VAT exemption on insurance: no longer a safe bet?

Indirect Tax | Large Corporate

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24 April 2024

A series of judgments by the European Court of Justice and the UK courts appear to have significantly narrowed the scope of the VAT exemption for insurance.

Key Points

What is the issue?

It was not until the European Court of Justice's judgment in *Card Protection Plan* (Case C-349/96) that any considerable attention was paid to the scope of the VAT exemption for insurance. We ask what remains of the exemption and whether the relevant legislation has kept pace with the case law.

What does it mean for me?

If the plain meaning of the UK's VAT legislation and the English law test for insurance gives a different answer from the CJEU's case law, must the UK courts now give effect to the former and disregard the latter?

What can I take away?

Businesses may wish to consider whether the supplies that they make, or perhaps the outsourced back-office services that they consume, should now fall back within the scope of this exemption.

Just what is insurance? The Principal VAT Directive Article 135(1) mandates the exemption from VAT of 'insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents'.

These provisions have been transposed into UK law by way of the Value Added Tax Act 1994 Sch 9 Group 7 Items 1 and 4. But neither EU nor UK legislation has provided a definition of insurance for VAT purposes.

The scope of the insurance exemption

Despite the European Community (as it then was) implementing the Non-Life Insurance Directive in 1973 and the Life Insurance Directive in 1979, it was not until the European Court of Justice's judgment in *Card Protection Plan* (Case C-349/96) that any considerable attention was paid to the scope of the insurance exemption.

Here, the court held that: ‘The essentials of an insurance transaction are, as generally understood, that the insurer undertakes, in return for prior payment of a premium, to provide the insured, in the event of the materialisation of the risk covered, with the service agreed with the contract was concluded.’

Moreover, the court thought that there was no reason for the interpretation of the term ‘insurance’ to differ according to whether it appears in the Non-Life Directive or in the Sixth Directive.

Taxpayers of the late 1990s might have been forgiven for thinking that any activity falling within the purview of the EU’s insurance directives could be exempted from VAT. Since then, however, the court appears to have whittled away at the exemption and, in a series of well-known judgments, concluded that a range of insurance-related activities are nonetheless taxable.

Continual interpretations

In *Skandia* (Case C-240/99), for instance, the court found that a commitment by an insurance company to carry out the business activities of another insurance company ‘does not constitute an insurance transaction’. In other words, certain operational activities were not exempt as insurance.

A few years later, this principle was articulated more explicitly in *Arthur Andersen* (Case C-472/03), where the court found that ‘back office activities … do not constitute the performance of services relating to insurance transactions’.

The case of *Aspiro* (Case C-40/15) revisited this issue, with the court finding that ‘claims settlement services provided by a third party in the name and on behalf of an insurance company’ also do not fall within the exemption. No matter then that a given service might have been essential to the fulfilment of an insurance transaction; it was only the insurance transaction itself that could avail of the exemption.

Most recently, in *United Biscuits* (Case C-235/19), the CJEU decided that despite the management of group pension funds being classified as insurance for the purposes of the Life Directive (now the Solvency II Directive), and despite the dictum of the court in *Card Protection Plan* that there was no reason for the definition of insurance to differ between the regulatory directives and the VAT Directive, such transactions – even where they were carried out by insurers – could not be regarded as insurance because they did ‘not provide any indemnity from risk’.

Explaining away the court’s comments in *Card Protection Plan*, the CJEU now held that: ‘The court referred to the term “insurance” in general and not to the concept of “insurance transactions”, within the meaning of the common system of VAT.’ As such, an ‘insurance transaction’ has become a completely autonomous concept of EU law, far removed from the everyday practicalities of much insurance business.

Disparities with English law

Yet with all of these judgments appearing to narrow the scope of the insurance exemption, has UK law kept pace with the jurisprudence of the CJEU?

Apparently not. Through most of the period discussed above, the Value Added Tax Act 1994 Sch 9 Group 2 Note 1 had provided consistently – despite CJEU judgments that were adverse to the taxpayer – that services remained exempt if they consisted of carrying out work in preparation to concluding contracts of insurance or

reinsurance; providing assistance in the administration and performance of such contracts, including the handling of claims; and the collection of premiums.

There also remained the question of whether certain insurance-related activities, even if they did not satisfy the strict test imposed by the CJEU, were to be regarded as insurance as a matter of English law.

In the aged case of *Prudential*, which was decided in 1904, the High Court defined insurance as a contract where:

- for some consideration, the insured party secures a benefit such as the payment of money upon the occurrence of an event;
- that event must involve some uncertainty, either that the event will happen or *when* it might happen;
- the event must be adverse to the insured party, such that the payment amends for some loss or detriment; and
- in the case of life insurance, the insured party's interest is not the measure of loss.

In these ways, therefore, English law and UK legislation have gone further than CJEU jurisprudence, which appears to have limited the insurance exemption specifically to the indemnification of a non-life-related risk. The differences in English law include:

- including within the scope of insurance any uncertainty regarding the *time* of the adverse event;
- explicitly incorporating life insurance; and
- retaining a range of back-office services within the legislation which mandates exemption.

One might well question whether traditional life insurance – where there is no uncertainty about whether someone will die, since everybody dies – actually meets the CJEU's definition of an insurance transaction.

This disparity between English law and EU law shines a light on several well-known cases. In *Century Life* [2000] EWCA Civ 336, the Court of Appeal held that the outsourced review and remediation of mis-sold pension policies was properly VAT exempt. However, in the wake of *Andersen* and *Aspiro*, many VAT advisers took the position that *Century Life* had been wrongly decided.

Much more recently, the Upper Tribunal in *Intelligent Money* [2023] UKUT 236 (TCC) held that the administration of a self-invested personal pension satisfied the English law conditions laid out in *Prudential*, yet could not be regarded as insurance as a matter of EU law.

Negotiating the incompatibilities

One might ask now, however, whether the provisions of the Retained EU Law (Reform and Revocation) Act 2023 have effectively reversed the CJEU's direction of travel. Since 1 January 2024, UK courts have been prohibited from quashing or disapplying any enactment of the British Parliament because it is incompatible with EU law or a general principle of EU law. So if the plain meaning of the UK's VAT legislation and the English law test for insurance give a different answer from the CJEU's case law, must the UK courts now give effect to the former and disregard the latter?

According to a recent update to the internal VAT Manual, it appears that HMRC might share in this interpretation. HMRC's VAT Insurance manual at VATINS5210, updated in February 2024, now reiterates the point that: 'It will no longer be possible for any part of any UK Act of Parliament or domestic subordinate

legislation to be quashed or disapplied on the basis that it was incompatible with EU law. This will mean that businesses will no longer be able to rely on [the] direct effect of EU law.'

And after directing readers to new guidance on the scope of the intermediary exemption at VATINS5220, this provides that some services falling within the UK exemption at Item 4 (such as claims handling or the administration of contracts of insurance provided separately from introductory services) 'can be treated as outside the exemption and therefore taxable, in the event that a business wishes to apply [the] "direct effect" of EU law. This does not apply to periods following 1 January 2024.'

HMRC appears to suggest that it had formerly been open to UK businesses to choose whether to follow the plain language of UK legislation or the direct effect of the CJEU's interpretation of 'insurance transactions', but that such a choice has been removed by the Retained EU Law (Reform and Revocation) Act 2023, leaving only the broader scope of the UK's implementation of the exemption by way of Item 4 and Notes (1) to (6).

Businesses may therefore wish to consider whether the supplies that they make, or perhaps the outsourced back-office services that they consume, should now fall back within the scope of this exemption.

Moreover, businesses and their advisers may well ponder whether the plain wording of UK legislation now trumps the case law of the CJEU when it comes to back-office and intermediary services related to insurance and whether that same principle of interpretation applies to insurance transactions themselves, as well as to other, broader areas of VAT law.