In most jurisdictions around the world, insurance premiums are subject to indirect taxation. This could be VAT, GST, stamp duty or other levies, or a specific tax, usually insurance premium tax (IPT).

In this article, we look at some of the recent developments in taxing insurance premiums and the challenges that insurers face in meeting their IPT obligations.
The indirect tax landscape for insurance

In recent years, in line with a global shift from direct to indirect taxation, an increasing number of countries have introduced or increased IPT and similar tax-related charges on insurance.

In the EU, insurance services are generally exempt from VAT (that is, not subject to VAT with no right to input tax deduction). In the past 25 years, following the Second Non-Life Directive issued in 1988, most EU Member States have introduced a tax or levy on insurance premiums.

Outside of Europe, many countries are actually taxing insurance services and premiums with VAT or sales tax. This is the approach that has been proposed for the new GST in India and for VAT in China.

Recent IPT rate and tax changes

A number of countries have introduced IPT in recent years. This trend has been especially strong in Central and Eastern Europe (e.g., Bulgaria, Hungary and Romania). In addition, several countries have increased their IPT rates. The most significant rate change in Europe happened in the Netherlands, where a 9.7% rate was increased to 21% to bring it in line with the Dutch standard VAT rate.

In 2015, a number of European countries also increased the rates for taxes that apply to insurers from other Member States providing insurance cover under “Freedom of Services” (FOS), including:

- **France**: The IPT rate for legal expenses cover has been increased from 9% to 11.6%.
- **Malta**: The stamp duty rate applicable to existing taxable non-life insurance policies has been increased from 10% to 11%.
- **Portugal**: The National Medical Emergency Service Fund (INEM) tax rate applicable to accident, health, life, motor and travel insurance policies has increased from 2% to 2.5%.
- **Slovenia**: The IPT rate applicable to existing taxable insurance policies has been increased from 6.5% to 8.5%.
- **Italy**: There have been a number of changes to the provincial IPT rates on motor insurance policies for cars registered in each province.
- **UK**: The standard rate of IPT will increase from 6% to 9.5% from November 2015.
- **Greece**: The standard rate of IPT levied on most non-life insurance policies has been increased from 10% to 15% with effect from 16 July 2015.

Figure 1. A selection of global IPT changes since the beginning of 2015.
Recent IPT court cases

Aside from increases in tax rates, various court cases have addressed the scope of insurance and the application of IPT, e.g., about the reinsurance of suretyship, on the location of risk and related to indemnity agreements. The outcome of the indemnity agreements case, which originated in Germany, has been seen as sensational. The judgment found that insurance does not necessarily have to be defined by a policy, but it can be any transfer of risk and the supply can be subsequently subject to IPT – in this case indemnity agreements provided by a head office to its subsidiaries at a percentage of turnover.

In a recent case from the Netherlands, it has been clarified that activities of a company offering breakdown assistance for a fixed annual fee constitute an insurance contract, and they are therefore subject to Dutch IPT.

At the CJEU level, there have also been a number of decisions on insurance-related cases. In the Mapfre case, the Court’s decision is bringing extended warranty sold by third parties into the scope of insurance. In the case of BGŻ Leasing, it has been decided that where a lessor insures an asset and recharges the cost of the insurance, this recharge is a VAT-exempt insurance supply. Lastly, following the RVS case, European IPT is now an issue for many life insurers as the CJEU clarified that if a policyholder moves to a different country within the European Economic Area (EEA), IPT needs to be paid in the country where the policyholder is habitually resident.

Tax authorities are becoming more proactive

Following the financial crisis, tax authorities have become very proactive in tackling noncompliance by non-domestic insurers. Germany, for example, went from having a loose network of local tax offices dealing with foreign IPT to centralizing the IPT function at the Bundeszentralamt für Steuern (federal tax office). The aim was to ensure that procedures for all foreign/FOS insurers are aligned and also that revenue enforcement targets are set for tax inspectors.

Many tax administrations have increased their IPT teams in recent years and are also working on updating or issuing more detailed IPT guidance. Also, many countries have started working more closely with regulators to identify noncompliant insurers. Information is also coming from the exchange of information between tax administrations – for example, tax inspectors who audit a company and find that a policy was taken out from a non-domestic insurer are now passing on that information to the relevant IPT authorities, who then contact the insurer with an assessment for the unpaid IPT. This is happening to the extent that the basis of premium apportionment across countries where risks are located is also being inspected.

Issues for insurers

The variety of taxes on insurance premiums can be a burden for insurers that issue global insurance policies with risk coverage in many countries, as they need to understand which taxes apply in the countries where the risks are located. Often, insurers also need to administer and pay taxes in those countries and, historically, there has not always been a high level of compliance with “foreign” insurance taxes.

Various trends are forcing insurers to think differently about IPT compliance. IPT, which was previously just seen as a very small revenue source for governments, is becoming more significant as Solvency II and the OECD’s Base Erosion and Profit Shifting (BEPS) initiative drive the importance of correct taxation and compliance issues.

With these considerations in mind, brokers are becoming more concerned about their tax liabilities and their role in calculating taxes for insurers. Even policyholders are less willing to bear the burden of noncompliance and are demanding evidence of correct settlement of taxes by insurers.

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4. Germany: Cologne Finance Court (FG Köln) 2 K 430/11, 6 May 2014.
5. The Netherlands: Dutch Supreme Court (Hoge Raad) 12/05800, 14 February 2014.
6. CJEU: C-584/13 – Mapfre Asistencia and Mapfre Warranty.
7. CJEU: C-224/11 – BGŻ Leasing sp z o.o v Dyrektor Skarbowej Warszawie.
9. The EEA consists of the 28 EU Member States, Iceland, Liechtenstein and Norway.
Compliance hurdles

There is a lack of uniformity in how taxes apply to insurance. This can be a major obstacle to accurate multi-country compliance and can make it difficult for insurers to adopt standardized processes. For example, the following key elements of tax vary greatly from country to country:

- Risk definition and therefore the tax treatment
- Taxes paid by the insurer as opposed to taxes paid by the policyholder
- Tax settlement for co-insurance arrangements
- Tax points
- IPT credits
- The variety of taxes that apply
- Regional reporting

Many insurers are still unaware of their IPT obligations and risks across the globe. The complex nature of insurance contracts can add to this confusion. For example, most global policies are not provided by just one single insurer; instead, the risk is spread among a number of insurers (this is referred to as co-insurance). Many co-insurers are still relying on the lead insurer to settle the taxes due, without being aware that they may, in fact, be liable to settle their own tax portion as some countries do not allow the lead insurer to settle the tax. Reliable information about applicable IPT rates and legislation is scarce, and reporting requirements are often unclear. For example, the Hungarian IPT Act, which was introduced in 2013, was just two pages long and left many insurers (and the tax authorities) in the dark over several important questions, such as what is the tax point, how should co-insurance arrangements be treated and who is responsible for bearing the economic burden of the tax (i.e., the insurer or the policyholder).

At the other end of the spectrum, reporting requirements in some countries can be very onerous – for example, the necessity to report IPT regionally in Spain. Another issue facing foreign insurers is the requirement to appoint a local agent. More than 10 years after the abolition of fiscal representation for VAT in the EU, local agents for IPT are still required in some countries, especially in Southern Europe (e.g., in Portugal, Spain and Greece). Even though a recent CJEU case forced Spain to drop this requirement for IPT, in practice, insurers still need to have a Spanish bank account to make tax payments, and not many FOS insurers have branches in the country. Even within the EEA, with common risk location rules laid out in the Second Non-Life Directive, conflicts exist about where and how tax applies.

Data quality is the basis for accurate reporting, but it can be a big issue. Often, systems cannot cope with the reporting requirements as they cannot capture relevant information (e.g., the Spanish postcodes that are required for fire brigade tax reporting in Spain).

Getting IPT compliance right

Getting IPT compliance right usually starts with finding the correct location of the risk. This does not mean simply choosing the obvious country where an insured object or the policyholder is located; insurers and brokers need to consider whether the policy covers multiple insured and mixed risks, which could mean multiple risk locations. Having multiple risk locations can lead to double taxation, especially when a country outside the EEA is involved. Even within the EEA, with common risk location rules laid out in the Second Non-Life Directive, conflicts exist about where and how tax applies.

Some insurers may decide to register everywhere to settle their tax obligations, even if there is a very small tax liability. However, even if they do, there is still plenty to consider for getting their IPT compliance right.

Aiming for 100% compliance is a very challenging goal, and taxpayers need to adopt a consistent common-sense approach to global compliance. The key to improving cross-border IPT compliance is having quality data, appropriate premium allocations and clear audit trails. Achieving this requires commitment not only from the tax department, but also from underwriters and brokers.

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12. CJEU Case C-678/11 – Commission vs. Spain.