



CLARIFICATION ON ADMITTED REINSURER TAX STATUS IN BRAZIL

A recent decision issued by the Brazilian Tax Authority (RFB) has brought some clarity to the tax regime which is applicable to admitted reinsurers operating in Brazil. The decision distinguishes, for the taxation purposes, between those admitted reinsurers who act with “ample powers” (i.e. similar to local reinsurers) and those who act in a limited manner, exercising a service or ancillary activity (i.e. similar to occasional reinsurers).

“The ruling provides limited guidance on what it means by acting with "ample powers". However, it appears that a local entity who is not underwriting risks, signing contracts, receiving premium or paying claims, should be treated as an occasional reinsurer for tax purposes, where such activities are carried out "in full" by the overseas entity.”

Internationalisation of Brazilian Specialty Market

The recent IPO of the IRB and its strong focus on overseas risks, together with the fact that Brazil strives to be a reinsurance hub for the region, are changing the dynamics of the Brazilian market for specialty business. One aspect is an increasing emphasis on the need for clarity around the rules which will set the legal framework for the country's pursuit of a more free market, aligned with international practice, including in the area of tax.

Under the Brazilian reinsurance regulatory framework, the market is currently comprised of three different categories of reinsurer – local, admitted and occasional – each with different licensing and capital set-up requirements and each subject to different risk cession rules and taxation requirements. There are currently about 16 local reinsurers in Brazil, 40 admitted reinsurers and 78 occasional reinsurers. Lloyd's of London has admitted reinsurer status.

In private letter ruling (PLR) No. 62/2017, dated 20 January 2017, the Brazilian Tax Authority (RFB) ruled that representative offices established in Brazil by non-resident reinsurers (i.e. so-called admitted

reinsurers) should be treated, for tax purposes, in the same way as a reinsurer incorporated in Brazil (i.e. a local reinsurer).

Tax authorities shock Admitted Reinsurers

The ruling, which came as a shock to admitted reinsurers, was primarily based on the RFB's decision that the representative offices of admitted reinsurers are to be considered a permanent establishment, and therefore subject to the same taxation applicable to local reinsurers. In the RFB's view:-

“... the activities of representative offices do not have the character of mere brokerage, preparatory or ancillary services, but are characterized for tax purposes as equivalent to provision of services by local reinsurers.”

However, the local representative office of an admitted reinsurer is a service office, pursuant to CNSP Resolution 168/2007 (among other rules). It should follow that all underwriting and claims handling is carried out in the overseas office of the admitted reinsurer. Premium flows direct from the cedant insurers to the overseas entity and not via the account of the local representative.

The practical effect of elevating the tax status of admitted reinsurers to local reinsurer was potentially considerable in terms of tax exposure. Although the effects of the ruling were unclear, in principle they represented an 11% percent increase in the rate of corporate income tax for the local representative office of admitted reinsurers, plus the application of 4.65% PIS/COFINS tax (i.e. federal contributions for funding social security).

The ruling also raised difficult questions about application, not least because it anticipated taxing the local service office for the gross premium generated by admitted reinsurers even though, as explained above, these payments are not channelled through the account of the local representative and are normally taxed overseas.

The ruling was also problematic because it was binding as of the date of its issuance, potentially retrospective for five years and, as it was not a new law but the clarification of an existing law, it was not subject to appeal. For these reasons, the ruling did much to shake the credibility of the Brazilian reinsurance market with international investors.



Comfort and certainty?

However, some comfort has now been provided with the publication of private letter ruling No. 91 of 2 February 2018, which was published in the Brazilian Federal Official Journal on 8 August 2018. This ruling is of retroactive effect and renders the earlier ruling void. The new ruling distinguishes between those admitted reinsurers with an office in Brazil:

- Acting with "ample powers" for the purposes of their reinsurance operations who will be treated like local reinsurers for the purposes of taxation.
- Those acting in a limited manner in performing a service activity, who will be treated like occasional reinsurers for the purposes of taxation.

The ruling provides limited guidance on what it means by acting with "ample powers". However, it appears that a local entity – acting as a "mere commercial representative" – involved for example in the resolution of regulatory matters and who is not underwriting risks, signing contracts, receiving premium

or paying claims, should be treated as an occasional reinsurer for tax purposes, where such activities are carried out "in full" by the overseas entity.

The recent tax developments brought by PLR No. 91/2018 have added fuel to wider speculation in the local market that the three license model in Brazil (i.e. local, admitted and occasional) is under pressure.

Authored by Geoffrey Conlin, partner of HFW with assistance from Bernardo de Senna, an associate at the Brazilian law firm, CAL¹.

For further information, please contact:



GEOFFREY CONLIN

Partner, HFW
geoffrey.conlin@hfw.com



BERNARDO DE SENNA

Associate, CAL
bernardo.desenna@cal-law.com.br

¹ <https://www.legalweek.com/2018/06/19/hfw-expands-latin-american-presence-with-brazilian-firm-association/>

HFW has over 500 lawyers working in offices across Australia, Asia, the Middle East, Europe and the Americas. For further information about our Insurance and Reinsurance capabilities, please visit hfw.com/Insurance-Reinsurance-Sectors.

hfw.com

© 2018 Holman Fenwick Willan LLP. All rights reserved. Ref: 00475

Whilst every care has been taken to ensure the accuracy of this information at the time of publication, the information is intended as guidance only. It should not be considered as legal advice. Holman Fenwick Willan LLP is the Data Controller for any data that it holds about you. To correct your personal details or change your mailing preferences please contact Souhir Jemai on +44 (0)20 7264 8415 or email souhir.jemai@hfw.com

Beirut Brussels Dubai Geneva HongKong Houston Jakarta Kuwait London Melbourne Paris Perth Piraeus RioDeJaneiro Riyadh SãoPaulo Shanghai Singapore Sydney