

Insurance tax

Identify risks, use opportunities

1. INTRODUCTION

Companies, as policy holders, are liable to insurance tax. It is difficult for multinational corporate groups with a high number of operating sites and employees to gain an overview about for which shares of the insurance premium insurance tax has to be paid and where.

The risks of wrong tax payments are severe. Usually, the insurance company takes care of the payment of insurance taxes on behalf of the policy holder. It may though have consequences in terms of criminal tax law to rely on the insurance company's correct conduct. Furthermore, companies make insufficient use of their saving potentials resulting from correct payments of insurance taxes.

2. INSURANCE TAXATION

2.1 Germany

The German statutory tax rate has regularly increased during the last years and by now equals the value added tax.

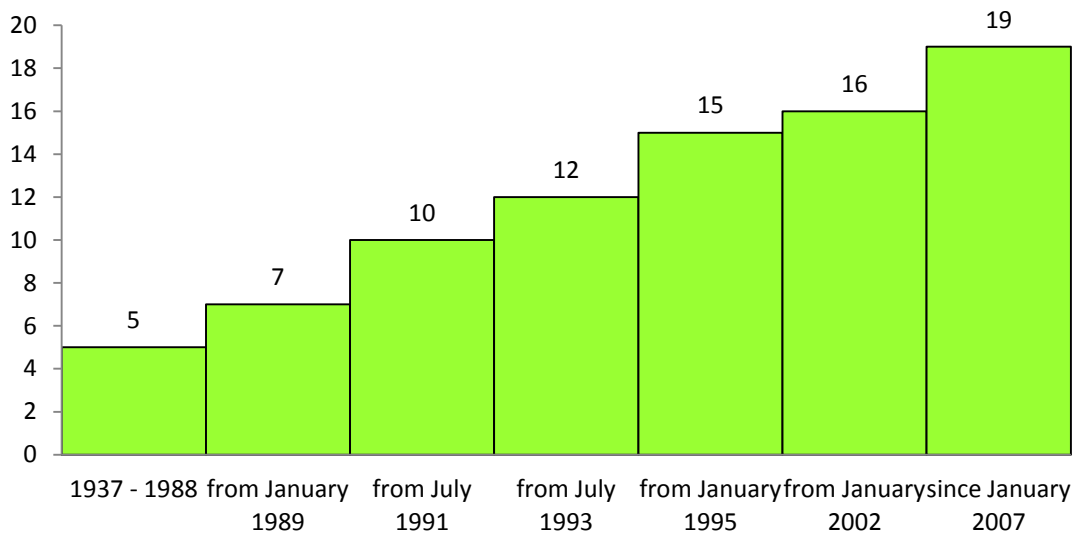


Chart 1: Development of the statutory tax rates in Germany (in %)

Since 1 January 2007, the tax rate amounts to 19% of the insurance premium. There are lower tax rates for some lines, e.g. for marine insurance (3%), for fire insurance (22% of 60% of the fee), for accident insurance with return of premiums (3.8%) and for hail insurance (0.3% of the sum insured p.a.). Some lines of insurance are excluded from insurance tax according to sec. 4 Insurance Tax Law ("VerStG"), e.g. insurance for transported goods.

The purpose of this tax is to generate revenues. In 2014, the federal budget had insurance tax revenues of EUR 12 billion. With its share of 8.5% of all tax revenues at federal level, insurance tax constitutes an important source of revenues for the state.

2.2 Rest of the world

Within the EU and beyond, tax rates vary. In many, also European states, no tax is charged on insurance premiums, for example in Poland and the Czech Republic. Thus, there are enormous ranges between tax rates, both within insurance lines with one country and also among countries. In Finland for example, the statutory insurance tax rate is currently 24%, in Spain only 6%.

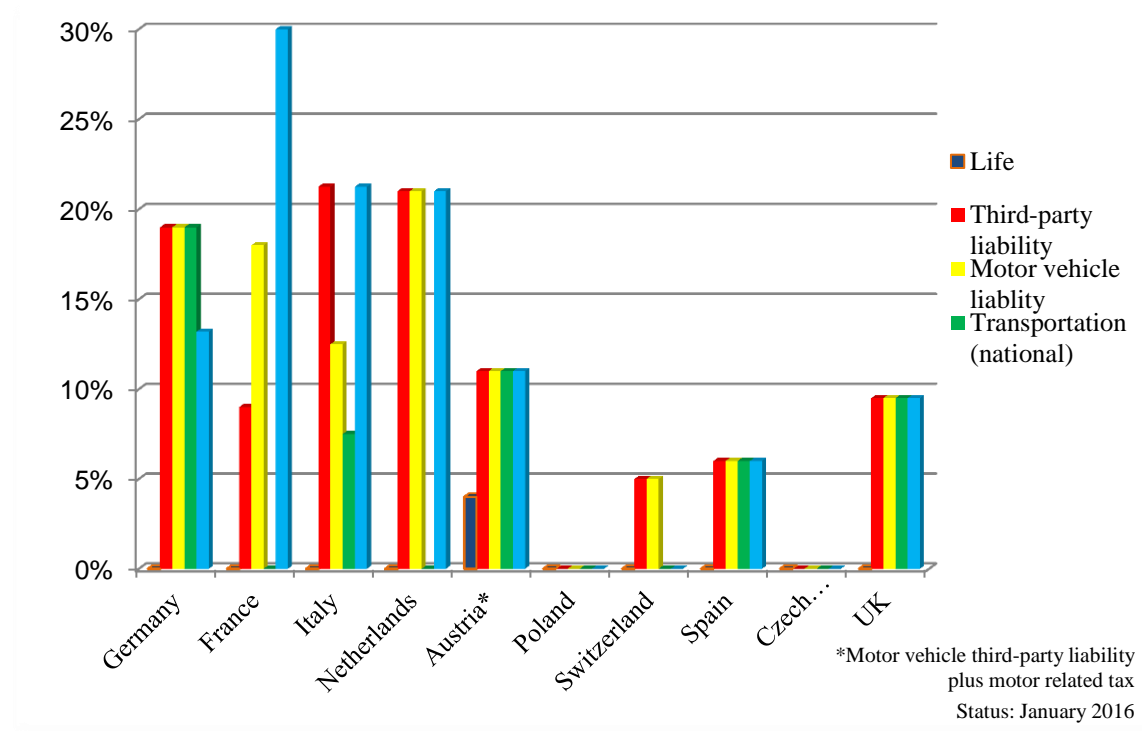


Chart 2: Insurance tax rates in Europe

2.3 Dangers resulting from wrong tax payments

According to applicable law, insurers seated in the EU have to pay German insurance tax on behalf of the policy holder. If the insurance company is seated outside the EU, the policy holder has to pay insurance tax itself. In any case, the policy holder is liable to insurance tax. The insured company is thus responsible for correct payments. If the insured company does not make the payment to the state entitled or does not make any payment, it commits tax fraud. This will in most states of the world be subject to penalties. The threat of punishment ranges from fines to several years of imprisonment up to death penalty (e.g. in China).

3. CORRECT PAYMENT OF INSURANCE TAX IN CASE OF CROSS-BORDER INSURANCE

A correct calculation of the insurance tax offers advantages. If insured risks are correctly localized, the insurance tax liability may decrease or be entirely omitted.

At least within the European Economic Area and the EU, a common principle between the states stipulates, which state may impose insurance tax in which case.

3.1 Insurer within the EEA – the situs principle

If the insurance company is seated within the EU or in a contract state of the Agreement on the European Economic Area (EEA), the taxation is subject to the situs of the risk. An EU-Directive makes this principle obligatory for all member states in order to avoid double taxation. According to such principle, member states are only entitled to impose insurance taxes, if the risk is located within the own sovereign territory. Thus, if the risk is located in the EU or in a contract state, the insurance tax is due there. If the risk is located in a non-member country, the tax is due in this country.

Example: Production in Hong Kong

Assuming that someone insures a risk located in Hong Kong, for example a production site, with a European insurance company. Since Hong Kong does not impose insurance tax, the policy holder does not have to pay insurance tax. If risks are located, as in this example, in a non-member state, the exact knowledge of the local insurance tax conditions is decisive.

Special case: Financial Interest Cover

German parent companies may compensate financial consequences of losses incurring at foreign affiliates through balance sheet protection coverage, so-called Financial Interest Cover (FINC). FINC-models are often used when the insurance abroad is subject to limitations, e.g. when it is only allowed through local insurers („non-admitted“-problem). Since the financial interest insurance covers the parent company’s risk (for its balance-sheet) located in Germany, insurance tax has to be paid in Germany, independent of the affiliate’s seat.

3.1.1 Insurance Tax Act

For Germany, the implementation of the situs principle into national law was made through sec. 1 para. 2 (new version) Insurance Tax Law (VerStG). Pursuant to this provision, all risks located in Germany are subject to German insurance tax.

The German Insurance Tax Act regulates for some sorts of risks individually, in what case they are located in Germany. For real estates, it is sufficient that they are located in Germany. For vehicles, the official registration respectively the registration need in Germany is decisive. Travel risks are located domestically if the policy holder concluded the insurance contract in Germany.

Otherwise, the following applies:

If the policy holder is a natural person, all other objects insured constitute domestic risks, if the policy holder's registered residence or habitual residence is in Germany at the point of time insurance premium is paid.

If the policy holder is a legal person, German insurance tax is payable, if "the enterprise's registered office, the permanent establishment or the corresponding institution to which the insurance applies is located within the territory of application of this Act" (sec. 1 para. 2 s. 2 VerStG).

3.1.2 Particularities for multinational companies

For multinational companies the question arises whether German insurance tax is payable for subordinated parts of the company which are located in Germany – for example an affiliate. The terms „company“ and „operation site“ are broadly interpreted according to the jurisdiction of the European Court of Justice („ECJ“) in the case Kvaerner¹. They also include subsidiaries, parents, affiliates, independent and non-independent branches. Companies always have to examine whether the insured part of the company is "in fact and physically" located in Germany. According to the jurisdiction of the ECJ, place and kind of the premium payment is irrelevant for where the risk is located. In so far as an insurance policy covers risks in several countries, for example in case of international "master" policies of a corporate group, the share of the premium, for which German insurance tax has to be paid, is to be determined according to reasonable economic points of view.² For this, turnover and number of employees of the part of the group situated in Germany may serve as measure.

¹ EuGH-judgment of 14 June 2001 - C-191/99

² Decree of BMF of 26 September 1990 (IV A 4-S 6356-16/90), B 1.6

Example: Affiliate in the Czech Republic

If a German company wants to insure its Czech affiliate with a European insurance company in a master policy, no German insurance tax has to be paid for the part of the premium payment related to the Czech affiliate. Since no insurance tax is payable in the Czech Republic at all, this part of the premium would be tax-free.

3.2 Insurers outside the EEA

The principle described above only refers to insurance relationships with insurance companies located within the EEA. For all other insurance relationships, the European situs principle which mostly avoids double taxation, does not apply. Pursuant to sec. 1 para. 3 VerStG German insurance tax is always payable if the policy holder has its registered seat (or habitual residence) in Germany or if the insured object is located in Germany at the beginning of the insurance relationship. If a German company insures a project abroad with an insurer outside the EEA, German insurance tax is payable due to the company's registered seat in Germany, but possibly insurance tax will also be payable in the project country. There are currently no double taxation agreements to prevent potential double taxation. Policyholders may though principally avoid double taxation of insurance premiums by choosing an insurance company within the EEA.

4. ALTERNATIVE APPROACHES TO OPTIMIZE INSURANCE TAX

Besides the saving potentials through correct payment of taxes, there are further approaches to reduce insurance tax payments for companies. Alternatives may be increased self-insurance, the foundation of a captive or efficient insurance contract drafting.³

4.1 Increased deductibles

If minor risks are not insured, the premium and thus the taxable base will be accordingly lower and in some cases no insurance tax will be payable. However, if deductibles are not calculated correctly, high capital costs may incur. This approach will thus only in some cases bring financial advantage.

³ Cf. Holzheu in „Die Belastung von Versicherungsdienstleistungen mit Verkehrssteuer“, p. 69 et seq..

4.2 Self-insurance through captives

Another approach which does not include external insurers is the self-insurance of corporate risks via a captive. A captive is a corporate-own insurance company which centralizes the company's risk management. Arising synergy effects can be especially advantageous for corporate companies.

This insurance relationship between a captive and the insured company is taxable. Thus, no insurance tax payment is avoided. However, compared to conventional insurance companies, captives are usually more cost-efficient. For example, the cost positions acquisition, receivables management and advertisements are almost entirely omitted. Consequently, captives can insure at lower insurance premiums. Due to the lower premiums, insurance tax is saved. The insurance through captives though implies costs for the implementation and administration of the captive and thus the advantages of a captive related to savings of insurance tax may relativize in the individual case.

Excursus :

In the past, companies mostly founded captives at off-shore sites such as Ireland, Malta or the Caribbean in order to save taxes. While there is principally a strict insurance supervision and high solvency requirements in on-shore countries, the taxation of profits in off-shore countries is low, if it exists at all. Insurance premiums set as high as possible, significantly lower the profit at the group's headquarter location, and thus the profit taxation of the parent was accordingly lower. At the same time, the taxation of premiums as profits at the off-shore location was low. The parent benefited from the captives profits in the end.

In Germany, this tax-saving model does not work anymore due to the legal inclusion of the captive's income to those of the group (sec. 10 German Foreign Tax Code "AStG")

4.3 Contract drafting

Insurance tax may also be optimized by prudent drafting of insurance contracts. A negative example is the agreement to reimburse a part of the premium by the insurer if the policy holder remains without claims. Although the insurer might reimburse the insurance premium, tax authorities will not pay back the respective insurance tax. If instead only a lower base premium is agreed with an additional premium payment in

the insured event, the taxable base will principally be lower. It will only increase in the insured event.

5. CONCLUSION

For many companies, the insurance tax constitutes both a cost factor and a criminal law risk. It is advisable to examine existing insurance relationships with regard to the correct payment of insurance tax and to implement a regular control concerning new and existing insurances.

By informing insurers about the location of individual risks, companies can protect employees in third countries from fines or even imprisonment. Also, double taxation can be avoided. If the company itself has to pay insurance tax to the fiscal authority, a careful examination of correct tax payment is even more important.

Authors:

Prof. Dr. Bodo Herold, heroldconsult, Burscheid, herold@heroldconsult.com

Dr. Mark Wilhelm, LL.M., Rechtsanwalt, Wilhelm Rechtsanwälte, Düsseldorf,
mark.wilhelm@wilhelm-rae.de

With competent support by Annika Gante, research assistant, Wilhelm Rechtsanwälte, Düsseldorf