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## E.U. tax rule may increase insurers' outsourcing costs

### Change in method of calculating VAT may add to expenses

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BRUSSELS—Some European insurers and reinsurers could see their tax bills rise significantly under changes to the way value-added taxes are charged on business outsourced to non-European Union countries.

The additional costs could be enough to cause combined ratios to creep up and give insurers fiscal headaches when they can ill afford more expenses, experts say.

A new E.U. “place of supply” rule that went into effect Jan. 1 requires VAT to be charged based on where the recipient of services is located. That reversed the previous requirement that the tax be assessed in the place where the service was rendered.

The rule creates a new tax liability for E.U. businesses that outsource services to countries such as India that have no VAT. Insurers and reinsurers that outsource to countries with lower VAT rates than their home countries also will see their tax bills increase.

While the rule won't affect insurance transactions, which generally are exempt from VAT, insurers that outsource services such as administrative, clerical, technological and others that are nonfinancial will feel the pinch.

The new rule is the latest VAT concern for insurers. In October, the Luxembourg-based European Court of Justice ruled that Swiss Reinsurance Co. is responsible for €2 million (\$2.9 million) in VAT on a portfolio transfer seven years ago of 195 life reinsurance contracts.

The reinsurer transferred the portfolio from a German subsidiary to the Zurich-based parent. The court ruled that the transfer was not an exempt insurance transaction and therefore was subject to Germany's VAT.

Insurers and reinsurers are particularly affected by the new E.U. rule because, unlike many other types of businesses, they will be unable to offset the VAT. Because financial services companies are exempt from European VAT, insurers do not hold VAT numbers. The numbers

allow companies that are charged the tax to offset it with the amount of VAT they charge others.

If no loopholes exist that would allow insurers and reinsurers to skirt the new VAT rule, “it is likely to be of significant importance to the majority of European insurers,” said Vasilis Katsipis, general manager-analytics at A.M. Best Europe Ltd. in London.

British insurers may be particularly affected because they tend to outsource services more heavily than those located in continental Europe, Mr. Katsipis said. German insurers that outsource to Eastern European countries also could see expenses rise as a result of the change, he said.

Mr. Katsipis and others said it is unclear how much the change could cost the insurance and reinsurance markets. The Assn. of British Insurers said it could not provide an estimate of the potential expense to U.K.-based companies, many of which outsource to India.

The costs could be high, given that VAT rates are generally double digits in Europe. The rate in Britain, for example, is 17.5%.

Richard Asquith, managing director of TMF VAT & IPT Services, a unit of London-based TMF Group, said the cost to British insurers alone could run several hundred million pounds.

Mr. Asquith said some U.K. insurers have tried to create VAT grouping structures whereby insurers' related companies can offset the irrecoverable VAT liability. But E.U. officials are looking to undermine that approach because of perceived abuses whereby some insurers have used companies not fully bound to them and, therefore, VAT grouping structures may not be effective in avoiding the tax, he said.

The VAT rule change is “fairly significant,” said Tony Lynne, director-indirect taxes at KPMG L.L.P. in London. “It will clearly have some impact on the attractiveness of non-E.U. locations,” he said, but insurers and reinsurers likely will view the rule as “painful but not a deal breaker.”

He acknowledged, though, that if some insurers already have concerns about the quality of services provided by outsourced operations, the addition of VAT could make them reconsider the relationship.

Not all companies will take a significant hit from the VAT changes.

Swiss Re acknowledged that it will be affected by the change, but the impact “will by no means be material,” the Zurich-based reinsurer said in a statement.