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## VAT Victory for insurance introductory service providers

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### Summary

Following the Court of Appeal decision in favour of the taxpayer in *HMRC v. InsuranceWide.Com Services Limited and Trader Media Group Limited* [2010] EWCA 422 ("**IW & TMG**"), Her Majesty's Revenue & Customs ("**HMRC**") have published Revenue & Customs Brief 31/10 (the "**Brief**") confirming their decision not to appeal the judgment.

Those introducing prospective customers to insurance providers, via the internet or otherwise, who fall within the scope of the *IW & TMG* ruling, may have the opportunity to claim back overpaid value added tax ("**VAT**") on such transactions. This Client Alert outlines the content of the HMRC Brief and what this means for insurance intermediary service providers.

### Background

European Union law provides that "insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents," are exempt from VAT (Article 135(l)(a) of the Directive 2006/112/EC). In the UK, this exemption is set out at item 4 of Group 2 of Schedule 9 to the Value Added Tax Act 1994, which provides that "the provision by an insurance broker or insurance agent of any of the services of an insurance intermediary in a case in which those services are related (whether or not a contract of insurance or reinsurance is finally concluded) to an insurance transaction or a reinsurance transaction" is an exempt supply.

The exemption essentially relies on a two-part test. First, the service provider must be an "insurance broker" or "insurance agent" and, secondly, the nature of the activities carried out by the service provider must constitute activities "related" to insurance transactions.

This means that an on-line insurance introductory service provider must form part of the chain of communication between the insurer and the insured, and be instrumental in bringing together the two parties to the insurance contract by finding prospective clients and introducing them to the insurer (and not merely advertising, which is not an exempt activity).

## Court of Appeal decision

The Court of Appeal upheld the decision of the High Court in favour of the taxpayers in the two recent joined appeals — *InsuranceWide.com Services Ltd v. Commissioners for Her Majesty's Revenue & Customs; Commissioners for Her Majesty's Revenue & Customs v. Trader Media Group Ltd* [2009] EWHC 999 (Ch). HMRC contested the availability of the insurance intermediary services exemption in both cases on the basis that the criteria in their published guidance at the time were not satisfied. The appeals raised the question of whether the provision of "click-through" on-line introductory services, by an insurance comparison website and an automobile advertisement website respectively, between people seeking insurance and a panel of insurers, with no further involvement in the negotiation of the terms of the insurance policy or in its preparation or the collection of premiums or the handling of claims or any authority to bind either party, constituted "intermediary" services. The facts of both cases were similar but not identical.

In *InsuranceWide*, customers could get a quote for insurance on the InsuranceWide comparison website itself, which best matched their requirements. From there, a customer was able to "click-through" to the insurer's/broker's website to complete a transaction. In *Trader Media*, prospects would browse the automobile advertiser's website, which contained a "click-through" to a third party co-branded insurance broker website from which they could obtain a quote for insurance. Both InsuranceWide and Trader Media were paid a commission for any policy sold via their website.

The Court of Appeal, confirming the decision of the High Court, found both services to be exempt — widening the understanding of the scope of the insurance intermediary services exemption to encompass the provision of certain "click-through" introductory services between insurers and insureds, without the need for further involvement in the intermediation of the insurance contract, provided that they were not acting as "mere conduits."

Crucially, the taxpayers were providing more than just a "click-through" service. They were, amongst other things, involved in identifying as well as appraising and selecting appropriate insurers for their target markets, having regard to the competitiveness of their pricing and products and their level of consumer service. In the case of *InsuranceWide*, customers were given access to the most appropriate insurers, either directly or through another intermediary. In the case of *Trader Media*, it not only had an input into the questions to be answered by those

seeking insurance but, importantly, it made suggestions for the composition of the insurance panel based on its understanding of the experience and demographics of the customers and with a view to providing customers with insurers who would quote competitive prices. These were activities which were more indicative of an insurance broker as opposed to an advertiser or "mere conduit."

### **HMRC's response**

In light of the decision of the Court of Appeal, HMRC now accept that insurance introductory services will be exempt from VAT when a business is doing much more than acting as a "mere conduit" through which a potential customer is passed to an insurance provider. They cite the following four conditions which must all be met for the supply of insurance related introductory services to be exempt:

- The services are provided by someone engaged in the business of putting insurance companies in touch with potential clients or more generally acting as intermediaries between the two parties (although this may not necessarily be their principal business activity).
- The business provides the means (that is, by way of an internet "click through" or some other form of introduction) by which a person seeking insurance is introduced to a provider of insurance or to another intermediary in a chain leading to an insurance provider.
- That introduction takes place at the time a customer is seeking to enter into an insurance contract (although in some instances an insurance contract may not actually go on to be finally concluded).
- The introducer also plays a proactive part in putting in place the arrangements under which that introduction is effected.

For the purposes of the last condition above, HMRC say that evidence that the introducer has been proactive in putting in place the arrangements under which the introduction is effected could, for example, take the form of **some** or **all** of the following:

- active endorsement of the insurer or the insurance product;
- involvement in the selection of the insurance products and/or providers;

- involvement in the process under which the insurance contract is entered into, even though the intermediation of the contact itself is undertaken by a third party (for example, by having input into what questions should be asked of the prospective insured or the design of the third party's website);
- negotiating a special rate for the insurance product(s) on behalf of its customers or membership base; and
- some form of assessment of the customer's requirements so that they are directed to the most appropriate insurer for them.

### **Analysis**

The crux of the matter, with which the domestic and European Court of Justice case law and the tax authorities in Member States have grappled, is the distinction between introductory services, on the one hand, and non-exempt advertising or ancillary/administrative activities on the other hand.

In the *IW & TMG* decision, the key question was whether the provision of on-line introductory services was sufficiently instrumental in "marrying up" an insurer with an insured and not merely a line of communication.

In that context, as a practical matter, the more "active" role an insurance intermediary service provider plays in "bringing together" the insured and the insurer, the more likely it is that the services supplied fall on the exempt side of the line and reduce the likelihood that they are considered merely advertising/administrative in nature.

It is clear from the *IW & TMG* ruling that the outcome is determined by the substance of what is actually done, not the form — i.e. it is based on the activities actually performed by the service provider and not according to how it describes its business activities nor whether it is regulated as an insurance intermediary. Further, it should be noted that the Brief points out that "whilst remuneration based on successful take-up may indicate an introduction, it is not enough in itself to determine exemption and it is always important to consider what is actually being done rather than how it is paid for."

The decision of the Court of Appeal was generally a welcome one for those providing on-line introductory services to the insurance industry, and their insurance company clients, and recognises the way in which the internet has changed how business is conducted.

The decision is also relevant to other non-internet based introductory services — for example, those provided by affinity groups.

The publication of the Brief by HMRC and confirmation of the decision not to appeal provides further certainty to those involved in providing and receiving such services and greater practical guidance on the boundaries of the exemption.

The case highlights a broader problem of defining the scope of the VAT insurance exemption. The problem has become more acute over recent years because of commercial pressure to outsource various functions of an insurance business – creating a risk that such “hived off” activities lose their “insurance” nature on a stand-alone basis and become purely administrative in nature. This remains an issue for the insurance (and banking) industry. The EU Commission is currently considering a wide-ranging reform of the VAT exemptions for the insurance and financing sectors.

### **Action Points**

A claim can be made by those insurance introductory service providers falling within the scope of the *IW & TMG* ruling to recover overpaid tax charged on their fees. This is subject to the usual limitations.

The three-year “cap” (or time limit) on repayment claims needs to be watched, which means that businesses should consider making any refund claims as soon as possible.

In addition, HMRC can refuse a repayment claim if repayment would unjustly enrich the claimant. This would be the case if the relevant VAT cost has been passed on to the insurance company client, unless the repayment is also passed back to the client (either in fulfillment of contractual obligations to the client or to enhance the client relationship). In practice, it can be difficult to determine whether the VAT cost has actually been passed on or whether, instead, the claimant business has absorbed the VAT cost or suffered a loss of profit as a result of having wrongly charged VAT to its customers.

Although the insurance company receiving the services is unlikely to be in a position to make a direct repayment claim against HMRC, it will wish to look at the terms of its contract with its insurance introductory service provider to see whether it has a right to insist on the service provider making a repayment claim and, if so, the proportion of any repayment which it is entitled to receive and the effect of the exemption on the level of future fees.

This memorandum is intended only as a general discussion of these issues. It is not considered to be legal advice. We would be pleased to provide additional details or advice about specific situations. For additional information on this important topic, please feel free to call upon your Dewey & LeBoeuf relationship partner.

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The direct “benefit” of the exemption for the insurance company will depend on the extent to which it can recover input VAT under its partial exemption arrangements, which in turn will depend on the nature of its underlying business. However, the overall net effect on the insurance company is harder to quantify. If the service provider makes exempt supplies to its insurance company customer, then the service provider’s ability to recover input VAT on its own costs will be reduced. In other words, although the application of the VAT exemption to the insurance introductory services, in principle, reduces the insurance business’s irrecoverable input VAT costs, the service provider’s own cost base will increase. This in turn will affect the proportion of any repayment which the service provider will wish to pass on to its insurance company client and also the level of fees which it will wish to charge the insurance business for its services in the future.

The precise economic impact of the *IW & TMG* decision on particular businesses in the insurance industry will involve some careful analysis.

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