Scope of exemption

Indirect Tax



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Richard Insole and *Thomas Jacobs* review the *Aspiro* case, and the implications the judgment will have on 'insurance related services'

Key Points

What is the issue?

The CJEU has decided that claims handling services fall outside the EU VAT exemption for insurance

What does it mean to me?

The decision could lead to HMRC having to change UK law which would impact on the VAT liability of certain services in the UK insurance market

What can I take away?

Further comment is expected from HMRC after the EU referendum but businesses should begin to consider the implications of any potential change in law prior to this

On 17 March 2016, the the Court of Justice of the EU (CJEU) delivered its judgment in Aspiro SA (C-40/15) concerning the VAT liability of claims handling services. Although many correctly predicted the outcome of the case referred by the Polish courts, it could have a significant impact for the UK insurance industry.

The CJEU's judgment has once again sparked a debate about the scope of the VAT exemption for insurance related services in the UK, an issue originally raised following the CJEU's decision in *Arthur Andersen* in 2005. The decision confirming that claims handling services do not fall within the scope of the VAT exemption relating to insurance. The judgment is a reminder of how UK law does not reflect EU legislation in this area. It remains to be seen how HMRC will react to the judgment but guidance on the issue is not expected until July 2016 at the earliest. The CJEU decision could eventually lead to a change in UK law and those within the insurance industry will need to carefully consider what the impact of any change in law might be.

Background

Aspiro SA, a Polish company, provided claims handling services for and in the name of an insurance company. It had no contractual relationship with the insured party and was paid a flat rate by the insurance company depending on the complexity of the claim. Eighteen tasks were performed by Aspiro for the insurance company. These included:

- Establishing the reasons for a claim, establishing liability and calculating compensation due under an insurance contract.
- Processing relevant documentation, considering appeals and complaints, and transferring monies as a result of the settlement process.
- Providing the insurer with a report on the handling of the claim.

Aspiro believed its services constituted a single supply of claims handling which were VAT exempt. This was disputed by the Polish tax authorities who argued that the services would only part qualify for the VAT exemption where certain substantive claims were settled; the remainder of the tasks being technical and administrative in nature. In the absence of any clear authority, the Polish Supreme Court referred the case to the CJEU for confirmation of the wording of the VAT exemption at Article 135(a) of the Principal VAT Directive EC/2006/112 covering ‘insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents’.

Conclusions of the CJEU

The CJEU endorsed the analysis of Advocate General J Kokott that claims handling services provided by Aspiro did not fall within Article 135(a) and were therefore subject to VAT.

In reaching this conclusion, the CJEU considered the precise wording of Article 135(a) choosing to split the exemption into two. In doing so, it rejected the concept that Aspiro was performing an ‘insurance transaction’ which by definition must imply a contractual relationship between the provider of the insurance and the person whose risks are covered by the insurance. This was unsurprising given that Aspiro had not been providing insurance cover. Aspiro had used the wording of the CJEU’s decision in SDC C-2/95 (which had considered the VAT exemption for payment transfer services) to suggest that as claims settlement was a key element of an insurance transaction this should be sufficient for the VAT exemption to apply. This was robustly dismissed by both the AG and court, which emphasised that no analogy between the VAT exemptions for financial services and insurance transactions is possible due to the difference in wording and the requirement for the VAT exemptions to be interpreted narrowly.

Concerning the second aspect of the exemption, covering ‘insurance related services’, the court confirmed that two distinct tests must be met. First, a person

must perform an activity related to insurance and second it must be akin to that performed by an insurance agent or insurance broker. Although it was accepted that claims handling would qualify as an insurance related service, it was not deemed to include the essential aspect of work performed by a broker or agent which consists of prospecting for new clients and introducing them to an insurer with the view to concluding an insurance contract. This was an interpretation originally set out in the CJEU decision in *Arthur Andersen* C-472/03 which both the court and AG referred to consistently in reaching their judgment. Instead, it was confirmed that the activities of Aspiro had more in common with those performed by a division of an insurance company than either a broker or agent.

Interestingly, the UK Government's observations that it was necessary to refer to the notion of 'insurance mediation' and definitions of 'insurance agents and insurance brokers' in other European directives when determining the scope of the exemption were dismissed by the court. It was made clear by the judge that these directives had a different objective and did not have any relevance to the interpretation of the wording of the Principal VAT Directive.

Impact of the judgement

The UK law governing the VAT exemptions for insurance, VATA 1994, Sch 9, Group 2, includes a number of services related to insurance such as claims handling. Consequently, although the outcome of the *Aspiro* judgement was predicted by many due to the precedent set by the CJEU in *Arthur Andersen* it is likely to increase the prospect that the UK VAT exemption covering insurance services will need to be amended. Historically, HMRC have reduced the scope of the VAT exemption through changes in policy affecting services such as mis-selling reviews and helpline services, but have resisted wholescale changes to UK law following a review by the European Commission of the EU VAT exemptions for insurance and financial services. This position was outlined in HMRC's guidance VATINS5210. However, the Commission's review, which lasted approximately 10 years, was officially scrapped in November 2015 without resolution, meaning the shield behind which HMRC could defend no change disappeared.

The nature of any potential change in law is difficult to predict. This is because in addition to claims handling services, the scope of the VAT exemption in UK law covers services such as policy administration and premium collection which could

also be affected. However, interestingly, the CJEU does appear to have suggested in its decision that other insurance related services could be VAT exempt if outsourced to a person also performing the essential activities of an insurance agent or broker (i.e. prospecting for clients with a view to concluding insurance contracts). How this could be applied without distorting competition within the insurance market will need further consideration.

Finally, if a provider would prefer to charge VAT on its services or rely on an entitlement to recover input tax when providing services outside the UK it is entitled to rely on direct effect of EU law to invoke the Aspiro decision immediately.

What next?

HMRC have confirmed that no guidance on its policy following the decision will be released until July 2016 at the earliest. The EU referendum could have an impact on HMRC's reaction to the decision, along with many other areas of VAT. However, it is likely that businesses will be forced to consider the potential financial and commercial implications of the decision long before HMRC's intentions are known. Although some businesses could potentially choose to absorb the additional irrecoverable VAT cost incurred as a result of a change in law, there is also an expectation that it would increase the value of insurance premiums which have already recently been impacted by the increases in the IPT rate. There is also a question of whether alternative solutions to combat any change in law could be considered by businesses. This might involve a commercial decision by insurance companies to in-source more activities of this nature or to consider whether the application of other VAT exemptions such as that applicable to cost sharing groups could be viable.