



# Targeting IPT

By **Richard Asquith**

The Homeserve case has focused the HMRC's attention on closing a loophole in UK insurance premium tax laws, with lasting implications for captives

On 9 December 2009, in his Pre-Budget Report, the UK Chancellor of the Exchequer announced emergency amendments to the Finance Act which had been allowing the avoidance of millions of pounds in insurance premium tax (IPT) on split administration contracts. It follows a number of attempts by the UK tax authority, Her Majesty's Revenue and Customs (HMRC), to establish IPT as due on such services through the Homeserve tax test case.

The result of this increase in the scope of IPT means there will be a rise in tax – including that for captives managing service warranty risks on behalf of parent companies – which will inevitably be passed on to the consumer.

## Targeting administrators

This change in scope centres on the practice of companies providing ancillary insurance cover in addition to their core services. To reduce the tax liability, many companies have been splitting contracts into two parts: taxable and non-taxable.

Homeserve, the emergency home boiler and electrics call-out service,

was offering its customers insurance to cover the costs of its services for several years. For the insurance administration, Homeserve was responsible for the management of the insurance cover, including: marketing; processing applications; receipt of premiums; altering or renewing policies; claims handling; and complaints. The insurance contract was executed directly with an insurance company, Inter Partner Assistance, of Belgium, a subsidiary of AXA, and was set at £59.99.

In the marketing material issued to potential customers it was made clear that the insurance cover would be provided under a contract with the insurer. There would be a separate charge from Homeserve, an 'arrangement and administration' fee of £14, in addition to the insurance premium. The £14 fee was under a separate agreement between the customers and Homeserve.

Under the Finance Act 1994, any premium paid to an insurer as part of a taxable insurance contract is liable to IPT. This includes any part which is "wholly or partly referable to... costs of administration". HMRC assessed that the underlying nature of this secondary contract was an insurance

supply and therefore liable to IPT at 5%. It viewed such dual contracts as an insurance premium 'splitting' mechanism to avoid taxation. HMRC raised an assessment of approximately £1m against Homeserve.

As an aside, no actual contract for the above was ever concluded between Homeserve and the customer. However, HMRC contended that even if there was, it would still not constitute a separate agreement, and so would still be liable to IPT.

Homeserve took this to the Tax Tribunal Appeal in 2008. This upheld HMRC's view that IPT was liable. It held that there was effectively only one contract, and that both contracts related to the same cover. The tribunal gave the term "separate contract" a distinct meaning for IPT purposes. It was given to mean not simply 'another' contract, but one that was completely independent of the insurance contract.

This came as a surprise to many in the insurance industry as it was felt that Homeserve was simply trying to act as a facilitator and not providing insurance premium taxable services itself. This led to Homeserve pushing the case through the judicial system to the High Court. It wished to challenge

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the ruling that there were not two distinct contracts for the purposes of IPT.

#### HMRC frustrated

The High Court overturned the IPT Tribunal last year, ruling that no IPT was due. The judge concluded that the tribunal had been mistaken in giving a special meaning to the phrase ‘separate contract’. The Court disagreed with the Tribunal’s view that the contract overlapped and so represented a way of splitting the service for IPT avoidance. The High Court opined that the legislation did not demand a completely separate contract, but that the two could be interlinked.

It also pointed out that the contract between the customer and Homeserve could outlive the contract between the customers and Inter Partner Assistance, the insurer. This term had been included by Homeserve in the event that it wished to change insurer during the contract.

This has come as a huge relief for many parts of the industry which had been sent into flights of panic at the thought of having to meet unscheduled IPT bills.

Since these types of splitting arrangements have been increasing in the past five years, HMRC was alarmed at losing this appeal. While it shortly afterwards declared its intention not to appeal Homeserve further, HMRC quickly announced plans to close off this loophole. There seems little doubt that this announcement was also pushed forward as the government faced a sharp decline in tax-take as a result of the financial crisis.

To the industry’s surprise and consternation, in the December 2009 Pre-Budget Report, it was announced following the Chancellor’s speech that income from such separate contracts would now be included within the premium, and therefore liable to IPT. This would be introduced with immediate effect from 9 December and the

required legislation would be incorporated into the Finance Bill 2010.

This would mean all administration fees associated with insurance contracts and not liable to VAT would be subject to 5% IPT.

#### Brokers caught in crossfire

The rapid closing of the IPT administrators’ loophole has, however, had some unintended consequences. Most dramatically, the extension of IPT liability to administration charges on personal line insurance has brought in brokers’ services.

While it is claimed in the press that there was no consultation with the industry, this is not entirely true. There were some initial proposals from the UK government to require the administrators themselves to register with the tax authorities, and then submit IPT returns and payments. However, this was pushed back by key market players as it would lead to hundreds of new IPT registrations and an impossible administrative burden. Instead, the insurance company will be responsible for collecting the IPT and submitting it to HMRC under its existing IPT registration.

As the Broker Network has warned, neither the insurer nor the broker will have the necessary IT systems in place. This will be further complicated by several insurers being involved but with just one broker fee. The British Insurance Brokers Association has made a number of protestations to HMRC and will continue to do so in the forthcoming months.

Of particular concern for brokers will be the requirement to pass on to insurers full financial details of their administration charges, to allow the insurer to report the associated IPT to HMRC. This is often where the broker makes the lion’s share of their profits given that their regular broker fee is not so tight. The fear will be that the insurance company takes advantage of this

new knowledge in future negotiations.

The speed of this move will take the insurance market by surprise. There has been no serious discussion with the insurers, brokers or intermediaries involved and so there is significant scope for misinterpretation. Since the amounts at risk run into many millions and given the current need for the government to raise revenues, perhaps this haste is not totally surprising. There is no doubt that this tax-raising move will be passed through to the consumer wherever purchase repair cover is offered in conjunction with household appliances, breakdown services or even holidays.

#### THE DSG EFFECT

Earlier in 2009, the DSG International group of companies (which includes UK firms Dixons, Curry’s and PC World) settled its long-running dispute with HMRC over transfer-pricing arrangements.

Following a final appeal before HMRC Tribunal Service’s special commissioner of tax, DSG International agreed at the beginning of June 2009 that it owed HMRC £52.7m in unpaid insurance premium tax (IPT).

DSG International was alleged to have charged its customers high prices for extended warranties and then accumulated profits in its Isle of Man captive, Dixons Insurance Services (DISL).

In 2007, DSG won a separate tribunal by insisting that insurance premium tax (IPT) could not be imposed on the warranty business, because the insurance transactions took place on the Isle of Man, which is exempt from UK IPT.

DSG International is unlikely to have to settle the agreed IPT liability in cash however, instead setting it off against income tax receivable held on its balance sheet.