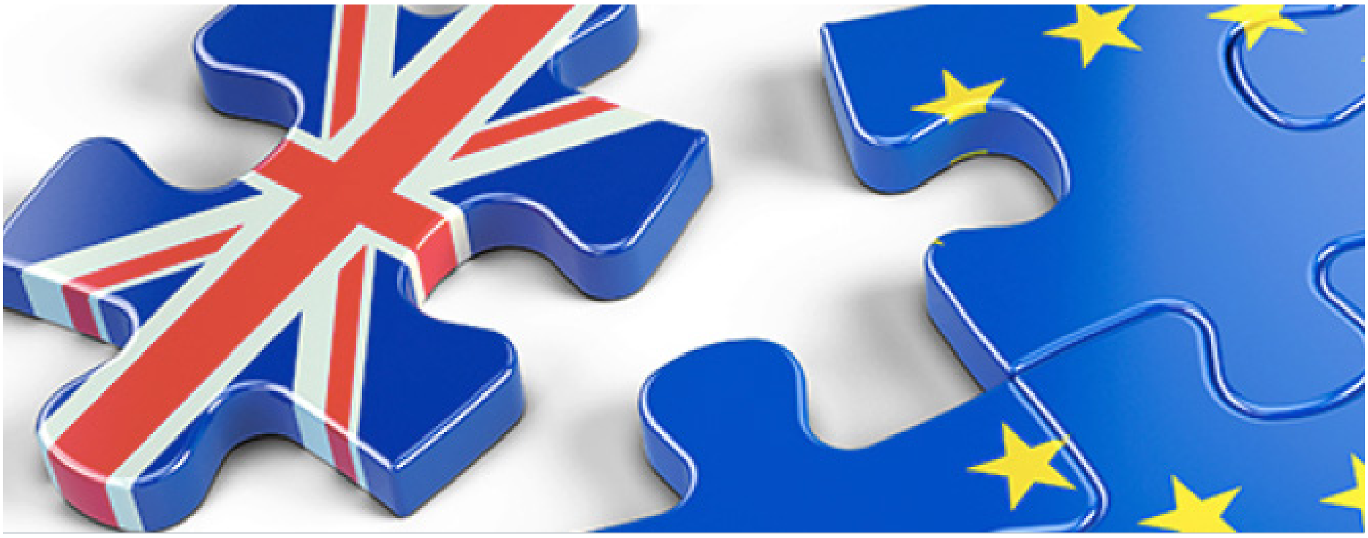
NAVIGATING BREXIT

Tax Implications for the Insurance Industry



Introduction

In light of the recent triggering of Article 50 we look at the potential tax issues to consider for those in the insurance industry looking to re-structure to safeguard passporting rights across the EU.

There are a number of locations being discussed within the industry, the most popular currently look to be:

- Luxembourg
- Netherlands
- Malta
- Ireland
- Belgium
- Germany
- France

Each would give access to EU passporting, but could have significantly different tax consequences for an insurance group.

Branch structures

Many groups have a risk carrier in the UK with branches across the EU to benefit from the regulatory capital efficiency this structure can offer. If it will not be possible to passport from the UK after Brexit and EU business is significant for a group, then they will need to consider picking a new territory from which to passport.

Where the trade and assets of the old branch are to be transferred to the new branch of the new company under Part 7, it will be necessary to consider UK tax as well as the local tax. Foreign branches of a UK company are still taxable in the UK unless the company has made an election under the Branch Exemption. These rules were not intended to give the flexibility many may now wish for in their planning stage. The election is currently irrevocable and needs to be made during the period before it takes effect. This means that it would be necessary to make the election before the outcome of the Brexit negotiations are made and once made could not be reversed and would cover all the branches of the relevant company.

For those groups that use a freedom of services model rather than branches in some or all territories it is worth noting that this structure is likely to need further consideration even if a new EU resident risk carrier is set up. For those jurisdictions signing up to the relevant parts of the new multi-lateral instrument in June 2017 the definition of permanent establishment is changing, effectively lowering the bar in the test on what activity will create a taxable presence.

Whilst the current thinking is that the lowest level of activity that could lead to a new taxable presence should not have significant profits attributed to it for tax, there is a risk that this could lead to a dispute with the tax authority there initially. It makes sense for those potentially affected to consider this change as part of any Brexit restructuring to look at ways of mitigating this risk. A further area of uncertainty exists here though because the OECD announced in its webcast of 28 March 2017 that further guidance on the attribution of profits to permanent establishments was to be issued in June 2017. We will need to wait and see whether this has a material impact on current or future structures for insurers.

VAT

There is much uncertainty surrounding the effect of Brexit on VAT. VAT is a European tax governed by the Principal VAT Directive 2006/112/EC (PVD). All EU members base their systems around the PVD but even then there are differences in how it is applied in each member state.

Some differences may be subtle but others are very significant. Take the effect of the Skandia case as an example. This case effectively said a VAT group was an individual taxable person in its own right. So, in the case of cross border services provided within the same legal entity but where that part of the legal entity which is providing or receiving the service is in VAT group, the service should be treated as if it were provided by an independent third party. The result of this is that whilst the provider may be able to recover more VAT if they are in the EU, the receiver will have to declare tax by way of a reverse charge if the service they are provided with would normally be taxable if provided by someone in the UK.

Sounds simple doesn't it? The complications come in how the different EU countries have decided to implement Skandia. Ireland and the UK have decided to apply the narrowest definition possible whilst some countries, including Belgium and Denmark have applied the "establishment only" VAT group registration (i.e. only establishments in the country of the tax authority are in the VAT group). This difference in how a country has implemented, or is still thinking about, how it has or will implement Skandia makes it really important to think about where services, particularly support services, are provided to. If all support services provided by members of a corporate group to its branches or associates are taxable at the rate in the receiving country by way of a reverse charge it could costly to be in a country which has implemented Skandia to the full. Something to think about if you are considering a change of location.

Leaving the EU has other VAT implications. The UK will no longer be subject to tax rulings coming out of the Court of Justice of the European Union (CJEU). In the past, CJEU decisions have been good and bad news for the UK insurance community. The BGŻ Leasing case (C-224/11) clarified the tax treatment of insurance sold with leased goods when taking out the insurance was optional. Two different supplies rather than one supply: one of which was subject to VAT and the other subject to IPT. This decision was welcomed in the UK as it made it clear the insurance was separate from the leasing. This meant IPT applied to the insurance, rather than VAT. As IPT is set at a lower rate than VAT in the UK the tax differential was maintained.

A not so welcomed decision was that in the Aspiro case (C-40/15). This decision (released in March 2016) reaffirmed the CJEU's view that claims handling was subject to tax. The UK has consistently rejected the implementation of VAT on claims handling but given the CJEU's view it was difficult to see how long the UK could hold out against taxing claims handling. Then along came Brexit. Taxing claims handling is now off the agenda and may never happen. Very good news for UK insurance. This is different from the approach some other European states have taken where they tax claims handling and other insurance related back office services as per the Andersen CJEU VAT case (C-472/03). Claims handling and other related back office services used by insurers can be subject to VAT if provided to insurers outside of the UK. Another good reason to think carefully before moving an insurance provider outside of the UK.

Exit Taxes

Whilst moving a UK incorporated company could be a difficult and uncertain process, if it is a possibility then exit charges would need to be considered. The UK imposes an exit charge on companies which stop being UK resident for tax purposes. Currently where the move is to the EU or EEA, it is possible to negotiate an instalment or deferral of this charge. Whether this continues after Brexit is less certain.

Losses

Every jurisdiction has different rules on how losses can be used. Up until 2017 the UK has always had very generous rules and this can have an impact for insurers even where they don't currently have any tax losses to use because of the potential regulatory impact. It is possible under Solvency II to get regulatory capital credit where it can be demonstrated that losses from the 1 in 200 event can be set against projected profits. Where there are restrictions on how losses can be carried back or forward this can have implications on the regulatory capital.

For instance some of the jurisdictions currently under consideration have no loss carry back rules, and time limited carry forward. For some groups the loss absorbing capacity of deferred tax assets is a significant issue, and any impact on this would need to be carefully factored into any restructuring.

Transfer Pricing

In any restructuring it is likely that any transfer pricing documentation would need to be updated for additional transactions or entities. Many people are currently updating anyway do to the changes from the OECD's BEPS project and the new three tiered standard documentation.

As part of this process it is likely that consideration will need to be given to whether the current structure and transactions with the new risk carrier can be replicated in a different jurisdiction. The VAT issues are discussed above, but there are also potentially other issues of withholding taxes for instance to consider once the UK is outside of the EU.

For instance if there is an R&D team in the UK will the new EU company be using its output? If so then you would expect a charge to be made from the UK and if this takes the form of a royalty, or could be seen as such, then there is the potential for withholding taxes even under existing Treaties between the UK and certain EU jurisdictions.

Alternatively if there is currently a reinsurance programme to say Bermuda will this continue for the new EU risk carrier? If so, there are certain jurisdictions where this could potentially cause an issue. Belgium for instance has a withholding tax for service transactions to certain low or no tax jurisdictions including Bermuda.

Transparency

All of this will be done in an era of unprecedented tax transparency. Not only will there be the Country By Country Reporting (CBCR), as well as the proposed public CBCR in the EU but for lots of groups there will also be a requirement to publish their tax strategy in relation to the UK by the end of 2017. Tax authorities will be able to see, and will automatically share, information about numbers of people and profits generated. The amount of substance of businesses in different jurisdictions will be put under more scrutiny than ever before, as will the profit making locations. If sufficient thought to potential tax issues is not made at the beginning of the process it could lead to significant disputes down the line with potentially multiple tax authorities.

Repatriation of profits

For dividends currently within the EU the parent/subsidiary directive allows dividends within EU to be paid without withholding. Once the UK leaves the EU it will no longer have this protection and will instead rely on its extensive network of tax treaties. However this does not offer the same protection. Whilst the UK does not currently withhold on dividends out, certain other jurisdictions do. Dividends from Germany to the UK would for instance be subject to a 5% withholding.

Similarly within the EU there exists the Interest and Royalties directive which prevents withholding. Without this protection for instance interest with Italy would have a 5% withholding in either direction, and a royalty to Luxembourg would have a 5% withholding.

Conclusion

Tax is very unlikely to be the driver for any restructuring but it will need to be a consideration early on in any project. In addition to the corporate tax and VAT issues highlighted here, any movement of people between countries potentially creates tax issues. Every group will have their own particular issues, there is no 'one size fits all' solution. Currently, there is no clarity on what the Brexit deal will look like, but there are a huge number of issues for everyone in the industry to consider.

Please get in touch...

If you have any questions or wish to discuss in more detail, please do not hesitate to contact:

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