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Indirect Tax Alert

Italy's Tax Authority rules reinsurance fees for Claims Handling Services are subject to VAT

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Executive summary

By Resolution Letter No. 63 of 5 October 2020 (Resolution), the Italian Revenue Agency (IRA) addressed the value-added tax (VAT) treatment of fees for claims handling services (Claims Handling Services) supplied by reinsurers acting as a delegated party on the behalf of ceding insurers.

According to the IRA, Claims Handling Services provided by the delegated reinsurer within the framework of a reinsurance agreement are subject to VAT, because they cannot be considered:

- Exempt reinsurance services
- Services related to those performed by insurance brokers or insurance agents
- Services ancillary to insurance or reinsurance services

Detailed discussion

The facts

In the second quarter of 2019 the IRA started a VAT inspection campaign on the VAT treatment applied to reinsurance fees,[1] for fiscal years between 2014 and 2016, by some reinsurers operating in Italy within the non-life insurance class 18 "Assistance," that carried out claims management activities on the behalf of delegating insurers.

Building a better working world

The IRA focused on certain contractual schemes where the reinsurer was delegated by the ceding insurer to provide Claims Handling Services in respect of the reinsured policies. The Claims Handling Services were either produced internally by the reinsurer or outsourced to third party providers and then recharged to the ceding insurer.

The remuneration for the Claim Handling Services was treated as a component of the reinsurance fees paid by the ceding insurer to the reinsurer, and consequently treated as VAT-exempt pursuant to Article 10, Para 1.2 of the Italian VAT Law, implementing Article 135, Para 1.a, of the European Union (EU) VAT Directive.

However, following the tax inspection, the IRA concluded that Claims Handling Services could not be considered exempt because they did not meet the requirement to qualify as either reinsurance or insurance-related services.

IRA's position

The IRA held, via the Resolution, that the Claims Handling Services provided by the reinsurers in relation to reinsured policies must be considered as an independent and separable service from reinsurance, because there is no contractual link between the reinsurer and the policyholder.

The IRA then concluded that Claim Handling Services shall be considered subject to VAT on the basis of the following positions.

Claim Handing Services are not insurance/reinsurance services

Article 10, paragraph 1, No. 2 of the Presidential Decree no. 633 of 26 October 1972 (VAT Decree) provides for a VAT exemption for insurance and reinsurance services.

This provision implements Article 135(1)(a) of Directive 2006/112/EC (EU Directive), according to which "Member States shall exempt the following transactions: (a) insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents."

However, neither the Italian legislation nor the EU Directive provide for a legal definition of "insurance transaction."

In this respect, reference can be made to settled case law issued by the Court of Justice of the European Union (CJEU)[2] according to which "the essentials of an insurance transaction are, as generally understood, that the insurer undertakes, in return for prior payment of a premium, to provide the insured, in the event of materialization of the risk covered, with the service agreed when the contract was concluded."

According to the IRA, the VAT exemption may be extended to a broader range of services only if from an economic perspective such services may be referred to as a unique insurance (or reinsurance) service, as defined above by the CJEU.

In particular, the IRA makes reference to the judgment in Case C-40/15 (Aspiro) by which the CJEU stated that the act of entrusting a third party for the provision of claims handling within the framework of an insurance contract does not imply the automatic extension of VAT exemption to claims handling services.

To this aim, it is required that "... a taxable person who is not himself an insurer but, in the context of a block policy, procures such cover for his customers by making use of the supplies of an insurer who assumes the risk insured. However, such transactions necessarily imply the existence of a contractual relationship between the provider of the insurance service and the person whose risks are covered by the insurance, that is to say, the insured party."

Based on the above, the IRA points out that reinsurers are not contractually bound to the policyholders, whereas by express regulatory provision (i.e. Art. 1929 of the Italian Civil Code) the reinsurance contract does not create any contractual relationship between the policyholder and the reinsurer.

Consequently, according to the IRA's view, the absence of the contractual relationship implies that the Claims Handling Services at stake shall be deemed to be standalone services in which the reinsurer does not undertake any obligation to cover a risk of the policy holder.

The IRA then concluded that Claims Handling Services are not eligible for the VAT exemption provided for insurance/reinsurance.

Claim Handing Services are not related to insurance/reinsurance services

Article 10, paragraph 1, No. 9 of the VAT Decree states that services related to financial exempt transactions, such as agency, mediation and brokerage activities, are also exempt from VAT.

With reference to services related to insurance and reinsurance, in 2009 the IRA clarified[3] that the VAT exemption under Article 10(9) of VAT Decree applies not only to mandate, agency and mediation contracts, but also to:

- Any consultancy and assistance activity aimed at presenting and proposing insurance (and reinsurance) products; and

- The collaboration, management or performance, especially in case of claims, of the executed insurance contracts.

With reference to the possibility to qualify the Claim Handling Service at stake as services performed by insurance brokers or insurance agents, the IRA notes that two conditions should be met, namely:

- The agent must have a relationship with both the insurer and the insured party.
- The activities performed by the broker/agent must cover the essential aspects of the work of an insurance agent, such as the finding of prospective clients and their introduction to the insurer.

In the light of the above, the IRA ruled out the possibility to qualify the Claim Handling Services as services performed by an insurance agent/broker, because the delegated reinsurers are not committed to finding prospective clients to be introduced to the insurer.

Accordingly, the IRA concluded that the Claim Handling Services provided by the reinsurers are not eligible for the exemption provided for insurance broker/agent services.

Claims Handling Services are not ancillary to insurance or reinsurance services

Finally, the IRA analyzed whether the services at stake can be considered ancillary to the reinsurance business.

In this respect, the IRA refers to judgment No. 11442 filed on 11 May 2018 by the Italian Supreme Court stating that transactions to be considered ancillary to the insurance or reinsurance business are only those rendered by insurance brokers or insurance agents.

Consequently, the IRA ruled out that the Claim Handling Services provided by the reinsurers cannot be exempt as ancillary to insurance or reinsurance business, since, as already noted, they do not entail essential aspects of insurance brokerage, such as finding prospective clients and connecting them with the direct insurer.

Applicable penalties

With reference to tax penalties,[4] the IRA acknowledged that the wrong VAT treatment (i.e., the exemption) applied to Claim Handling Services until **the publication of the Resolution** (i.e., until 4 October 2020) cannot be subject to penalties, given the **objective conditions of uncertainty** about the scope of application of the VAT exemption provisions to the case at hand, as well as the absence of any previous official guidance.

Implications

- For fiscal years up to and including 2019, the tax assessments will be limited just to the claim of the VAT, without penalties; this circumstance may facilitate settlement proceedings with the IRA.[5]
- On the other hand, those entities that have already taken or will undertake tax litigation proceedings against the assessment on the VAT treatment of the Claim Handling Fees raised by the IRA before the Resolution may ask for the disapplication of tax penalties in their defensive strategy by arguing that the assessments were grounded upon an interpretation of the law that was affected by objective conditions of uncertainty, as stated by the IRA themselves in the Resolution.
- With reference to the ceding insurers, based on the evidence gathered against reinsurers, the IRA may then issue tax questionnaires (and/or start ad hoc tax inspections) aimed at scrutinizing if the ceding entities did amend the VAT exempt treatment applied by the reinsurers; in this regard, at least for those transactions that will take place after 4 October 2020,[6] the IRA may impose penalties on ceding entities for the omission in correcting the wrong invoices that may be issued by the reinsurer.[7]
- The local insurers and reinsurers trade association (i.e., ANIA) appears to remain convinced of the legitimacy of the VAT exemption applied by insurers and reinsurers and it is not recommending that its members undertake tax settlement procedures, except for any different ad hoc consideration that may be made by the parties involved.
- Moreover, the recognition of objective conditions of uncertainty could support the defusing of potential tax criminal implications for the case at hand, since objective conditions of uncertainty may lead to exclude the existence of the element of specific intent (i.e., the purpose of evading taxes, a *condicio sine qua non* for grounding the tax crime of incorrect VAT return).
- If an entity elects to opt for the regularization of previous fiscal years (i.e., FY2015 is still assessable in the event of an incorrect VAT return), it is crucial to identify a correct regularization strategy in agreement with the IRA thus verifying the requirements provided by Art. 60, paragraph 7[8] of the VAT Decree that may allow the delegated reinsurers to recover VAT due from the delegating insurance companies.

Endnotes

1. See EY Global Tax Alert, *Italian tax authorities start tax inspections aimed at assessing reinsurance fees as subject to VAT*, dated 3 June 2019.
2. See judgment of the Court of Justice in Case C-349/96, paragraph 17: "With respect, first, to the interpretation of the expression 'insurance transactions', it must be observed that Directive 73/329 does not define the concept of insurance either. However, as the Advocate General states in point 34 of his Opinion, the essentials of an insurance transaction are, as generally understood, that the insurer undertakes, in return for prior payment of a premium, to provide the insured, in the event of materialisation of the risk covered, with the service agreed when the contract was concluded."
3. See Resolution Letter No. 267/2009 above.
4. Pursuant to article 6, paragraph 2, of Legislative Decree no. 472 of 18 December 1997 " The person who commits the infringement is not punishable when it is caused by objective conditions of uncertainty about the extent and scope of the rules to which they refer, as well as by the unclear nature of the requests for information or models for tax returns and forms for payment."
5. The IRA should apply both the penalty for an incorrect VAT return and the one for incorrect invoices issued. Each of these penalties can range between 90% and 180% of the higher VAT assessment, according to provisions carried respectively by Art. 5 para 4 and by Art. 6 para 1 of Legislative Decree No. 471/1997. Furthermore, the IRA could impose the penalty ranging from €1,000 to €8,000 for incorrect keeping of the VAT register according to provisions carried by Art. 9 para 1 of Legislative Decree No. 471/1997.
6. Date of publication of the Resolution.
7. For an amount equal to 100% of the VAT not applied according to provisions carried by Art. 6 para 8 of Legislative Decree No. 471/1997.
8. Art. 60, Para 7 of VAT Decree provides that a taxpayer who settled a deed of assessment by which the IRA assessed higher VAT, has then right to claim the amount paid to IRA as higher VAT back from the counterparty ("VAT right of redress") to which such VAT was not imposed at the time the relevant fee was charged; the exercise of such right is subject to a 10 year statute of limitations, starting from the date in which the higher VAT is paid.

   On the other hand, the counterparty has the right to deduct the higher VAT refunded to the claimant taxpayer; the tax payer has the possibility to exercise such right in the VAT return relevant for the second fiscal year following the date of refund of the VAT.

   According to clarifications rendered by the IRA in circular letter No. 35 issued on 17 December 2013, in order to benefit from VAT right of redress the tax payer has to be able to clearly and precisely identify the relevant counterparty as well as the relevant transaction – or part of it – to which the higher VAT assessed is referable.

For additional information with respect to this Alert, please contact the following:

Studio Legale Tributario, FSO Head of Tax, Milan
- Giuseppe Marco Ragusa marco.ragusa@it.ey.com

Studio Legale Tributario, FSO Global Compliance and Reporting, Milan
- Paolo Zucca paolo.zucca@it.ey.com

Studio Legale Tributario, FSO International Tax and Transaction Services – Transfer Pricing, Milan
- Antonfortunato Corneli antonfortunato.corneli@it.ey.com

Studio Legale Tributario, FSO International Tax and Transaction Services – Transaction Services, Milan
- Giancarlo Tardio giancarlo.tardio@it.ey.com

Studio Legale Tributario, FSO Insurance Tax, Milan
- Renzo Rivolta renzo.rivolta@it.ey.com

Studio Legale Tributario, FSO VAT, Milan
- Gabriella Cammarota gabriella.cammarota@it.ey.com

Studio Legale Tributario, FSO Tax Controversy, Milan
- Alberto Giorgi alberto.giorgi@it.ey.com

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