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By PwC Deutschland | 26 April 2012

Fire insurance policy reinsured with group captive not an abuse

The Supreme Tax Court has accepted as legitimate an arrangement under which an independent insurance company offers a group subsidiary cover against a 100% reinsurance with a group captive.

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A German operating subsidiary of a worldwide group held by a Liechtenstein trust through holding companies in Germany and Luxembourg was faced with the refusal of its (independent) insurance company to continue to offer fire insurance cover for the factory on the same terms as in the past. Rather, the insurer insisted on significantly higher premiums, a higher excess (the uninsured initial amount of the risk to be borne by the insured company itself) and a more comprehensive risk management system in the factory. After a round of difficult negotiations, a solution was found based on continued cover from the previous insurer at market rates acceptable to the company's management, but with reinsurance of the entire risk through a group captive insurance company without its own employees based on the Isle of Man. The arrangement was mirrored for four other operating subsidiaries. The independent insurance company forwarded its premium receipts to the reinsurer, receiving in return a commission. The tax office saw the scheme as a sham and disallowed the premium expense borne by the company as a hidden distribution of profits. The lower tax court agreed.

The Supreme Tax Court, however, took a different view and allowed the premiums borne by the company as genuine business expenses. The immediate insurer was an independent entity and was the sole contracting party of the insured company. It therefore bore the full risk under the policy and was unable to refer the insured company to the reinsurer in the event of loss. It had also taken steps to ensure recourse to the reinsurer – it had asked for accounts, a bank letter of credit for the risk and for information on the reinsurer's own reinsurance measures. The overall picture was one of a genuine business arrangement. The court emphasised that a payment to an independent third party could not usually be construed as a hidden distribution, as it could not generally be assumed to have been made at shareholder behest. In the present circumstances there were good business reasons for the independent insurance company's involvement and for the Isle of Man reinsurance. The insurance company had competent staff for assessing risks and adjusting claims on whom the reinsurer could rely, whilst the reinsurer was able to enjoy the benefits of the more relaxed Manx supervisory requirements and formal obligations to which reinsurance companies need adhere. The court also discussed the Manx tax exemption for the reinsurance company, but did not draw negative conclusions on the grounds that those involved were free to take advantage of favourable tax regimes, provided the business arrangements were genuine.

Supreme Tax Court judgment I R 19/11 of February 15, 2012 published on April 4.

Keywords

captive insurance, reinsurance