premium tax compliance, case law and court rulings often create legal liabilities for the insured, as shown by the Kvaerner ruling in 2001. In that instance, the European Court of Justice ruled that any unpaid insurance premium tax (IPT) could be collected from the local insured rather than the insurer.

As with most indirect taxes, the costs of premium taxes are effectively

borne by the policyholder either directly as a separate invoiced amount or indirectly as an increased insurance premium.

Double-digit taxes

Premium taxes are commonly calculated as a percentage of the premium invoiced, so when premium rates increase, so do taxes. Many premium taxes are significant additions to the cost of insurance: for example, the Canadian FET is 10% and German IPT is 19%. It is important, therefore, that due care is taken to make sure calculations are accurate.

Much uncertainty remains within the insurance market as to who is responsible for the allocation of premiums, the calculation of premium taxes and, increasingly, which party is at fault when things go wrong. Technically, the party with the liability for tax settlement with the relevant tax authority has ultimate responsibility. However, the situation can be far more complex with a global programme. There may be a number

of different tax-payers, depending on which countries are covered under the programme, the programme structure and the methodology used to allocate premiums. In some countries, such as Spain, the failure to settle certain taxes could lead to invalidated coverage.

Despite much confusion, there is an answer. Rather than considering on whose shoulders the burden of tax compliance falls, consider the cost of the tax itself and the gains to be made by correct calculation.

Brokers, risk managers and underwriters are not tax experts by profession. Asking them to perform tax calculations based on inconsistent premium allocations could result in costly errors. The cost of compliance failings within the insurance industry could easily result in increased premium costs for the buyer, a scenario that is often repeated in other regulated industries.

Take control

Policyholders should therefore take greater responsibility for tax calculations for themselves and their captives. In many cases, policyholders have a primary or potential liability for the payment of the taxes themselves. This responsibility is increased when the policyholder is using a captive through which a part of the group coverage is insured.

Taking responsibility for calculation ensures the potential tax cost and liability to your business is accurately established. Being able to

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HOW TO DEFUSE A PREMIUM TAX 'TIME BOMB'

A global financial services institution (GFSI) had for a number of years purchased global insurance policies for a range of liability risks covering global operations.

Following an internal review, management were unable to fully establish whether all relevant premium taxes had been correctly calculated; furthermore, internal evidence proved insufficient to prove conclusively what due premium taxes had been settled with the appropriate tax authorities.

Internal calculations initially estimated GFSI's premium tax 'time bomb' at \$10m. GFSI needed a swift resolution.

Upon discovery, GFSI had to make significant financial provisions for the estimated cost of settling unpaid premium taxes over time. In addition, provisions had to be made for the cost of settling the due premium taxes, which included professional fees, penalties and fines, which were likely to be imposed by local tax authorities.

Mindful of protecting a market-leading reputation, GFSI wanted this issue dealt with promptly, professionally and discreetly, to minimise any negative impact.

GFSI decided to engage FiscalReps to perform a detailed review of company insurance policies. The review's purpose was to establish the correct amount of premium taxes that should have been paid. Secondly, a thorough

reconciliation was performed to identify which premium taxes remained unpaid. FiscalReps approached the relevant tax authorities and agreed a full and final settlement of the unpaid premium taxes.

Vitality, FiscalReps also developed a series of internal controls that GFSI could adopt to ensure its premium tax position remained fully compliant in future.

GFSI was able to save money by reducing the overall unpaid tax provision and settling the remaining premium taxes quickly and efficiently, with minimal penalties incurred.

Following the FiscalReps review, the estimate of total unpaid premium taxes was reduced to \$6.7m, a considerable saving from the original estimate.

At the time of the engagement, GFSI was undergoing a number of important strategic and structural changes. The use of FiscalReps allowed management to remain focused on core business issues at this time. Crucially, the FiscalReps team was able to resolve the premium tax issue without GFSI suffering any reputational damage.

The overall cost of the exercise to GFSI, including all professional fees and penalties, was far less than the original estimate of unpaid premium taxes.

calculate your cost base reliably is the first basic rule for any company accountant.

Equally, there may be real tax cost savings if an accurate premium tax calculation is performed. Premium taxes and premium allocations especially remain a technically complex area. Many brokers and underwriters do not possess the necessary resources, depth of skills and up-to-date tax information to perform the calculations with the level of consistent accuracy required.

By taking control of the tax calculation process, policyholders are able to direct compliance operations, taking responsibility for compliance where the law requires and forcing other parties to do the same where necessary, thus ensuring total compliance and avoiding potential penalties and fines.

The reputation of businesses as good corporate citizens is dependent on their ability to trade within compliance requirements, including premium taxes. Many business experts are now able to assign financial values to a brand, of which reputation is one element. Consequently, the potential damage to profits and share prices can often be estimated, based on an event leading to a damaged reputation.

Corporate buyers of insurance – especially those buyers with captives – have a lot to gain from effectively controlling the requirements of premium tax compliance. The opportunity to ensure compliance, save tax costs and drive process efficiencies within their own businesses could offer tangible and immediate benefits.

Additionally, the thoroughness of such an approach will ensure brokers and underwriters are fully compliant, thus reducing processing costs and the costs of compliance-failure for the industry. And in the long-term, this will reduce the percentage points of the next premium rate rise. ☺

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