Increased VAT Costs for Supplies Made to EU Insurance Branches?

In its recent ruling in the case of Skandia America Corp. (USA)¹ the European Court of Justice (ECJ) has brought into question the VAT treatment of, and thereby the potential costs relating to, supplies of services from a head office to a branch located in another jurisdiction.

The ruling in Skandia is likely to be of particular relevance to international insurance groups who currently operate through branches located in the European Union, and who currently supply services to such branches without accounting for VAT.

Current prevailing VAT treatment

Although insurance and reinsurance related services are specifically exempt from VAT, the provision of certain operational services, such as back office services and IT services, may fall within the scope of VAT. In many instances it will be these types of operational services which are supplied by a head office to its foreign branch.

To date, however, it has generally been understood that a branch has not been considered to be a separate taxable person for VAT purposes. Accordingly, it had been understood that services supplied by a head office to its foreign branch would, in any event, fall outside the scope of VAT.

This has allowed many international insurance groups, for which VAT is a real cost, to provide intra-group cross-border supplies of services without suffering any VAT costs; resulting, in many cases, in significant savings for the group.

ECJ ruling in Skandia

In short, the ECJ ruling appears to cut across the prevailing VAT treatment discussed above.

The ECJ ruled that in circumstances where the head office of a non-EU entity provides services to its EU branch, and such EU branch is a member of a VAT group, such supplies are potentially within the scope of VAT.

The crucial aspect of the Skandia case was the fact that the supply was considered to be made to the VAT group of which the EU branch was a member, and not to the EU branch itself. As a result, the supply was treated as being made to a separate taxable person and therefore within the charge to VAT.

¹ Judgment of the Court (Second Chamber) of 17 September 2014; Skandia America Corp. (USA), filial Sverige v Skatteverket; Case C-7/13
Potential increased cost to operating the group

Although the Skandia case involved supplies made by a U.S. company to its EU branch, the ruling is potentially relevant to any group (EU or otherwise) which currently makes cross-border supplies to an EU branch.

On the basis that many such international insurance groups will not be in a position fully to recover any VAT which is suffered within the international group, the possibility of VAT being charged on intra-group supplies is cause for significant concern and could result in significantly increased operating costs.

The quantum of such cost will, to an extent, be determined by the date on which relevant EU member states give effect to any necessary changes to domestic VAT legislation. With respect to the UK, it is expected that any changes to UK VAT law will take effect from a future date.

What action should insurers with EU branches be taking?

In the first instance, it will be necessary to see how the various taxing authorities within the European Union respond to this ruling. With respect to the UK, it is expected that HM Revenue & Customs will publish a public response in the near future.

In the meantime, it would be prudent for any insurance groups with EU branch structures to:

- determine what supplies, if any, are currently being made to EU branches, and whether such EU branches are part of an existing VAT group; and
- assess what additional VAT cost potentially arises, and what steps could be taken to reorganize existing arrangements (for example, by bringing services in-house) in order to mitigate or avoid such increased costs.

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