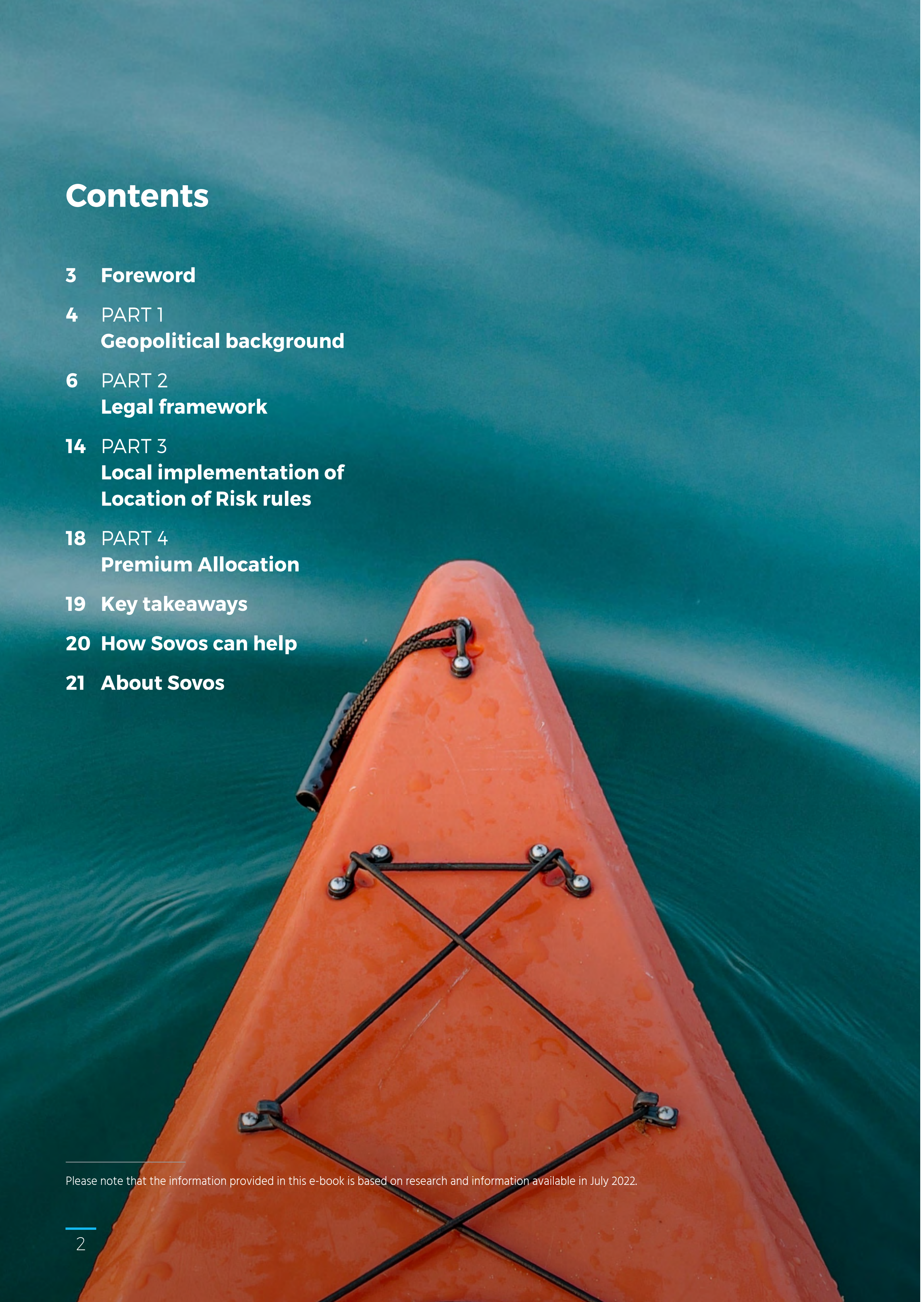
Navigating Location of Risk Rules

Insurance
Premium Tax



Contents

Please note that the information provided in this e-book is based on research and information available in July 2022.

FOREWORD

How to Navigate Location of Risk Rules Across Europe

The global economy offers businesses endless opportunities for growth, however underpinning cross-border trade are a complex web of systems, processes and mandates necessary for effective governance.

Insurance is no stranger to these concepts and anyone working within the sector will be familiar with the fact that the location of the underlying risk must be established to determine the correct tax. When dealing with complex multi-country insurance policies, this location requirement can lead to complications, from penalties and double taxation to reputational damage.

Ensuring that an insurer's calculation and apportionment procedure remains robust is critical.

To ease this pressure, this Location of Risk e-book discusses:

- **Geopolitical background** – countries where the rules apply
- **Legal framework** – what prompted the rules
- **Local implementation of Location of Risk rules** – common examples
- **Premium allocation** – how things work in practice

Key takeaways

- **IPT is not harmonised**
  It's key to consider local IPT law when determining Location of Risk
- **Risk determines the criterion**
  Assess the risk to apply the right criterion to use when determining Location of Risk for different classes of insurance e.g. property, vehicle, holiday, travel etc
- **Non-EU / EEA region**
  Be aware of the different rules that apply per region

Geopolitical Background

PART 1

Geopolitical background

When discussing Location of Risk, we are referring to the 27 member countries of the European Union (EU), the European Economic Area (EEA) and the UK.

Location of Risk rules apply not only in EU and EEA countries, but also apply to other territories, including the Overseas Countries and Territories of the EU (such as French Overseas Territories including French Guyana, Guadeloupe, Martinique and Mayotte).

It is also worth noting that there are seven recognised candidates for EU membership. These countries are Turkey (applied in 1987), North Macedonia (2004), Montenegro (2008), Albania (2009), Serbia (2009), Ukraine (2022), and Moldova (2022).

Statistics:

The European Union

27 member countries

3 political centers

24 official languages

9 currencies (Euro + 8 others)*

Estimated population of 448 m

Other European Countries

European Economic Area (EEA) Non-Members

- EU Member States
- EU Member States since 2004
- EU Member States since 2007
- EU Member State since 2013
- EU Candidates
- EEA Member States (but not EU members)
- Not an EEA country, but the location of risks rules are applicable

Source: www.nationsonline.org

*As of January 2023, Croatia will be part of the Eurozone.

PART 2

Legal Framework

Beyond geopolitics, three sources are called upon to identify Location of Risk:

1. EU Directives

EU Directives are instructions from the EU to each Member State to implement certain rules. Pertinent to the insurance market is the Solvency II Directive which currently governs the operation of the free market for insurance.

Previously there was the Second Council Directive (88/357/EEC) of 22 June 1988 and later 14 Directives, known as Solvency I and then in 2009 Solvency II came into force which has since been amended several times.

Solvency II had to be implemented into the national laws by the Member States before 31 March 2015 and became fully applicable on 1 January 2016.

Article 13(13) and 157(1) and also Annex I and II of Solvency II are the most important parts of this Directive regarding to premium tax and Location of Risk.

2. European Court of Justice

The European Court of Justice's (ECJ) role is to ensure EU legislation is interpreted and applied consistently across all EU countries.

Working directly with the ECJ is the European Commission. The European Commission enforces EU law in conjunction with the ECJ to ensure legislation is interpreted and implemented correctly. If there are discrepancies in interpretation, the case is passed on to the ECJ.

Within insurance, one of the landmark cases regarding non-life insurance premium taxes (IPT) is the Kvaerner case of 2001, which is focusing Articles 2(c) and (d) and 3 of the Second Council Directive (88/357/EEC) of 22 June 1988 which is the predecessor Directive of Solvency II Directive.

Another ECJ case has been published recently (in 2021) which case is in relation to Article 13(13) b) of the Solvency II Directive 2009/138/EC.

Both cases are discussed in more depth in this e-book.

3. National legislation

Each national government has the right to tax insurance premiums within its own territory. Consequently, each country leverages IPT (including taxable basis and tax rates) based on its own political, economic and funding requirements.

The Kvaerner Case

The Kvaerner Case set out the precedent for Location of Risk and liability to premium taxes for non-life business. It was a milestone case in the world of IPT and indirect insurance, moving the market into a different space and being a use-case for the years that followed.

The details

Kvaerner was a UK resident company that bought liability insurance from a UK insurer to cover its international operations. Global subsidiaries were also included in the policy. All relevant IPT was paid solely to HMRC, the UK tax authority.

The crucial thing to note in this case was the wording of the policy – it stated that Kvaerner plc and any of its subsidiaries were insured. One of these subsidiaries was John Brown Engineering and Construction, based in the Netherlands.

It's possible that John Brown Engineering and Construction didn't wish to be covered or management wasn't even aware the organisation was included, but by virtue of the policy's wording, the company was included in the coverage.

Dutch authorities caught wind of the situation and notified tax authorities that a Dutch establishment was insured under the policy. Despite the establishment being unnamed, the policy itself stated all subsidiaries were covered, therefore denoting that a policyholder existed in the Netherlands. The Dutch government demanded taxes be paid.

The case was referred to the ECJ (Kvaerner plc v Staatsseretarisvan Finanancien [2001] STC 1007) with three questions:

1. Question: Can a tax authority of an EU country levy a legal entity established in another EU country for premium taxes due on a business establishment within its boundaries where the premium was paid to an insurer based in the EU?

   ECJ ruling: Yes

2. Question: Does it matter if the policyholder is not the overall parent company, but some other company in the group?

   ECJ ruling: No

3. Question: Does it matter if the cost of the insurance premium is not passed on (wholly or in part) to the subsidiary company?

   ECJ ruling: No. The method of payment or invoicing is irrelevant. Even if no intra-group charge exists, the tax authority can still impose a premium tax levy.

This case set a precedent and paved the way for the Solvency II Directive of 2009.

The North of England P&I Association case (case no. C-786/19)

The North of England P&I Association case is another precedent for Location of Risks rules. This case focused on the Solvency II Directive 2009/138/EC, Article 13(13) b) point which states that where insurance policies relate to vehicles of any type, the Member State of the registration is deemed to be the location of risks.

This point raised several questions in the past and can lead to double taxation or avoidance of taxation for the reasons detailed in this e-book. The main reason for the ambiguity is that the phrase of "registration" and "vehicles of any type" are not defined in the Directive. As such it's interpreted differently in various countries. And because of the various interpretations, it was thought previously that if the definition was ever challenged then the potential ruling could lead to disastrous consequences for the vehicle insurance market.

The details

This case involved insurance contracts covering various risks linked to the operation of sea-going vessels. The policies were written by The North England P&I Association Ltd. ('North England P&I') an insurance company established in the UK, with 14 shipowner companies established in Germany. The coordinating German shipowner and the Maltese and Liberian bareboat charterers were also the parties of these policies. The vessels were registered into the shipping register maintained by the District Court in Hamburg, Germany.

The case arose because the vessels were temporarily authorised to fly the national flags of Malta and Liberia.

The German tax authority argued that German IPT was due on these contracts because the vessels remained on the German shipping register throughout the flagging out period. In contrast, the North England P&I contested that the location of risk should be determined by the Member State that certified that the ship is fit for use and whose flag the ship flies, that is Malta and Liberia.

The dispute between North England P&I and the German federal tax authorities was whether Germany had the power to tax the premium amounts. This ultimately resulted in a request for a preliminary ruling from the German court to the ECJ.

Regarding this case it's important to note that Malta treats marine insurances as exempt from its stamp duty regime. Therefore, if the insurer was successful with its argument, then no taxes on its insurance premiums would be due. Exemption for ships, aircrafts exist in several other EU countries, so the decision could or should have had major importance to the taxation of vehicles.

The dispute between North England P&I and the German federal tax authorities was whether Germany had the power to tax the premium amounts. This ultimately resulted in a request for a preliminary ruling from the German court to the ECJ.

The case was referred to the ECJ (The North of England P & I Association Ltd v Bundeszentralamt für Steuern, Case C-786/19) with 2 questions:

1. **Question:** With respect to insurance relating to 'vehicles of any type', the 'Zulassungsmitgliedstaat' (the German definition) which can be translated into English to as 'the Member State of certification' or 'the Member State of registration' could also refer to the State whose flag is flown by the ship. **Therefore, the question is whether which State has the right to tax the vehicle: the State where the seagoing vessels are registered in the ownership register or the State whose flag is flown by the vessels.**

   ECJ Ruling: It is the Member State of registration because, in the light of all the language versions, the definition refers to the Member State of registration of that ship or where it is entered in a register,rather than to the Member State of its authorisation or certification as fit for use, which only the German languageversion of that provision might be capable of sustaining by virtue of one of the two senses of the term 'Zulassungsmitgliedstaat'. All other languages have just one meaning, that is the State of registration.

2. **Question:** To what extent it is possible to rely solely on the entering of a vehicle in a register while not taking any account of the certification of that vehicle as fit for use.

   ECJ Ruling:`Member State of registration' refers by implication to the link that exist between a person or a company that has a right of property in the ship concerned or a financial interest in that ship and the State which maintains the shipping register in which that ship is entered, as evidence of the ownership of that ship.

In summary the ECJ stated that it is the Member State which maintains the shipping register in which the primary purpose of entering that ship is to prove ownership of that ship has the exclusive power to tax premiums paid with respect to those insurance contracts.

Sources:

1. https://curia.europa.eu/juris/liste.jsf?lgrec=fr&td=%3BALL&language=en&num=C-786/19&jur=C
2. https://sovos.com/blog/vat/determining-location-of-risk-marine-insurance/

Solvency II Directive 2009/138/EC, Article 13(13):

Following this directive enables an insurer to identify the correct Location of Risk. This directive, amongst other things, defines the four criteria to determine which territory the risk is deemed to be located in and where it should be taxed.

Article 13(13) – 'Member State in which the risk is situated' means any of the following:

a. The Member State in which the property is situated, where the insurance relates either to buildings or to buildings and their contents, in so far as the contents are covered by the same insurance policy;

If the insurance premium relates to property and property related policies, this criterion applies and is quite straightforward.

Example:

1.1 Mr. Holden, whose principal place of residence is in the UK, purchases a holiday chalet in the French Alps, and takes out an insurance policy to insure the chalet and contents. Which country has jurisdiction to apply tax on the insurance premium?

The Location of Risk is France – where the property and contents are situated (Article. 13 (13) (a)), so the premium is subject to French IPT.

1.2 Mr. Holden later purchases a washing machine and fridge for his holiday home and purchases separate "extended warranty" insurance to cover these appliances. Which country has jurisdiction to apply tax on the insurance premium?

The Location of Risk is the location of the property in which the movable property is kept (Article. 13 (13) (a)) which in this case is France. The insurance is subject to IPT in France.

b. The Member State of registration, where the insurance relates to vehicles of any type;

If you have a car registered in the UK, the UK is the Location of Risk. If you have a ship that's registered in Germany then it's a German Location of Risk. If you have an aircraft registered in Bulgaria, it's a Bulgarian Location of Risk. So far, straightforward.

Industry Practice: ships, aircraft and land vehicles

Now come the particularities. Firstly, ships are governed differently as demonstrated by this clause:

Does the insurance contract (i) relate to a specified vessel and (ii) cover risks under non-life insurance class 6 or 12?

- **If YES** – related to ship – use 'registration rule'
- **If NO** – not related to ship – use 'establishment rule' (Art. 13 (13) (d) (ii))

Then there are several Member States that interpret "vehicles of any type" differently.

In the **UK** oil rigs are considered a vehicle and are included.

Malta's definition includes only land motor vehicles – not ships or aircraft. This means if a plane is registered in Malta, it wouldn't be considered a Maltese Location of Risk.

In **Germany** there is a different definition of registration for ships and aircraft. For example, a ship flagged in the UK operating a Felixstowe to Hamburg route yet docking in Hamburg for six months of the year would be on the shipping register in Germany. Germany takes the view that the ship is registered in Germany and subject to IPT in that jurisdiction.

c. The Member State where the policyholder took out the policy in the case of policies of a duration of four months or less covering travel or holiday risks, whatever the class concerned;

The rise of online insurance applications has made it slightly more complicated to determine where an insurance policy was taken out as the policyholder's home address is not always used. This is a problem for tax authorities and insurers.

Example:

2.1 Mr. & Mrs. Long, who are habitually resident in Ireland, belatedly purchase travel insurance during their holiday in Germany. The policy covers their German holiday which has a duration of two weeks. Which country has jurisdiction to apply tax on the insurance premium?

As the policy is for less than four months the Location of Risk is the Member State in which Mr. & Mrs. Long bought the policy (Article 13 (13) (c)), which is Germany. This means the premium is subject to premium taxes in Germany.

2.2 Mr. & Mrs. Long, who are habitually resident in Ireland, are travelling through France to get to their holiday destination in Germany. They purchase travel insurance whilst they are travelling through France. The policy covers their German holiday which has a duration of two weeks. Which country has jurisdiction to apply tax on the insurance premium?

As the policy is for less than four months the Location of Risk is the Member State in which Mr. & Mrs. Long bought the policy (Article 13 (13) (c)) so in this case it's France and the premium is subject to premium taxes in France.

Something to note, in this particular example more often than not the French insurer would not insure that risk.

d. In all cases not explicitly covered by points (a), (b) or (c), the Member State in which either of the following is situated:

i. The habitual residence of the policyholder;

ii. If the policyholder is a legal person, that policyholder's establishment to which the contract relates

These criteria apply if the case doesn't fall under the previous three criteria of Article 13 (13).

i. The habitual residence of the policyholder.

Example:

3. Mr. & Mrs. Long, who are habitually resident in Ireland, belatedly purchase travel insurance during their holiday in Germany. The policy covers their German holiday and travel plans for the next 12 months. Which country has jurisdiction to apply tax on the insurance premium?

As the policy is for 12 months the Location of Risk is the Member State in which Mr. & Mrs. Long are habitually resident (Art. 13 (13)(d) (i)), i.e. Ireland. As a result, the premium is subject to IPT in Ireland.

Unfortunately, not every Member State has the same definition of 'habitual residence'.

In **Spain** for example, the country is considered your habitual residence if you've been in Spain for six months. Austria takes the place the policyholder most associates with home – this is a charming definition but difficult from a compliance perspective.

ii. If the policyholder is a legal person, that policyholder's establishment to which the contract relates;

This is in reference to the Kvaerner case. The definition of establishment here can include head offices, branches, subsidiaries, selling agents, oil and gas wells and construction sites.

Example:

4. Magic Machines, a UK manufacturer of washing machines, purchases a Product Liability policy. Magic Machines sells across the UK to UK, France and Ireland. Which country has jurisdiction to apply tax on the insurance premium?

The Location of Risk is the establishment of the policyholder (Article 13 (13) (d) (ii)) so that's the UK and the premium is subject to IPT in the UK.

5. A haulage company based in Belgium pays a premium to cover the loss/damage to goods that it's transporting to a customer located in Portugal. The goods will travel via France and Spain. Which country has jurisdiction to apply tax on the insurance premium?

The Location of Risk is the establishment of the policyholder (Article 13 (13) (d) (ii)) which is Belgium so the premium is subject to premium taxes in Belgium.

SOLVENCY II DIRECTIVE 2009/138/EC, ARTICLE 157(1):

Article 157 completes the picture. After identifying your Location of Risk, you're 95% there.

Now we've worked out where the Location of Risk is, this article simply outlines that the Member State can tax that premium.

Article 157(1)

Without prejudice to any subsequent harmonisation, every insurance contract shall be subject exclusively to the indirect taxes and parafiscal charges on insurance premiums in the Member State in which the risk is situated or the Member State of the commitment.

The first paragraph of the article provides answers for goods in transit.

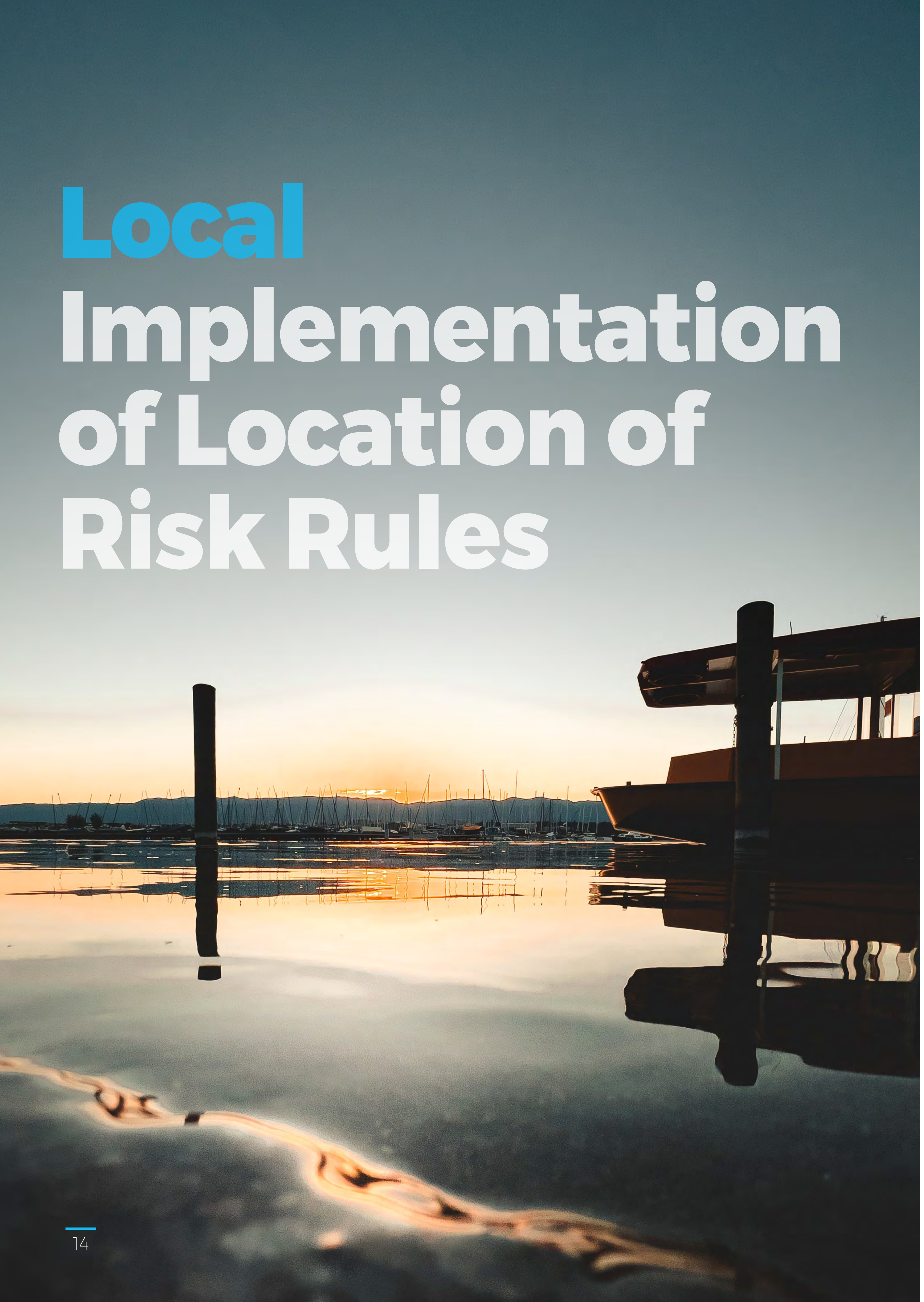
For the purposes of the first subparagraph, movable property contained in a building situated within the territory of a Member State, except for goods in commercial transit, shall be considered as a risk situated in that Member State, even where the building and its contents are not covered by the same insurance policy.

Whereas Article 13 says that if you have building and contents, any property inside the building must be under the same contract, this says for the purposes of tax it doesn't have to be under the same contract.

For example, a printing company would have a building housing a large printing machine inside. The printer will have its own insurance contract because it's a large capital expenditure, but it doesn't have to be under the same contract. It's still going to be in the Member State where the printing company is situated.

In the case of Spain, an insurance contract shall also be subject to the surcharges legally established in favour of the Spanish 'Consorcio de Compensación de Seguros' for the performance of its functions relating to the compensation of losses arising from extraordinary events occurring in that Member State.

In Spain, the Consorcio de Compensación de Seguros administers the Extraordinary Risk regime. The law states that the Consorcio collect additional premiums, which is not technically a tax. They may look like taxes but they're technically additional premiums.



Local Implementation of Location of Risk Rules

PART 3

Local implementation of location of risk rules

In this section, we discuss the local implementation of Location of Risk rules where these differ from the norm.

Switzerland

Switzerland is a Non-EU/EEA Member State and doesn't follow the default EU Location of Risk rules.

Key points of difference are:

- Domestic insurance – domestic portfolio
- Location of policyholder

The insurance premium payment is subject to Swiss stamp duty:

a. Provided the premium payment relates to the domestic portfolio of an insurer that is supervised by the Swiss insurance regulator or insurance written by domestic public insurers.

b. If the Swiss policyholder takes out insurance with a foreign insurer that does not fall under the Swiss supervision.

If the Location of Risk rules in Switzerland are different to the EU, this can lead to double taxation.

For example, if you have an entity that is domiciled in Switzerland and it pays a premium in Switzerland to cover a property located in France, the stamp duty on the premium will need to be paid in Switzerland but the IPT on the premium will need to be paid in France.

Liechtenstein

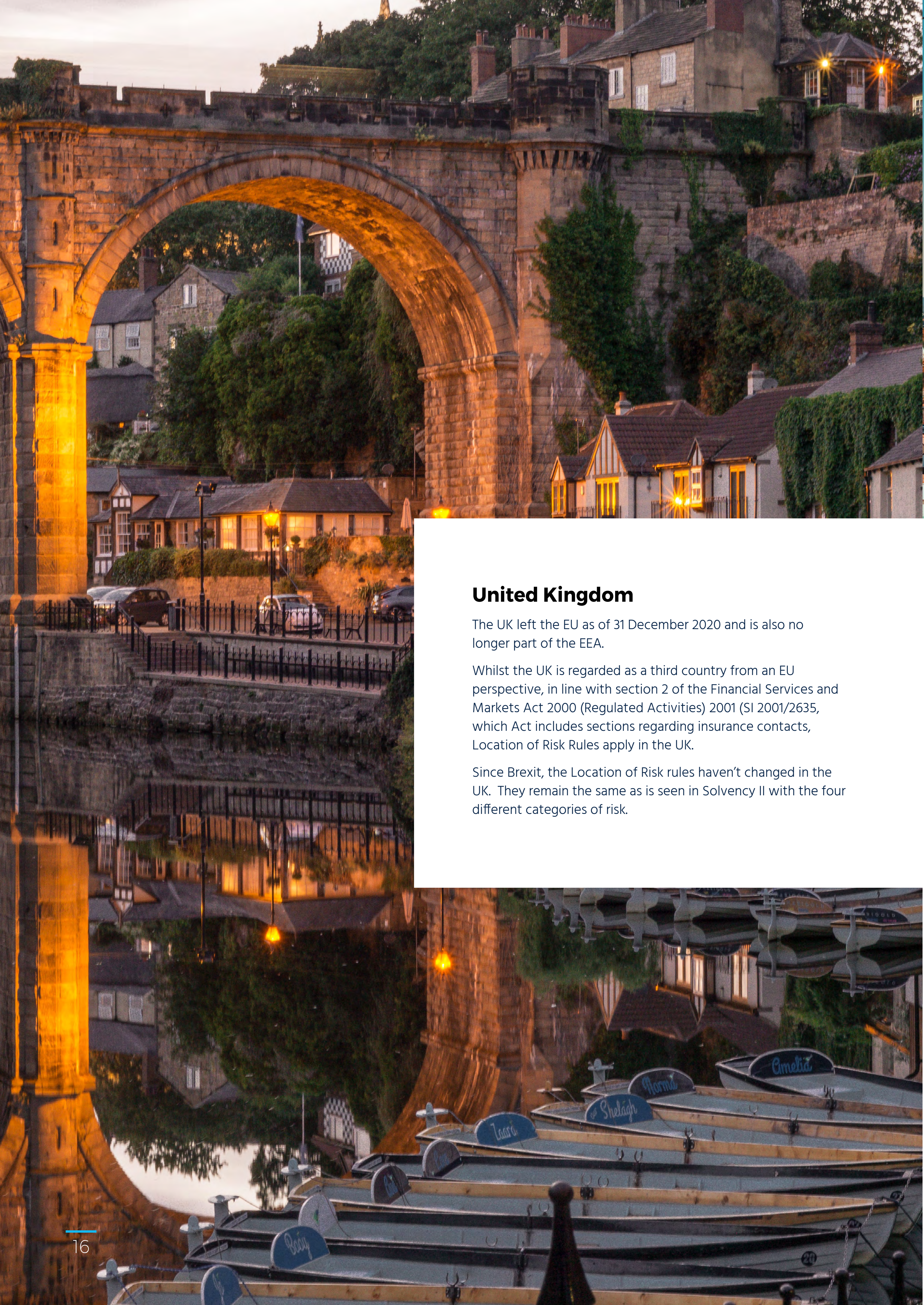
Liechtenstein is a non-EU Member State but part of the EEA. By default it follows Swiss stamp duty rules.

Key points of difference:

- Domestic insurance – domestic portfolio
- Location of policyholder
- Location of Risk

It's important to consider the domestic insurance and domestic portfolio, the location of policyholder and the Location of Risk. These four articles, where Swiss stamp duty could apply, applies to risks located in a territory:

- **Article 67 of Liechtenstein Tax Law** (Steuergesetz 640.0) states that where the Swiss stamp duty law does not apply then Liechtenstein stamp duty could apply.
- **Article 68 of Liechtenstein Tax Law** refers to Liechtenstein stamp duty being applicable on insurance premium payments related to risks located in Liechtenstein.
- **Article 70 of Liechtenstein Tax Law** refers to the liable party for Liechtenstein stamp duty as the insurance company conducting insurance in Liechtenstein.
- **Article 107 of Liechtenstein Tax Law** mentions a requirement for a foreign insurer to appoint a local fiscal representative.



United Kingdom

The UK left the EU as of 31 December 2020 and is also no longer part of the EEA.

Whilst the UK is regarded as a third country from an EU perspective, in line with section 2 of the Financial Services and Markets Act 2000 (Regulated Activities) 2001 (SI 2001/2635, which Act includes sections regarding insurance contacts, Location of Risk Rules apply in the UK.

Since Brexit, the Location of Risk rules haven't changed in the UK. They remain the same as is seen in Solvency II with the four different categories of risk.

Germany

The new Insurance Tax Act, effective from 10 December 2020, raised concerns in relation to the application of Solvency II Location of Risk rules.

The reform implements a new concept for Location of Risk rules and adds a new factor to the four pillar rules as listed by Solvency II and detailed in this e-book. This new factor is the investigation of the establishment of the policyholder, namely whether the policyholder is established in Germany or not. In this context the phrase "establishment" covers German enterprises, permanent establishments, or corresponding institutions, or an individual habitually resident in Germany.

According to the new rules German IPT is payable, hence the Location of Risk is deemed to be in Germany (as well) if the policy was taken out by a policyholder having a German establishment.

1. From an insurer seated in an EEA country and the policy covers non-EEA countries.

   As per the new German Insurance Tax Law, in these cases any premium amount, irrespective of the nature of the risk(s), allocated to the non-EEA countries (e.g. the UK or Switzerland) the Location of Risk is deemed to be in Germany, hence German IPT is due.

   Example: A Norwegian insurance company writes a policy on property located in the UK (theoretical example not considering the applicable licencing rules) where the policyholder is a German individual, then German IPT is payable in addition to the UK IPT.

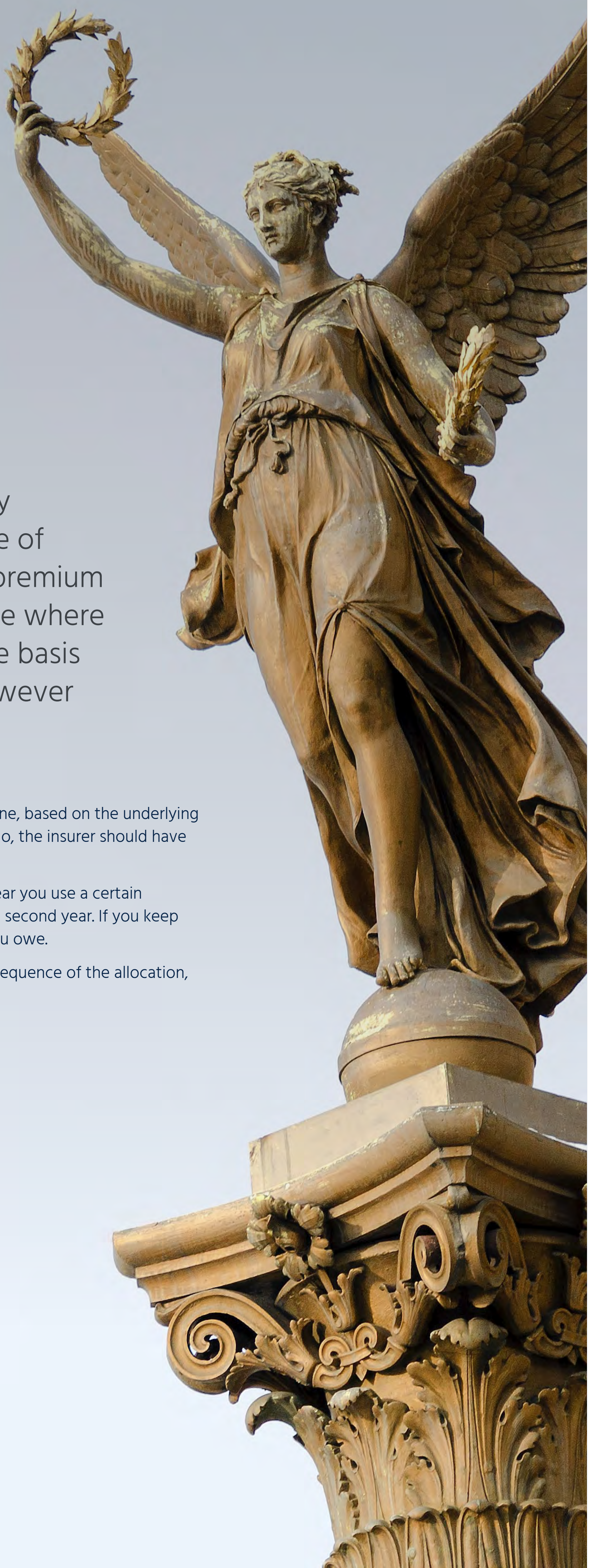
2. From an insurer seated outside of the EEA region

   In this case, the Location of Risk, on the basis of the establishment of the policyholder which is in Germany, the whole premium is taxable in Germany, again irrespective of the risks covered.

   Example: A UK insurer writes a policy regarding a property in Belgium (theoretical example not considering the applicable licencing rules) whereby the policyholder is a German individual. In this case German IPT is due in addition to the Belgian IPT.

The German interpretation of the Location of Risk rules raises several questions, but most importantly the potential possibility of double taxation. One of the most important achievements of Solvency II Directive and its predecessor the Directive of Second Council Directive 88/357/EEC was to avoid double taxation (and tax avoidance) creating as clear rules as possible regarding the location of risks. Although, since the introduction of these rules there were four ECJ cases, it might be possible that further cases will be submitted for preliminary ruling to the European Court of Justice regarding the German insurance tax reform.

It's worth mentioning that the local "policyholder" approach, when the nationality of the policyholder is considered, is not a new concept in the insurance world. In the case of Switzerland, Swiss Stamp Duty is due when the policyholder is resident in Switzerland irrespective of the risk covered by the policy.



PART 4

Premium Allocation

Premium allocation is not covered by Solvency II. And we're also not aware of any Member States that mention a premium allocation in law. There's one example where the UK has provided guidance on the basis of just and reasonable examples, however it's ultimately up to the insurer.

Each insurer should be able to justify the allocation they determine, based on the underlying risks. Tax authorities have the right to challenge this and if they do, the insurer should have robust evidence on file.

As an insurer, changing your methodology isn't allowed. If one year you use a certain methodology and there is a renewal, you can't change this in the second year. If you keep changing, the tax authority has the right to ask for the money you owe.

The key thing to remember is that taxes should always be a consequence of the allocation, not a driver of the allocation.

KEY TAKEAWAYS

Regarding Location of Risk

In most cases, determining Location of Risk is relatively straightforward so long as you can determine the criteria of the risk you're insuring.

The Solvency II Directive 2009/138/EC, Articles 13(13) and 157(1) provide clear definitions to help insurers determine the Location of Risk and where IPT is due.

There are of course exceptions to be aware of to avoid double taxation or paying tax to the incorrect authority.

Consider these three points when determining Location of Risk:

1. **IPT is not harmonised**
   Consider local IPT law when determining Location of Risk
2. **Risk determines the criterion**
   Assess the risk to know what criterion to use: e.g. property, vehicle, holiday or travel, other
3. **Non-EU / EEA region**
   Local rules typically differ from EU/EEA Location of Risk rules.

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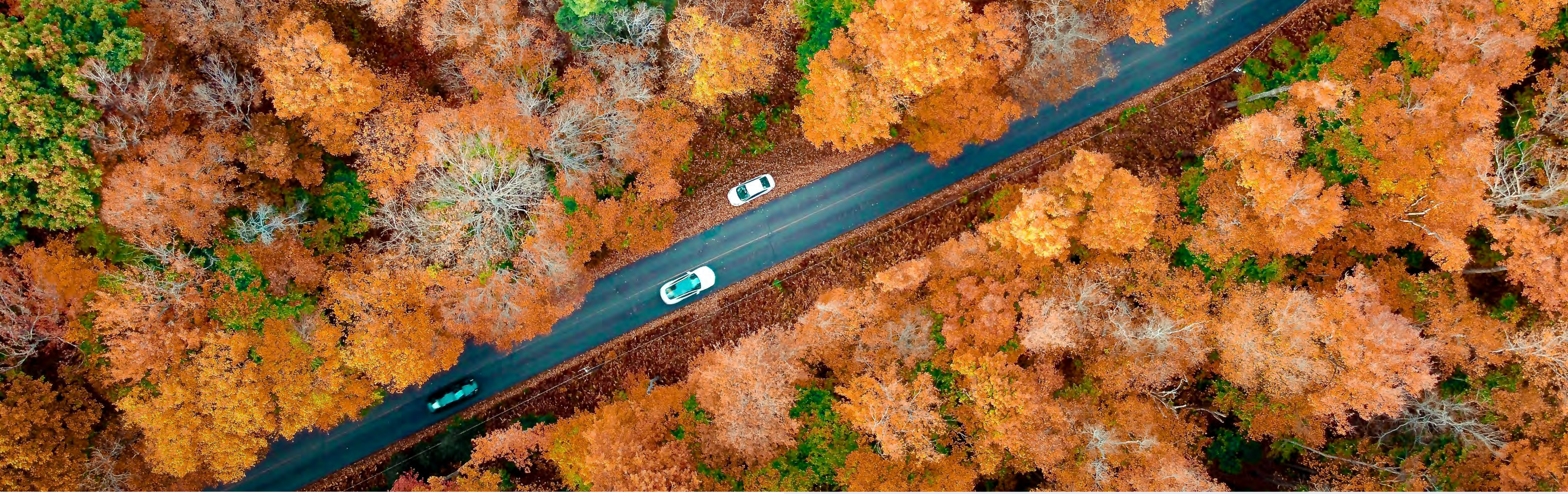

HOW SOVOS CAN HELP

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