CHAPTER 25

INSURANCE PREMIUM TAX (2)

25.1 Premium

We have seen so far that IPT applies to insurance where the risk is located in the UK and the rates are 5%, 17.5% and some insurance contracts are exempt. If our contract is liable to IPT the rate is applied to the '**premium'**.

The definition of a premium is found in s.72 of the Finance Act 1994. You will see from this section that a premium includes payment for the following: s. 72 FA 1994

- **risk**;
- costs of **administration**;
- **commissions;**
- any **facilities for paying in instalments** or making a deferred payment;
- **tax**.

Therefore, if **interest** is charged for payment by instalments - this must be included.

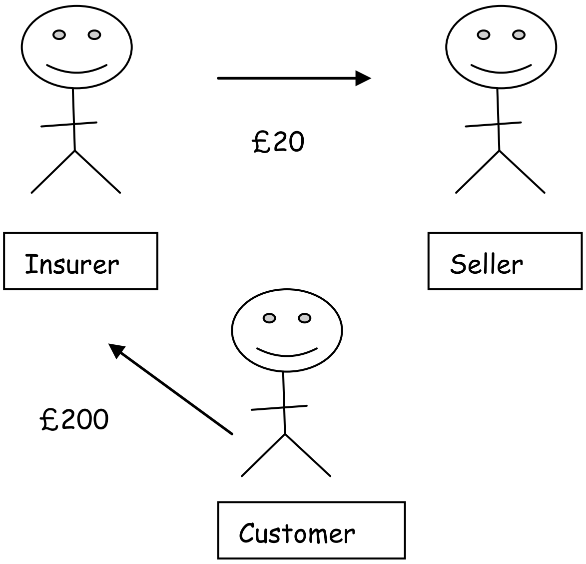
It also includes payments received in respect of a right to require an insurer to provide, or offer to provide, cover under a taxable insurance contract.

25.2 Commissions

S.72(1A) talks further about commissions. If the commission is **already chargeable to tax at the higher rate by virtue of section 52A** or the commission is **charged under a separate contract and identified in writing as a separate amount charged**, then it is **not included as part of the 'premium'** received by the insurer. s. 72(1A) FA 1994 s. 52A FA 1994

Illustration 1

Imagine that you are a supplier of domestic goods. You sell a dishwasher to your customer and at the same time you sell him insurance to cover the mechanical breakdown of the dishwasher. The customer pays the insurance directly to the insurance company and the amount of the premium is £200. The insurance company then pays a commission to you out of the premium received, which is £20. We need to decide on what amount IPT is due.



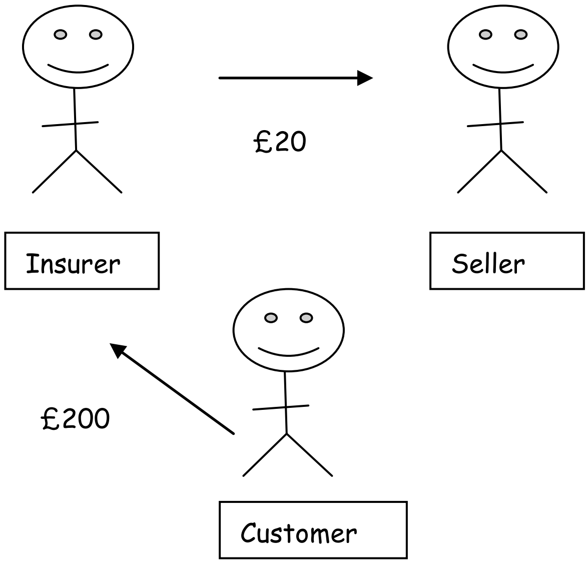
Although the insurance company has only really received £180 for the insurance, the commission of £20 is not deductible. This is because we do not satisfy the conditions in s.72(1A).

Remember – it had to be liable to tax at the higher rate by virtue of section 52A or charged under a separate contract. Well it isn't charged under a separate contract so we don't satisfy that condition so we would need to check whether it is liable to tax itself by virtue of section 52A. Let's look at that section now.

25.3 Section 52A – fees of taxable intermediaries

S.52A covers fees of taxable intermediaries for higher rate contracts. It says that if **someone charges a fee to the person who becomes the insured**, in respect of a **higher rate contract**, then that **fee itself is liable to the higher rate of IPT**. This means the **supplier has to register for IPT and account for the 17.5% on the £20 commission it has received**.

So let's go back to illustration 1 again. Remember this was where we have a supplier of domestic goods, who sells a dishwasher to a customer and at the same time sells him insurance to cover the mechanical breakdown of the dishwasher. The customer pays the insurance directly to the insurance company and the amount of the premium is £200. The insurance company then pays a commission of £20 back to the seller out of the premium received.

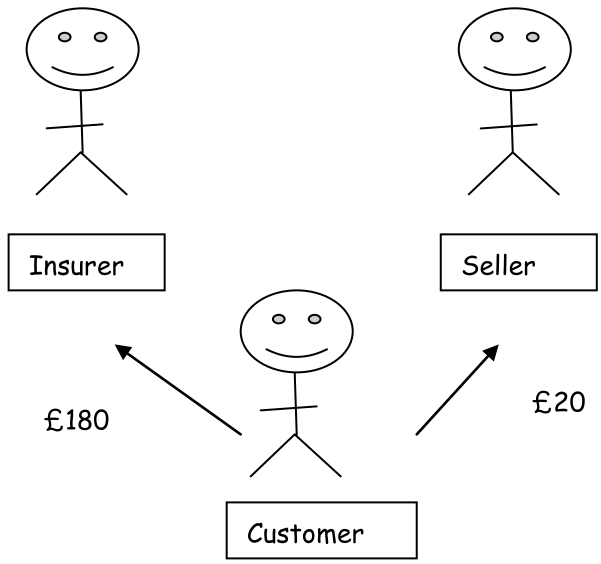


We said that the total premium received by the insurer is £200 – and according to section 72 that is the amount on which IPT is calculated. The section then went on to say that we could exclude the commission from the £200 if either it was liable to tax in its own right under section 52A or it was charged under a separate contract. Well we've already said that it isn't charged under a separate contract – so is it already liable to tax itself under section 52A? Well it isn't.

Remember to be liable under section 52A it had to be a fee charged by the seller to the insured. It isn't. The seller obtains the commission from the insurer. This means that because we don't satisfy either of the 'get-outs' the commission is included in the value of the premium and the **insurance company must register for IPT and calculate it on the full £200.** The **commission is not deductible.** So when would we fall within section 52A?

Well let's change the illustration slightly.

We still have the same supplier who is supplying the dishwasher directly to the customer. This time however the customer pays the £180 insurance direct to the insurance company and the £20 commission is paid directly to the supplier as part of a separate agreement between the customer and the supplier. Note that the total payable by the customer is exactly the same as before ie £200. It is simply being paid in two separate amounts to two separate parties.



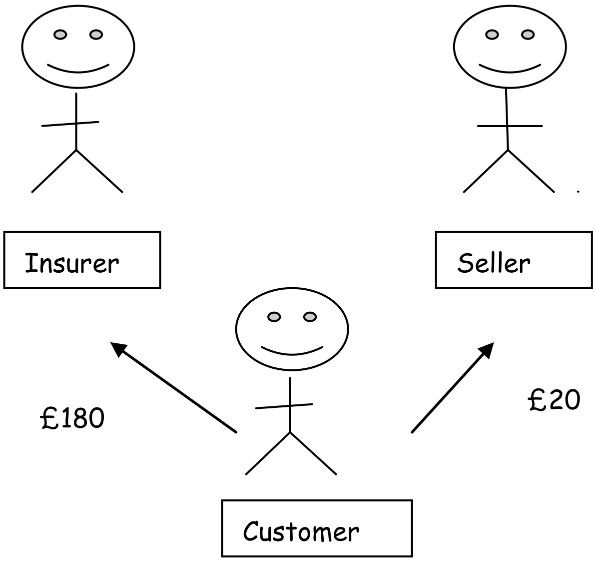
Firstly, let's look at the insurance company. What is the amount of the 'premium' for them? Well we know that they are **allowed to exclude the commission if <u>either</u> of the two 'get-outs' in the legislation are satisfied**. Remember the first one was that the commission is already chargeable by virtue of section 52A.

It is charged under section 52A. Remember this section says that if the supplier charges the insured a fee in relation to a higher rate contract then it falls within section 52A. So this means that for the insurer they only have to account for IPT on the amount they receive of £180. Does this mean that the commission escapes IPT? No! Remember the effect of falling within section 52A is that the **commission is treated as a 'premium' in its own right received by the seller and the seller must now register and account for IPT on it**.

The effect of s.52A is that if the contract is liable to the higher rate of IPT you cannot avoid IPT on a commission, even if it is charged separately. You are back to the same scenario as before when you paid the £200 direct to the insurance company and they paid the £20 commission to the supplier in illustration 1. In that case IPT was due on the £200, just as it is in this example. The only difference here is that we now have **two bodies that have to register and account for IPT.**

So what would have happened if in our illustration the contract was not liable to the higher rate of IPT but was a contract for ordinary motor insurance for example? Remember this is liable to the standard rate of IPT.

Let's imagine that you buy a new car and the motor dealer also sells you an ordinary car insurance policy. You pay £20 to the motor dealer under a separate contract for his fee/commission and £180 to the insurance company. What is the amount of the 'premium' on which IPT is due?



Well let's take the insurance company first. They have received £180 – but do we have to add back the commission you paid to the motor dealer? Well remember the commission is not included in the premium received by them if one of the two conditions in section 72(1A) is satisfied.

The first one is that the commission is itself already liable to IPT under section 52A. Well it isn't. **It is only liable to IPT in its own right if it is received under a higher rate contract.** Ordinary motor insurance is a standard rate contract. So we then need to look at the next 'get-out'. Is it charged under a 'separate contract' and identified to the insured as a separate amount?

The words 'separate contract' have caused a lot of controversy in the past! In the **High Court case of Homeserve, the words 'separate contract' were given their ordinary grammatical meaning which meant that the commission or fee escaped IPT.** In the original tribunal case the chairman had found in favour of Customs. He had held that the phrase 'separate contract' meant that if the contract for the insurance and the contract for the commission were dependent on each other and the insured person had no choice of insurer then the commission was treated as part of the premium received by the insurer – because it wasn't in reality a 'separate contract.'

Homeserve 2009 EWHC 1311

As a **result of losing the High Court case Customs introduced legislation in the Finance Act 2010 to reverse this decision. The new legislation took effect from the 24th of March 2010.**

Section 72 has been amended so that, in essence, **where the contract of insurance and the contract with the broker are linked** – like that in the circumstances of the Homeserve case - then the **fee or commission will be included in the amount of the premium that the insurer as to account for IPT** on.

Details of the Homeserve case are given in section 25.8 at the end of this chapter. Read it now if you want to and then come back to this point.

So coming back to our illustration, it is likely that the **fee will be included in the value of the premium where the insured has no choice of insurance and the fee is therefore linked to that particular insurance contract**. Therefore, the insurance company will have to account for IPT on the whole £200.

Note that the **new legislation does not apply to businesses** that enter into insurance contracts as Customs felt that this sector was not engaging in the type of avoidance like that in the Homeserve case.

So in what type of situation would the commission or fee escape IPT? **The following situation should not be caught by the new anti-avoidance legislation.**

Illustration 2

Imagine you go to an insurance broker and ask him to find you some household contents insurance. The broker charges you £20 for doing so. The broker will search through a variety of insurance providers to find you the best deal. You will then pay the insurance company that you finally decide to go with direct for the insurance. In this case the fee of £20 should escape IPT.

It is not included in the premium for the insurance company. It is not charged already under section 52A as this is not a higher rate contract. It is charged under a 'separate contract'. Have a read of the new wording of Section 72. Also remember that the anti-avoidance does not apply to insurance bought by businesses. In addition, the broker does not have to register himself and account for IPT on the commission because it is not received under a higher rate contract – remember section 52A only kicks in if it is a higher rate contract.

Commissions are not as clear cut as they might appear!! If the commission does not appear to relate to services provided by the broker to the customer, then it may not be deductible.

Remember, the first part of s.72(1A) says that the amount has to be charged to the insured under a separate contract. If the broker is not carrying out services to the customer – there is in reality, no contract between them. Policy Admin Services Ltd (PAS) v CCE (MAN 03/9000) (IPT/00011)

This issue arose in the tribunal case of **Policy Administration Services**.

25.4 "Card in the Box" scheme

Some manufacturers operate what are known as "card in the box" schemes. A leaflet is included in the box, along with, for example, a washing machine, offering a quote for an extended warranty on the goods. The purchaser takes out a policy and the insurer pays a "commission" to the manufacturer.

Normally, the whole insurance premium would be liable to IPT at the higher rate. There would be no deduction for the commission. However, if the "commission" constitutes a fee paid by the insurer to the manufacturer for "advertising" services, then the fee incurs VAT at 17½% and the insurance premium is liable to IPT at 5%.

This is because of the operation of para 3(2) of sch6A. Read it carefully now.

A premium is <u>only</u> liable to the higher rate if it is either:

1) arranged through a supplier of relevant goods (or someone connected with a supplier), or the insurer themselves is a supplier or connected with a supplier of relevant goods; or

2) if the insurer pays part of the premium received under the contract or a fee for arranging <u>that</u> contract.

Where a "commission" is paid out of the premium for <u>each</u> insurance contract taken up, number 2) above would be satisfied – and therefore the premium is liable to the higher rate of IPT.

If, however, a flat rate advertising fee is paid, and it is paid regardless of the number of insurance contracts sold, number 2) above is not satisfied – no part of the premium is paid for <u>that</u> particular contract.

25.5 Tax

Looking back at s.72 and the definition of a premium, one of the things included within it was tax.

This means that the customer will pay a total premium, for example £200, which is the actual amount of cash that the customer hands over. They don't then hand over IPT in addition; it is already included in the premium. The total premium is made up of the net premium, plus the IPT that the insurance company will charge to the customer.

To work out the rate of IPT on the total premium we perform the following calculation - in doing this we'll imagine the contract is liable to the standard rate of IPT.

Mathematically the net premium is 100%; the IPT is 5% so the total premium is 105%.

$$\begin{array}{lcccc} \text{Net Premium} & + & \text{IPT} & = & \text{Total Premium} \\ 100\% & & 5\% & \longleftarrow & 105\% \\ & & & \frac{5}{105} \text{ or } \frac{1}{21} & \end{array}$$

If you are given a total premium figure, to work out the IPT included, you will need to take 5/105. Alternatively, this can be scaled down to 1/21.
If the contract was liable to the higher rate of IPT we would use the fraction of 7/47. This is the same as the VAT fraction which you have probably seen before and is calculated by taking the net premium of 100% adding to it the higher rate of 17.5% to give us a total premium equivalent to 117.5%.

$$\begin{array}{lcccc} \text{Net Premium} & + & \text{IPT} & = & \text{Total Premium} \\ 100\% & & 17.5\% & \longleftarrow & 117.5\% \\ & & & \frac{17.5}{117.5} \text{ or } \frac{7}{47} & \end{array}$$

To work out the IPT from the gross premium, we need to take 17.5/117.5 or as we've said this can be scaled down to 7/47.

Remember in the previous chapter we said the **higher rate of IPT will rise to 20% from the 4th of January 2011 and the standard rate will rise to 6%.** To work out IPT in these situations you do the following:

If it is a **higher rate contract at 20%** you need to take 20 and divide it by 120 and multiply it by the total premium. This effectively means it is **one sixth of the total premium.**

If it is a **standard rate contract at 6%** you need to take 6 and divide it by 106. This effectively means it is **3 over 53 of the total premium**.

Example 1

You are an insurance company that provides fully comprehensive motor insurance. The total premium paid by the customer to you is £280. This includes a commission of £20, which you pass back to the supplier of the car. How much IPT is due?

Example 2

A total premium of £80 is paid to an insurer for the mechanical breakdown of a washing machine. A separate fee of £20 is paid to the supplier of the washing machine by the customer. How much IPT in total is due on the contract?

25.6 Apportionment

We've covered the basic rules on rates of IPT and what contracts suffer the higher rate, but what would happen if someone supplies insurance that covers different types of benefits, which are liable to different rates, or include some benefits that are exempt?

Illustration 3

Imagine that we supply a contract covering **medical insurance** and **permanent health insurance**. Medical insurance is excluded from Schedule 7A and is therefore liable to the standard rate of IPT, whereas permanent health insurance is included in Schedule 7A and is exempt. Let's imagine that the total premium paid by the customer is £500. How do we account for IPT given that our contract covers both taxable and exempt components? Sch. 7A FA 1994

S.69 says that we need to apportion the premium. First we work out the **exempt** bit of the premium. If for instance the permanent health insurance makes up £100 out of the total £500, then this is the bit that will be exempt. Once we have established the exempt portion, to find the non-exempt bit of the premium, we simply need to take the total premium and deduct the exempt part that we've just calculated. s. 69 FA 1994

PHI	£100
Medical Insurance	£400 x 1/21 = IPT due
Total Premium	£500

The sum that's left is the taxable amount on which IPT is deemed to be included. Therefore, IPT will be due at 1/21 on the £400. Remember, that IPT is tax inclusive.

Continuing with apportionment, what if the contract covers risks both within the UK and overseas? Once again we need to **apportion the premium, as only the UK risks are liable to UK IPT.**

For example, if the contract covers buildings insurance for a number of properties and one of those properties is located in Spain, then the premium covers UK risks and non UK risks and needs to be apportioned. Apportionment is done on a '**just and reasonable basis'** according to s.69. Therefore, one way of finding the exempt part of the premium is to apportion it by the value of the properties.

Illustration 4

Value of UK properties	£700,000
Value of Overseas property	£100,000
Total value of properties	£800,000

$$\text{Premium} \times \frac{100{,}000}{800{,}000} = \text{exempt}$$

In our example, if we take the premium and times it by the value of the overseas property as a percentage of the value of all properties, this bit of the premium will be exempt.

Illustration 5

Another example of apportioning a premium is where the contract covers cars registered in the UK and overseas. We could take the premium and apportion it by number.

Number of UK cars	2
Number of Overseas cars	1
Total number of cars	3

Premium x $\frac{1}{3}$ = exempt

Therefore as one of the cars is registered overseas, the part of the premium that is exempt is one third, representing the number of cars registered overseas out of the total cars insured.

25.7 De-minimis rules

As well as the apportionment rules we need to look at something called the *de-minimis* rules which are given in paragraph 4.2 of Extra Statutory Concession, Notice 48. These provide that if you have a contract covering both exempt and non-exempt elements, for instance, as in illustration 3 where we had permanent health insurance and medical insurance within the same premium, then the total premium will be exempt if the following conditions are satisfied. para 4.2 Notice 48

1. The total premium must be for a **maximum £500,000**. Well, clearly this is satisfied, our premium in the last example came to £500, well within the half a million pound limit! and

2. That a maximum of **10%** of the premium is **attributable to the taxable part**.

If we look back at our previous example the medical insurance constituted 80% of the total premium, so clearly we don't satisfy the second condition! Therefore, the de-minimis rules would not have applied in our illustration.

The concession also goes on to say that if an insurance company, as a result of the de-minimis rule, only has exempt contracts, then they can **apply for exemption from requirements to make returns.** However, although they do not have to make returns, they still need to notify Customs of their liability to register from the outset. They must also comply with record keeping requirements so that Customs can inspect the records to check that the contracts are all correctly exempt.

25.8 Homeserve GB Ltd v Her Majesty's Revenue & Customs (IPT0014) (High Court decision July 2009 and tribunal decision 25th July 2008) (Appeal allowed against the tribunal decision)

As mentioned above in paragraph 25.3, here are the facts of the Homeserve case (as detailed in the original tribunal case.)

Remember the High Court overturned the decision of the tribunal so that the commission/fee was not included in the value of the premium because it was charged under a separate contract. But also remember that as a result of losing this case Customs changed the legislation so that these types of commissions/fees will now be included in the premium for the insurer.

What the case was to do with was whether a fee charged by a broker should be included in the amount of the premium and therefore be liable to IPT. The facts in this case were as follows:

Homeserve was an insurance intermediary. One of the insurances it arranged was plumbing and drainage cover for householders, with an insurance company, IPA. If the householder needed to make a claim, then a third company, Home Hotline Ltd would arrange for an engineer to attend the homeowner's premises. Since September 2002, Home Hotline has been a sister company of Homeserve.

When the home owner took up the insurance policy, they were told that the cover would include the premium plus an administration fee of £14. The issue in this case is whether the amount on which IPT is calculated is the premium alone, or whether the £14 has to be included in the amount on which IPT is due.

The legislation relating to commissions is contained in section 72 of the Finance Act 1994. Section 72 initially defines the 'premium' which is the amount on which IPT is due. It says that a premium is any payment received under the contract by the insurer and includes payments referable to commissions.

Subsection 1A then goes on to say that if an amount is charged to the insured by <u>any</u> person then that payment is to be regarded as a payment received under that contract by the insurer. Therefore, if we stopped there – the commission that Homeserve charges to the householder would be treated as part of the premium for IPT.

However, the legislation does not end there – it goes on to say that if the amount is charged under a separate contract and is identified in writing to the insured as a separate amount then it isn't included in the premium.

The essence of Homeserve's argument therefore is that the commission is charged under a separate contract and is identified in writing to the insured – so as it satisfies the wording of section 72(1A) then it is not included in the amount of the premium. Customs argument is that firstly there isn't in reality a contract between Homeserve and the householder or even if there was a contract it's not separate because it is part of a single contract between the householder, Homeserve and IPA.

Now the decision of the tribunal was that Homeserve were administering the insurance cover, so Customs first argument that there was no contract between the Homeowner and Homeserve was rejected.

So what the tribunal had to decide was whether there was a 'separate' contract so that the commission escaped IPT. The tribunal chairman interpreted the word to mean that the contract was separate from the taxable insurance contract itself. To determine this he looked at the facts of the case. The contract between IPA and Homeserve gave the terms and conditions about the plumbing and drainage cover. The £14 admin fee was covered in this contract.

It was not charged under a separate contract because:

1. There was an overlap between the consideration given by Homeserve to IPA and that given by Homeserve to the householder. Homeserve's obligations to IPA to administer the contract were the same obligations it was giving to the householder.

2. The price quoted to the householder was a single price. If the householder cancelled their policy within the cooling off period, then a full refund of both the commission and the premium would be given. The householder had no choice of insurer. The administration contract was dependant on and inseparable from the insurance contract.

The **High Court has overturned this decision and said that the words 'separate contract' should be given their ordinary grammatical meaning unless the legislation provides for an alternative 'special' meaning.** As the legislation does not provide a particular definition, then the contract is separate to the contract of insurance and therefore the commission/fee escapes IPT.

Remember that the new insertions into Section 72 have overturned this decision. In the circumstances above then, from 24th March 2010, the commission/fee would now be included in the premium.

Answer 1

1/21 x £280 = £13.33

Explanatory note

Firstly, we need to decide whether our type of contract constitutes insurance. Clearly motor insurance does fall within this definition. We then need to check that it covers a UK risk. We'll assume that it does. Next we need to decide what rate of IPT would apply to this particular type of contract, or if it is an exempt contract. Although motor insurance is listed in **Schedule 6A** and could be liable to the higher rate of IPT, this type of motor insurance is excluded (see paragraph 2(2A)). Therefore, the relevant rate is the standard rate of 5%. We now need to establish on what amount the 5% is going to be due, so how much is the 'premium' according to **s.72.**

In determining this we need to decide whether the commission has to be included. Looking back at what we've said already commissions are only included if they are not **charged separately and identified in writing** or **the commission is not already liable to IPT in its own right.** The commission is not charged separately as it is part and parcel of the £280 paid to the insurer. Therefore, the commission is not deductible and the total premium liable to IPT is £280.

Answer 2

£80 x 7/47 =	£11.91
£20 x 7/47 =	£2.98
Total IPT	£14.89

Explanatory note

Working through the method as previously, we firstly need to ask if this is an insurance contract and therefore liable to IPT. Again, clearly the answer to that is yes. We also need to check that it covers a UK risk, which we will assume it does. Then we need to decide the rate of IPT. Domestic goods fall within **Schedule 6A** and are liable to the higher rate of IPT. Mechanical breakdown insurance will fall within Schedule 6A and be liable to the higher rate when sold in these circumstances.

We now need to decide the amount of the premium. Once again we have a commission to think about here. The total premium is paid to the insurer and a separate fee of £20 is paid to the supplier. So what do we need to do with the commission? Looking back at **s.72(1A)** the commission is included unless it is **liable to IPT in its own right under s.52A. It will attract IPT in its own right as it falls within s.52A. It is a fee received under a contract that is liable to higher rate IPT.**

What this means is that the £80 premium will be liable to IPT at 17.5%, and this is what the insurer will pay. The person who is supplying the washing machine will also be liable to pay IPT on the £20 commission at 17.5%.

