# CHAPTER 24

# INSURANCE PREMIUM TAX (1)

## 24.1 Introduction

This is the first of a few chapters in which we're going to look at **Insurance Premium Tax** or **IPT**.

## 24.2 Legislation

First, we will introduce the legislation in which you'll find most of the rules. They are the **Finance Act of 1994** and **Statutory Instrument 1994/1774.**

FA 1994

SI 1994/1774

## 24.3 IPT basics

IPT is an **indirect tax** levied on the supply of insurance. For VAT purposes supplies of insurance are exempt. IPT is therefore a way that Customs collect a VAT like equivalent tax on supplies of insurance. You will see as we go through our chapters on IPT, that many of the rules are similar to VAT rules. In a moment we will have a look at the definition of what constitutes insurance. **Not all insurance contracts are liable to IPT, only insurance where the risk is located in the UK**. We will also look at this in more detail in a minute.

## 24.4 IPT rates

There are two rates to consider. Firstly, the **standard rate** and if you look up **Section 51 of the Finance Act 1994** you will see that this is **5%**. Secondly, there is the **higher rate** of IPT which you will also find in Section 51. This is **17.5%.** You will probably notice that these two rates bear an uncanny resemblance to VAT rates!

s. 51
FA 1994

You are probably already aware that from **4th January 2011, the standard rate of VAT is going to go up to 20%.** As a result of the increase to the VAT rate the **higher rate of IPT will also be 20%** from the same date. You will see a little later on in these chapters that the **higher rate of IPT was introduced to counter VAT avoidance schemes** – so this is the reason as to why the higher rate of IPT mirrors the standard rate of VAT. Also the current 5% **standard IPT rate will become 6% from the 4th January 2011.**

We mentioned a minute ago that contracts that do not cover UK risks are not liable to UK IPT. Even if the contract does cover a UK risk it may nevertheless be **exempt**. The legislation contains these exemptions. In a minute we will have a look at contracts that are liable to the standard rate, contracts that are liable to the higher rate and those that are exempt from IPT. You will find more details about the higher rate in **Schedule 6A** and those contracts that are exempt from IPT are detailed in **Schedule 7A.**

Sch 6A & Sch 7A
FA 1994

## 24.5 Insurance

What constitutes an insurance contract? The legislation is not much assistance to us. We have a definition in **section 73(1)** and this helpfully tells us that insurance constitutes *"…provision of insurance"*.

**Section 70** also tries to define what a taxable insurance contract is but this does not help us much either. It says:

s. 70 FA 1994

*"any contract of insurance is a taxable insurance contract".*

The only help it does give us is by using the word 'contract' we must have a legally enforceable agreement. This means we have an **offer** that has been **accepted**, with **consideration** having passed between the parties. This would usually be satisfied by a proposal being accepted by the insuree and payment of a premium to the insurer.

There is case law that further defines an insurance contract and the case of *Prudential Insurance Company v The Inland Revenue Commissioners 1904* identified three elements:

Prudential Insurance Co. v IRC 1904

1. that of a **premium** being paid;
2. the insured is being **indemnified against a loss** from an **uncertain event**, and
3. the insured must have been the one that suffered the loss as a result of that event. This is often known as an '**insurable interest'**.

**Public Notice IPT1** also provides Customs' view on the characteristics an insurance contract usually has.

Public Notice IPT1

## 24.6 Warranties

One type of contract that we have to be careful with when deciding whether it is liable to IPT is a contract for a **warranty**. Warranties can take the form of an **ordinary manufacturer's warranty** or an **extended warranty**.

## 24.7 Ordinary warranties/guarantees

An ordinary warranty that is given by the manufacturer to the purchaser of goods generally forms part of the price paid for the product.

**Illustration 1**

You purchase a dishwasher. You buy the dishwasher for £300. Included in the box along with the operating instructions is a guarantee card that says the manufacturer will replace or repair the dishwasher free of charge, if it breaks down within a two year period.

We have not paid for this warranty separately. Is IPT due on part of the £300 we paid for the dishwasher i.e. does this constitute insurance?

This type of warranty is not considered to be insurance. Effectively the purchaser is being given a guarantee from the manufacturer that the **product will perform as it should do for a reasonable period of time.** The manufacturer is simply complying with his legal obligations in that the goods correspond with provisions such as fitness for purpose contained in the **Sale of Goods Act.**

## 24.8 Extended warranties/mechanical breakdown insurance (MBI)

**Illustration 2**

Continuing with illustration 1, what if the seller of the dishwasher also sells an **extended warranty** with the dishwasher for £80 and the warranty provides for repair or replacement free of charge should the product breakdown within a three year period. This type of agreement is a contract of insurance. It is a **separate agreement** in addition to the sale of the dishwasher itself and has the **characteristics of insurance**. The insured is covering himself in the event that the dishwasher breaks down. So, even though the extended warranty may provide the same level of cover as the manufacturer's warranty, for the first two years at least, unfortunately due to the separate nature of the agreement it is liable to IPT.

## 24.9 Service Contracts/repair contracts

We also need to distinguish between a "service (or repair) contract" and an extended warranty. A service contract is where the customer enters into an agreement with the supplier and the supplier will, for example, inspect, maintain and repair the product over a specified period of time in return for an agreed sum of money.

This contract is not itself "insurance" – it is not an "extended warranty". With an extended warranty the product may never break down and therefore if that is the case then no repairs are ever carried out. With a service contract, the customer is paying for defined services from the outset. The inspection, maintenance etc., will be carried out. If the supplier subsequently takes out insurance to cover shortfalls in the cost of repairs, then this insurance itself will be liable to IPT.

## 24.10 UK risks

We're now going to look at what constitutes a UK risk. Before we go into the detail - let's find in the legislation where it says that only UK risks are liable to IPT. **Paragraph 8 of Schedule 7A** tells us that contracts covering overseas risks are exempt and not liable to IPT. We need therefore to decide what constitutes an overseas risk. Paragraph 8 refers us to another piece of legislation; the **Financial Services and Markets Act of 2000** which in turn, refers to **Statutory Instrument 2001/2635**.

Para 8 Sch 7A FA 1994

FSMA 2000

(Note that although this regulation has been amended by SI 2009/3075 the rules relating to where a risk is located as originally detailed in Second Council Directive 88/357/EEC – and now in Directive 2009/138/EC – are unchanged,)

**Regulation 2(2)** contains the rules.

reg. 2(2) SI 2001/2635

If we are looking at insurance contracts that relate to **vehicles**, and this includes cars, ships and aeroplanes then if that vehicle or vessel is **registered in the UK** the contract covers a UK risk.

This regulation was amended in 2007 for insurance that relates to a vehicle dispatched from one member state to another. For the period of 30 days beginning with the day on which the purchaser accepts delivery, the reference to the EEA state in which the risk is situated is a reference to the state of destination and not registration.

For contracts involving **buildings** then the contract covers a UK risk if the **building is located in the UK**. These first two rules should be easy to remember.

The next one on travel insurance is harder to remember. If the contract covers a **maximum four month period it constitutes a UK risk if it was 'taken out' in the UK.** When determining the four month period, it is the period from booking to the end of the insured period that we look at – not the period of the holiday itself.

For other travel insurance that is supplied to an individual, if the **individual habitually resides in the UK when the policy is 'taken out'**, then that will also constitute a UK risk and be liable to UK IPT. What constitutes habitual residence is **residence of generally one year**. If the travel insurance is being provided to a company, then it will constitute a UK risk if the **location of the establishment is in the UK when the policy is taken out.**

An ECJ case held that if the policy holder was the parent company of a group of companies, and the insurance related to its subsidiaries, then when deciding where the risk was situated, the "establishment" or location of the subsidiaries was used.

Kvaerner plc v Staatssecretaris van Financien (Case C-191/99)

Otherwise, IPT could be artificially avoided by setting up the policyholder in a state that levied no IPT.

You may have noticed that the same phrase cropped up a few times when we talked about travel insurance, the phrase 'taken out'. '**Taken out'** generally means **where you made the telephone call from** when you took out the policy, or if it is made in writing, **where did you post your application**, or if it is made over the internet **which country were you in when you were sat at your computer** booking it!

For all other types of insurance, the **location of the person** who is insured determines if the risk is in the UK. These are the same rules that applied for travel insurance covering more than four months.

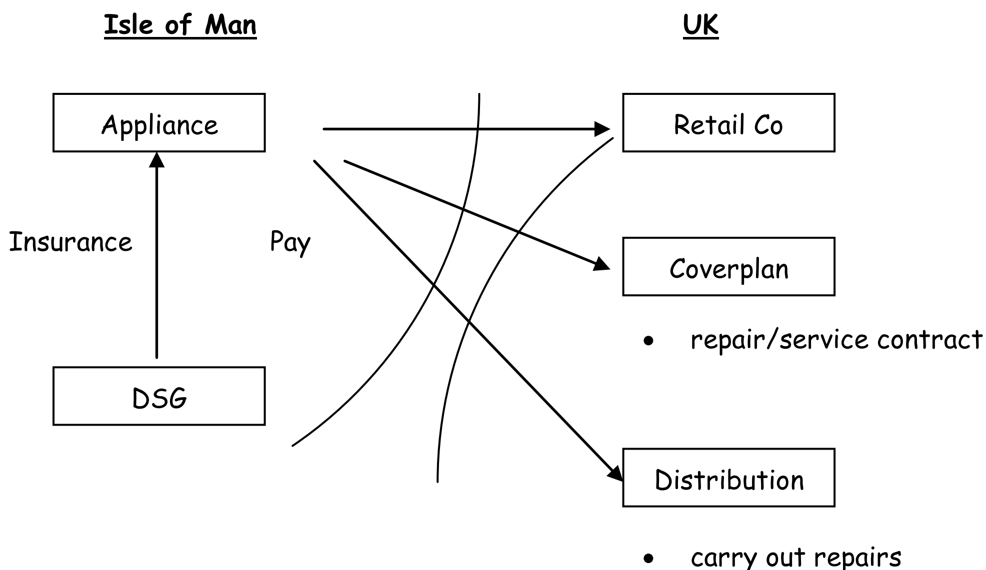
We'll also look at a tribunal case, which concerned the location of risk. In the DSG International case, the policyholder 'Appliance' was established in the Isle of Man. For IPT purposes the Isle of Man is not located in the UK. DSG was the company providing the insurance to Appliance and was also located in the Isle of Man. DSG was a member of a group of companies which included a retail company that sold domestic appliances. This company was located in the UK. There were 2 other companies in the same group, 'Coverplan' and 'Distribution'. Both of these companies were also located in the UK.

DSG Int. v HMRC IPT 00013 25th Oct 2007

The circumstances giving rise to the issue were as follows. The customer would buy a domestic appliance from Retail. Coverplan would sell a repair (or service) contract to the customer, as agent on behalf of Appliance. In the event of the product breakdown, Appliance would repair or replace the goods.

Appliance did not itself carry out the repair work, but this was done by Distribution. The insurance bought by Appliance was to reimburse it for having to pay Distribution for the cost of repairs.

Customs argued that the risk was located in the UK as the repair contracts gave rise to the risk. However, **the tribunal agreed with the appellant that the risk was a monetary loss suffered by Appliance where it had to pay Distribution to carry out the work.** Therefore, as the loss related to Appliance – and it was only located in the Isle of Man - it was not a UK risk and consequently the insurance was exempt from UK IPT.



**Example 1**

You have to decide whether each of the contracts constitute a UK risk and therefore are liable to UK IPT, or if they cover a non-UK risk and are not liable to UK IPT.

Tick the relevant one:

| | **UK risk** | **Non-UK risk** |
|---|---|---|
| Motor car insurance taken out by a USA citizen on holiday here using a UK car | | |
| UK insurance company sells insurance relating to a villa in Spain | | |
| Travel insurance for 2 months taken out by a USA individual with a UK company | | |
| Travel insurance for 2 months taken out by a UK individual in the UK via the internet with a USA company | | |
| Travel insurance for 12 months, taken out with a USA company over the internet by an overseas student who's been in the UK for 3 months. | | |

## 24.11 Higher rate contracts

We now need to look in more detail at the rates of IPT. We have already mentioned that IPT is charged at a standard rate of 5%, a higher rate of 17.5% and some contracts of insurance are specifically exempt. The standard rate of 5% is essentially the default. This means that if the contract is not liable to the higher rate or specifically exempted, then it will be liable to the 5% rate. We'll look first at those contracts that are liable to the higher rate.

These can be found in **Schedule 6A.** They include in the main - **motor car insurance**, **domestic appliance insurance** and **travel insurance**. We will look at these in more detail in a minute.

Sch 6A FA 1994

## 24.12 Exempt contracts

Contracts that are specifically exempt are contained within **Schedule 7A** and include the following:

Sch 7A FA 1994

- contracts of **reinsurance** (this includes reinsurance of surety bonds);
- contracts for **long term business**; for example **permanent health insurance**, or PHI for short, or **mortgage linked insurance**;
- contracts covering **motor vehicles for handicapped** people;
- **commercial ships, lifeboats, commercial aircraft**;
- **risks outside the UK**, which we have looked at already;
- **foreign or international rolling stock**, **channel tunnel**, **goods in foreign or international transit;**
- **credit**;
- **exchange losses**; and
- **financial facilities.**

Travellers Casualty & Surety v HMRC

This is a big list and you might want to spend some time having a look through the detail of Schedule 7A.

## 24.13 Motor car insurance

What we are going to do now is look in more detail at the types of insurance that are liable to the higher rate.

Let's take motor car insurance first. This was listed under Schedule 6A and liable to the higher rate of IPT. If we look closely at Schedule 6A it says that motor car insurance **does not fall within this schedule if it has been provided free of charge**.

In addition, the insurance only falls within this paragraph and is therefore liable to the higher rate of IPT if one of the following conditions is met:

- the insurer is a supplier of motor cars
- the contract is arranged through a supplier of motor cars
- the insurer is connected with a supplier of motor cars
- the contract is arranged through someone who is connected with a supplier of motor cars
- the insurer is someone who pays the whole or part of the premium received or a fee for arranging that contract to a supplier of motor cars (or someone connected with a supplier of motor cars), or
- the contract is arranged through someone who pays the whole or part of the premium received or a fee for arranging that contract to a supplier of motor cars (or someone connected with a supplier of motor cars)

**Illustration 3**

If you buy a new Peugeot and also purchase insurance from them at the same time, this would appear to fall within the schedule and be liable to higher rate IPT as Peugeot are a supplier of motor cars.

para 2(2A) Sch 6A FA 1994

However, if you read further on down paragraph 2 and take a look at sub paragraph 2A it impacts on what we have just said. It says that fully comprehensive, third party fire and theft, or just third party motor insurance does not fall within this schedule and therefore is not liable to the higher rate of IPT. Instead this type of insurance is liable to the standard rate of 5%. There is a reason why this "ordinary" motor insurance is excluded from the higher rate.

**Initially when the legislation was first written, IPT was only due at the 5% rate. The higher rate of IPT was introduced at a later point to counter VAT avoidance schemes some of which were run by motor car dealers**.

**Illustration 4**

Imagine a car dealer sells you a car and an extended warranty. The car is liable to 17.5% VAT and the extended warranty (under the legislation as it stood at the time) would have been liable to 5% IPT. There is no VAT on the warranty. The car dealer knows that if he reduces the price of the car and inflates the price of the extended warranty by the same amount then 17.5% VAT is saved in return for an additional 5% IPT charge. So overall there is a monetary saving. To counter this type of scheme, Customs changed the legislation and inserted schedule 6A which imposed 17.5% IPT on the extended warranty (instead of 5%). This meant that the "value shifting" carried out by the car dealer would no longer result in a monetary benefit. Reducing VAT by 17.5% to increase IPT by 17.5% would produce no savings.

So the reason why ordinary motor insurance is excluded from the higher rate and only liable to the 5% rate is because this was not the type of insurance that the avoidance schemes were targeting. It's the extended warranties when sold by car dealers that Customs were trying to impose a 17.5% charge on.

What insurance is left then to fall within Schedule 6A? The types of insurance include **mechanical breakdown**, for example **extended warranties**, or **roadside assistance**. These types of insurance would be **liable to 17.5%** where one of the conditions in the list above is satisfied.

## 24.14 Domestic goods insurance

We have already seen that this type of insurance is liable to the higher rate of IPT as it falls within para 3 of Schedule 6A. The legislation here is similar to motor insurance that we just looked at. In order to fall within this Schedule, it must **not be provided free of charge**, and needs to satisfy one of the following conditions:

para 3 Sch 6A FA 1994

- the insurer is a supplier of domestic appliances
- the contract is arranged through a supplier of domestic appliances
- the insurer is connected with a supplier of domestic appliances
- the contract is arranged through someone who is connected with a supplier of domestic appliances

- the insurer is someone who pays the whole or part of the premium received or a fee for arranging that contract to a supplier of domestic appliances (or someone connected with a supplier of domestic appliances), or
- the contract is arranged through someone who pays the whole or part of the premium received or a fee for arranging that contract to a supplier of domestic appliances (or someone connected with a supplier of domestic appliances)

There **used to be an extra statutory concession – contained in Notice 48 – that excluded ordinary household contents insurance from the higher rate of IPT**. This was under the same principle that we've seen for motor car insurance – i.e. this **was not the type of insurance that was the subject of the artificial "VAT value shifting" schemes** and therefore it was not Customs' intention that they be brought within the higher rate of IPT.

**From 1st April 2010, this concession is withdrawn**. Unlike the "ordinary motor car insurance" which we looked at above - which is specifically mentioned in the legislation as being excluded from the higher rate - there is no similar provision for ordinary contents insurance. The reason for this is that Customs does not believe that one is necessary. Domestic appliance insurance is only liable to the higher rate when one of the circumstances above is present. **Ordinary contents insurance is hardly ever sold by a supplier of domestic appliances so Customs have felt that there is no need to put this exclusion on a statutory footing**. They are expanding their guidance to confirm that this type of insurance is not liable to the higher rate. So withdrawing the concession does not alter the rate of IPT on these types of insurance, they will still be liable to the 5% rate.

So once again, the type of insurance that remains liable to the higher rate is contracts providing cover for the **mechanical breakdown** of goods where one of the conditions in the list above is satisfied.

## 24.15 Travel insurance

Travel insurance falls within para 4 of Schedule 6A and is liable to the higher rate of IPT. This is where it provides for travel risks for a person travelling.

Note that if a company takes out insurance which covers an employee's travel risks, but the employee has no right to claim on the policy, this is not travel insurance but corporate liability insurance and therefore is liable to the standard rate of IPT.

The types of travel risks are detailed further down the paragraph and cover **cancellation**, **delayed or missed departure**, **curtailment of travel**, **loss or delayed arrival of baggage** and **personal injury**.

There are further conditions about the risks as well. It includes risks associated with or related to travel:

- **outside the UK**;
- by **air within the UK**;
- **within the UK for travel falling in either one or two** as mentioned above; or
- **where absence from home is for at least one night**.

You will note from reading this paragraph that it is **irrelevant who is selling the travel insurance**. Therefore, unlike motor car or domestic appliance insurance, everybody who sells it will have to charge the higher rate of IPT.

## 24.16 Controversy with the higher rate of IPT on travel insurance

There has been some controversy with respect to the higher rate of IPT on travel insurance. We have just said that no matter who sells travel insurance it is liable to the higher rate of IPT. However, this was not always the case. Previously, it was only travel agents and tour operators who were liable to the higher rate of IPT on travel insurance. **Other entities were able to charge 5%** IPT on travel insurance that they sold.

Lunn Poly and their travel insurance provider sought **judicial review that the higher rate of IPT was incompatible with European law.** The High Court found for Lunn Poly on one ground that the application of the **standard rate of IPT was an illegal state aid** and therefore in order to be able to apply it, the UK should have notified it to the European Commission. Effectively by allowing some sellers of travel insurance to charge IPT at 5% puts them at an unfair advantage over the tour operators and travel agents who are liable to the higher rate. Therefore, the UK was illegally aiding one sector of the insurance business and **distorting competition**.

R v C&E Comrs, ex p Lunn Poly Ltd and another

As a consequence of this ruling, the **standard rate of IPT was withdrawn** on travel insurance, so everyone now pays the same amount and the issue of illegal state aid no longer applies here. Customs appealed the decision and the Court of Appeal, on the 26th of February 1999, dismissed their appeal. Customs decided not to petition the House of Lords to appeal the Court of Appeal's decision.

Since the Lunn Poly decision, there have been more cases concerning the issue of illegal state aid. The issue is equally relevant in respect of sales of mechanical breakdown insurance for cars and domestic appliances.

## 24.17 Controversy over the higher rate of IPT on domestic appliance insurance

We've already seen that if this insurance is arranged by suppliers of the goods, or people connected with such suppliers, it is charged at the higher rate of IPT. When sold by people unconnected with suppliers of the goods it is liable to the standard rate of IPT.

The tribunal case of **GIL Insurance Ltd** raised the issue of illegal state aid. This company was supplying domestic appliance insurance. The issue as to whether the standard rate constituted an illegal state aid was referred to the European Court of Justice. On the 29th April 2004, the ECJ issued its decision. It held that the reduced 5% rate did not constitute a state aid. This is because all contracts were initially liable to the 5% rate. The 17½% rate was imposed later on some contracts to counter avoidance.

C&E Comrs v GIL Insurance Ltd and others

Therefore, the UK was not illegally aiding one sector of the Community but countering avoidance by another. Currently, therefore, the two rates for domestic appliance and car insurance remain in the legislation.

**Example 2**

You need to correctly identify the IPT treatment. Tick the box that you believe is correct. In some cases you may feel that more than one box could apply. If this is the case tick all relevant boxes.

If you believe that any of the contracts listed are not insurance contracts at all, and therefore do not come within the IPT regime then leave all boxes blank.

| Cover | 5% | 17.5% | Exempt |
|---|---|---|---|
| Medical Insurance | | | |
| Permanent Health Insurance | | | |
| 3rd party, fire & theft car insurance | | | |
| 12 months travel insurance sold to a UK resident individual | | | |
| Free of charge car insurance | | | |
| Extended warranty on a dishwasher | | | |
| Credit insurance provided to a business with UK activities only | | | |
| Guarantee provided to a creditor in the event of non payment by another party | | | |
| Ordinary manufacturer's warranty on the sale of goods | | | |
| Travel insurance sold by a USA company to a UK resident individual | | | |

**Answer 1**

| | UK risk | Non-UK risk |
|---|---|---|
| Motor car insurance taken out by a USA citizen on holiday here using a UK car | ✔ | |
| UK insurance company sells insurance relating to a villa in Spain | | ✔ |
| Travel insurance for 2 months taken out by a USA individual with a UK company | ✔ (if taken out in the UK) | ✔ (if taken out abroad) |
| Travel insurance for 2 months taken out by a UK individual in the UK via the internet with a USA company | ✔ | |
| Travel insurance for 12 months, taken out with a USA company over the internet by an overseas student who's been in the UK for 3 months. | | ✔ |

For motor car insurance, the contract constitutes a UK risk if it covers a car registered in the UK. Therefore this contract is liable to IPT.

For example two, the insurance covers a non-UK risk because it relates to a building that is not located in the UK.

For example three, the travel insurance is for less than four months, therefore we look at where it is 'taken out' to determine whether it is a UK risk or not. Potentially both answers could apply here! It will be a UK risk if it was taken out in the UK, and if this American individual was abroad at the time of taking it out then it will not be a UK risk. For example, perhaps they booked it over the internet.

For example four, as with the last example, we look at where the person was when they took out the policy. As we are told it was actually taken out in the UK via the internet it constitutes a UK risk. It does not matter where the company is based. This means that the American company will be liable to register for UK IPT purposes. You will learn about this in a later chapter.

The final example covered travel insurance for a twelve month period, which was taken out with a USA company over the internet by an overseas student who had been in the UK for three months. This does not fall in our category of travel insurance up to a maximum four months, so we have to look at the other rule we saw earlier. It says that if the individual was habitually resident in the UK on the date the contract is entered into, then it will be a UK risk. The answer to that is no, he is not habitually resident in the UK, because he has only been here for three months and not at least one year. Therefore, the contract is not liable to IPT; it is a non UK risk.

**Answer 2**

| Cover | 5% | 17.5% | Exempt |
|---|---|---|---|
| Medical Insurance | ✔ | | |
| Permanent Health Insurance | | | ✔ |
| 3rd party, fire & theft car insurance | ✔ | | |
| 12 months travel insurance sold to a UK resident individual | | ✔ | |
| Free of charge car insurance | ✔ | | |
| Extended warranty on a dishwasher | ✔ | ✔ | |
| Credit insurance provided to a business with UK activities only | ✔ | | |
| Guarantee provided to a creditor in the event of non payment by another party | Not insurance | | |
| Ordinary manufacturer's warranty on the sale of goods | Not insurance | | |
| Travel insurance sold by a USA company to a UK resident individual | | ✔ | ✔ |

Medical insurance is liable to the standard rate of IPT as it is specifically excluded from Schedule 7A – it is not exempt as long term business.

Permanent Health Insurance however, is covered in paragraph 2 of Schedule 7A and is specifically exempt.

Third party fire and theft car insurance is liable to the standard rate of IPT. See sub paragraph 2A in paragraph 2 of Schedule 6A.

12 months travel insurance, which is sold to a UK resident individual, is liable to the higher rate of IPT, no matter who sells it. It is contained in Schedule 6A. It does not constitute an overseas risk as the insured was habitually resident in the UK when it was taken out.

Free of charge car insurance is liable to the standard rate of IPT. It is excluded from Schedule 6A.

An extended warranty on a dishwasher is likely to be liable to the higher rate of IPT where it is sold in one of the circumstances we mentioned earlier. For example, if it is sold by a supplier of dishwashers. It could be liable to the standard rate of IPT, if it is sold by other persons who do not fall within the categories mentioned earlier.

Credit insurance provided to a UK business is liable to the standard rate of IPT. Although credit insurance is listed in Schedule 7A it is only exempt if it is provided to overseas customers or UK businesses in relation to the export of goods.

A guarantee provided to a creditor in the event of non payment by another party is not an insurance contract.

An ordinary manufacturer's warranty on the sale of goods is not an insurance contract. The seller is complying with his legal obligations in that the goods are fit for their purpose and will last a reasonable amount of time.

Travel insurance sold by a US company to a UK resident individual is debatable. Although we are not told the length of travel insurance, if it is taken out in the UK or the person is a UK habitually resident individual when it is taken out, it will constitute a UK risk, so it is not exempt under Paragraph 8 of Schedule 7A and is liable to the higher rate of IPT. If it covered insurance of up to four months and was taken out abroad then it would not constitute a UK risk and would be exempt.

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