

Italian tax authorities start tax inspections aimed at assessing reinsurance fees as subject to VAT

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Executive summary

The Italian tax authorities (ITA) have started a tax inspection program related to insurance and reinsurance companies with a taxable presence in Italy (i.e., both legal entities and permanent establishments) aimed at verifying the value added tax (VAT) treatment applied to reinsurance fees.

In particular, the ITA are focusing their examinations on the VAT treatment applied to that part of the reinsurance fees that are remunerated by the claims handling services (Claims Handling Services) provided by the reinsurer, acting as the delegated party by the ceding insurer.

According to the ITA's position, the Claims Handling Services provided by the delegated reinsurer within the framework of a reinsurance agreement would be neither exempt financial services nor ancillary to insurance services and therefore subject to VAT.

Detailed discussion

Several insurance and reinsurance companies in Italy are currently facing a tax inspection program established by the ITA to verify the VAT treatment applied to reinsurance fees.

In principle, reinsurance fees paid to the reinsurer have been treated as VAT-exempt insurance services pursuant to Article 10, Para 1.2 of the Italian VAT Law, implementing Article 135, Para 1.a, of the European Union VAT Directive.

In the inspections, the ITA are focusing on certain contractual schemes where in respect of the reinsured policies, the reinsurer - delegated by the ceding insurer - provided Claims Handling Services which could be either produced internally or outsourced to third party providers and then recharged to the ceding party.

Taking into consideration the challenges raised with reference to the VAT treatment of coinsurance fees,¹ the ITA may determine that Claims Handling Services cannot be considered as reinsurance or insurance-related services because they do not provide the ceding party with the possibility to cover against risks of insurance activity. In such case, the ITA may challenge that at least part of the reinsurance fee - which remunerates Claims Handling Services - should be treated as subject to VAT.

Implications

If the ITA reach the conclusion that coinsurance fees related to Claims Handling Services have to be treated as subject to VAT, at the end of the relevant tax inspection, the ITA may issue against the reinsurer a final tax audit report, and then a deed of assessment, challenging the omission in the application of VAT to reinsurance fees earned by the reinsurer, plus relevant interest and penalties.²

With reference to ceding entities, based on the evidence gathered against reinsurers, the ITA may then issue tax questionnaires (and/or start ad hoc tax inspections) aimed at scrutinizing the VAT treatment applied by ceding entities to the reinsurance fees paid to reinsurers; in this regard, the ITA may impose on ceding entities penalties for the omission in correcting the wrong invoices issued by the reinsurer.³

It is important to note that the ITA could also issue a criminal notice to the Public Prosecutor's Office that may charge the crime of wrong tax return⁴ against the legal representative who signed the relevant VAT return.

Endnotes

1. The Italian Court of Cassation issued a landmark judgment concerning the VAT treatment of coinsurance fees. The Court ruled that the services supplied by the delegated insurer to the other co-insurers are neither exempt financial services nor ancillary to insurance services and therefore subject to VAT. See EY Indirect Tax Alert, [Italian Supreme Court rules coinsurance fees are subject to VAT](#), dated 26 June 2018.
2. The ITA 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 ITA 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.
3. 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.
4. The crime of an incorrect return occurs when, in order to avoid the VAT or income tax, in one of the returns relating to such taxes, active elements are indicated for an amount lower than the actual amount or nonexistent liabilities are claimed. The relevant provision (i.e. Art. 4 of Legislative Decree No. 74/2000) identifies the border between the criminal offense and the administrative offense: all conduct that does not fall within the provision of the law will not have criminal, but only administrative consequences. The rule provides for a double punishment threshold: in fact, the conduct becomes criminal if the tax evaded is higher than €150,000 and if the total amount of the assets removed from taxation, including by indicating nonexistent passive elements, is higher than 10% of the amount of the active assets indicated or in any case higher than €3 million. The possible penalty is imprisonment from one to three years and it is imposed against the legal representative who signed the relevant VAT return.

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