



FLA RESPONSE TO HM REVENUE & CUSTOMS CONSULTATION ON CHANGES TO THE VAT EXEMPTION FOR INSURANCE-RELATED SERVICES

FLA (Finance & Leasing Association) welcomes the opportunity to comment on HMRC's consultation document on changes to the VAT exemption for insurance-related services.

FLA is the main representative organisation for the UK consumer credit, motor finance and asset finance sectors, and the largest organisation of its type in Europe. Our members comprise banks, subsidiaries of banks and building societies, the finance arms of leading retailers and manufacturing companies, and a range of independent firms. The facilities they provide include finance leasing, operating leasing, hire purchase, conditional sale, personal contract purchase plans, personal lease plans, secured and unsecured personal loans, credit cards and store card facilities.

FLA consumer and motor members distribute general insurance products supplied by the insurance industry, such as payment protection insurance, extended warranty and GAP. A high proportion of FLA members are now authorised for their insurance businesses under the new FSA regulatory regime for general insurance.

FLA members provided £68.4 billion worth of new finance to the consumer sector in 2004, which represented 29.6% of all unsecured lending in the UK. In the above total is £18.3 billion of finance provided to the motor sector. FLA members financed at least 50% of all new car registrations in the UK in 2004.

FLA members provided asset finance to business of £25 billion in 2004, representing over a quarter of all fixed capital investment in plant, machinery, vehicles, ships and aircraft in the UK.



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1. OVERALL COMMENTS

The resultant changes from the Andersen Judgment are likely to herald a new era for insurance outsourcing with businesses looking to relocate off-shore given the cost implications. The addition of VAT will ultimately fall on consumers who may be dissuaded from taking out insurance cover.

We would like some guidance around the role of insurance agents. As set out below, it is important to our members that web-based business should continue to benefit from the exemption.

2. SPECIFIC COMMENTS

Q1	Do you agree with our interpretation of the Andersen Judgment? If not, please explain why you disagree and provide an alternative interpretation where appropriate.
	Only in part. We do not agree with the ECJ's assertion that the Andersen Judgment effectively overrules the VAT Tribunal decision in Teletech. The Consultation document sets out the essential elements needed for the exemption to apply. It seems to us that Teletech were indeed supplying these elements. We touch upon this later.
Q2	Do you have any comments on the proposed approach to the changes to UK law?
	We wholeheartedly believe that the UK should implement the wording used in the Directive. However, we believe that UK legislation should attempt to define, in notes to the Group [Group 2 of Schedule 9 in the VAT Act 1994], what constitutes an insurance agent. We understand that there are calls for the Directive to include

	definitions and the UK could lead the way in this regard.
Q3	<p>Do you have any comments on the substance of the draft guidance on changes to the VAT liability in the UK of certain insurance-related services, following the Andersen Decision, included at Annex E?</p> <p>The ECJ confirmed that an essential aspect of the work of an insurance agent includes the finding of prospective customers and their introduction to an insurer. We agree that in so doing the agent must be carrying out the independent function of bringing the parties to the insurance contract together (Annex E, paragraph 1.4, 3rd bullet point).</p> <p>We consider that guidance is needed on what an agent needs to do in order to demonstrate that, acting independently, he has brought the contracting parties together. We question whether it is absolutely necessary for the agent to be involved in a specific act of intermediation such as that suggested by the Commissioners (i.e. the negotiation of terms and conditions). Is it not enough that the agent carries out activities that merely deliver to the insurer, persons seeking insurance cover? If it is, then the example of the mail-shot (Annex E, paragraph 1.5.2) would be an exempt service and would not be taxable by reason of a failure to negotiate terms and conditions.</p> <p>Example</p> <p>A company maintains a web site and on the web site it promotes (following an agreement to do so) a particular insurer and the insurer's products.</p> <p>The company's web page contains a link to the insurer's own on-line quotation system. The prospect 'navigates/clicks' on through the quotation engine and having received a satisfactory quote concludes</p>

the contract on-line or is prompted to call the insurer.

The insurer's systems recognise that the insured party (the customer) had been introduced via the company's web site link and pays the company a commission based on the amount of business introduced.

We accept that in respect to customers seeking to obtain insurance via the web, the company promoting the insurer and/or its policies would have little opportunity to intermedate directly at the time of the enquiry. However, but for the company facilitating the delivery of a prospect (an introduction) to the insurer, the latter would not have had the opportunity to conclude a contract of insurance.

Exemption should therefore extend to companies that facilitate, by whatever means, the coming together of an insured party and an insurance agent.

We question if it is necessary that intermediation occurs at the time the policy is written. We have in mind affinity type arrangements where an organisation does more than simply lending its name and endorsing an insurer. Some organisations will be actively involved in negotiating terms and pricing of policies before they are taken to the customer base. They will also be involved on an ongoing basis to make sure the product(s) offered are attractive to their customers. In a sense the intermediation occurs first and is followed by the finding of customers and their introduction to the insurer.

With regard to Annex E, paragraph 1.5.4 (page 27), the Andersen Judgment does not, in our view, override the TeleTech Decision. We trust that the Commissioners are not saying that exemption should be denied in circumstances where a person puts the insurer on risk rather than merely introducing the customer to the insurer. The essential role of TeleTech was to bring about a situation whereby

individuals were persuaded to enter into an insurance transaction with ALICO.

The proposed guidance should make it clear the “cold calling” or the taking of an opportunity to sell a policy of insurance is VAT exempt.

“Cold Calling” should be recognised as including any means by which an insured party is encouraged to take some action to enter into a contract of insurance – thus a cold call would include speculative – doorstep sales, telephone calls, mail shots (paper or email based) and web links.

In Annex E paragraph 1.5.1 (page 26) the guidance states:

“...As part of its introductory services, therefore, an agent or broker must be carrying out the functions necessary for two parties to enter into a contract of insurance (such as, the negotiation of terms and conditions) without having any interest of his own in the terms of the contract”.

It is not immediately clear what is meant by the term “interest of his own in the terms of the contract”. Some further explanation of this term is required and illustrative examples of when it is likely to arise would be welcomed.

We assume that the term simply refers to an agent not having any financial interest in the policy being arranged other than the reward he receives (the fee or commission, however calculated) from the insured party or insurer.

We trust that the term will not be applied by HMRC to deny exemption to commissions paid by an insurance company to a subsidiary company that undertakes the selling of the insurer’s

	products.
Q4	<p>Does the proposed implementation date of 1 January 2006 give you any practical difficulties e.g. renewal dates of contracts? Please provide actual examples where possible.</p> <p>We are concerned that other EU Member States might not implement the changes as quickly as is being proposed in the UK. This would put the UK insurance industry at a competitive disadvantage against insurance companies in other Member States until the other Member States catch up.</p> <p>We fear that implementation of the Decision will drive business out of Europe as the additional VAT cost will be built into premiums which are already subject to the insurance premium tax (IPT), an additional cost that European customers currently have to pay.</p>
Q5	<p>If so, what sort of transitional provisions would assist in alleviating the difficulties?</p> <p>All contracts or agreements to contract agreed on or before 3 March 2005 (date of the Andersen Decision) should be allowed to retain the benefit of VAT exemption until such time as the contract has run its course.</p>
Q6	<p>Are there any other specific factors which you feel might support an alternative implementation date? Please supply details</p> <p>HMRC will need time to assimilate the responses to the Consultation exercise. In addition it is evident that the industry will need clear guidelines on which supplies HMRC consider remain exempt and which they consider become taxable. This is particularly so in the area of commissions paid for what could be termed the modern way</p>

	<p>of “finding and introducing” i.e. the web site “click throughs” mentioned earlier. Such guidelines will need to be issued well before implementation date to allow sufficient time for computer programmes to be amended and provision made for VAT invoices to be issued where they have not been necessary previously. We therefore believe that the proposed start date of 1 January 2006 will bring practical difficulties such that introduction on that date will not have allowed due time for responses to be properly considered. Consequently, implementation will be rushed and confused.</p> <p>We consider a start date of 1 January 2007 would allow HMRC the necessary time to consider responses, discuss matters with interested parties / trade bodies, and issue clear guidelines in respect of difficult areas. It will also allow industry to implement the necessary changes to its computer systems.</p>
Q7	<p>Which of the courses of action suggested in paragraph 5.2 above is the most likely scenario for your business(es) and why?</p> <p>Many businesses will pass the cost on by increasing premiums. Some products operate at a low margin making it necessary to either pass on the additional cost by way of additional premium or withdraw the product. We consider that in some cases adding the additional cost to the premium will not be acceptable to the market and insurers will be forced to withdraw the product anyway.</p>
Q8	<p>If more than one approach might be applicable (for example if this depends on the type of services received or whether closed funds are involved) could you provide details and the reasons why?</p> <p>We are aware that some insurers have to date deliberately avoided switching to offshore outsource providers, others have only switched a limited amount of business. This additional cost may now force</p>

	insurers to take this step in order for them to continue to compete with suppliers based around the world.
Q9	Are any other courses of action likely for affected businesses? If so, please provide details and reasons why?
Q10	If you are an insurance company, how much additional irrecoverable VAT would you expect to incur, without taking account of any of the above courses of action?
Q11	How much of that irrecoverable VAT do you expect to pass on to your policyholders in the form of increased premiums or lower returns?
	We anticipate that most insurers will pass on the cost in the form of increased premiums.
Q12	Will there be any VAT implications for structures that are set up to facilitate the sale of insurance products (such, as 'networks') and, if so, how?
	In recent years non-financial services businesses have begun to provide insurance cover to their customers. For example supermarket chains (eg Sainsbury, Tesco) now "sell" insurance products branded as their own but which, in reality, are underwritten by a third party insurance company. Some life insurance companies and other financial service companies (e.g. Building Societies) will "sell" general and/or life insurance products branded as their own but which are underwritten by another insurer.
	The underwriting insurance company will pay commissions to the

	<p>retailer or life company where customers of the retailer or life company take out a policy.</p> <p>We consider that a payment by an underwriter to such a retailer or life company should be regarded as the consideration for an exempt supply of insurance related services. It seems to us that the policy adopted by the Commissioners prior to the Andersen Judgment regarding insurance related introductory services would, with some minor modification, still be a good indicator of when a person can be regarded as an insurance agent providing insurance transaction related services.</p> <p>We would like confirmation from the Commissioners that there is an exempt supply of insurance related introductory services where :</p> <ul style="list-style-type: none"> • the insurer pays a third party by reference to customers taking up contracts of insurance; • those seeking insurance are regarded as part of the third parties customer base; and • the third party endorses the insurer's policy directly to the insured party or as evidenced by its branding of the policy.
Q13	<p>To what extent do you think competitiveness of UK insurers is a real issue in practice, and why?</p> <p>Insurance is already a very competitive market. IPT on business written in many Member States is already forcing companies to squeeze their margins to remain competitive. The additional irrecoverable VAT costs will force companies to review their practices and the outcome could well be to move offshore. It is self-evident that the insurer with the lowest cost base has the ability to stay more competitive.</p>

Q14	Can you provide examples e.g. comparative premiums where the VAT cost might tip the balance in favour of an overseas competitor?
Q15	If you are a provider of outsourced services, what do you think the likely impact on your business will be? Please provide specific details including estimates of lost (or gained) income where possible.
Q16	Will you suffer a VAT cost as a direct result of the change in status of cross-border supplies? Please provide details, including an estimate of the cost.
Q17	Will the place of supply rules influence any of the courses of action referred to in paragraph 5.2? Please provide details.
	Yes we have no doubt that the rules will have some bearing on a trader's decision whether or not to relocate outside of Europe. We believe that UK established suppliers with establishments outside Europe will be weighing up their future options in light of the Judgment.
Q18	Will you incur significant administrative costs (one-off and/or continuing) as a direct consequence of the proposed changes? If so, please explain and provide an estimate of the additional cost likely to be incurred.
	We are aware that many insurers and agents have already had to review many large contracts to consider whether they will be affected by the proposed changes. They are already incurring professional fees in relation to the impact.

	<p>Other costs will occur, for example extra pension costs following on from in-sourcing. These may run to many millions.</p>
Q19	<p>Are any of these increased costs attributable to one of the courses of action referred to in paragraph 5.2 above? If so, please explain.</p> <p>The review costs mentioned are being incurred to ascertain whether any of the currently exempt services received are potentially taxable from 1 January 2006 and to investigate what action can be taken to avoid these additional costs (e.g. increasing premiums and in-sourcing). Obviously one alternative included in the considerations is relocation offshore (and outside the EU).</p>
Q20	<p>Will any reduction in administrative costs be attributable to one of the courses of action referred to in paragraph 5.2 above? If so, please explain and provide an estimate of the likely reduced cost.</p> <p>Yes they could be. It is well known that wages and salaries in places such as India and China are much lower than in the UK. Therefore should a business decide that the best course is to locate offshore then subsequent administration costs (e.g. reduced wages) would fall.</p>
Q21	<p>Do you have any further comments on the partial RIA?</p> <p>We believe that the estimate of £175 seriously understates the cost impact of the proposal.</p>
Q22	<p>Please comment on any practical difficulties you are likely to incur. Please provide specific examples where possible.</p>

	We have detailed above the matter of the VAT liability of “click through” introductions. We are also concerned by the difficulty of discerning when a supply is marketing and therefore taxable or finding and introducing new business and therefore exempt.
Q23	Are you likely to be affected by the issue outlined in paragraph 5.10? If so, how will this impact on your business?
Q24	Question 24. Please provide details of any other implications the implementation of the Andersen Judgment is likely to have.
	Increased premiums will deter people from taking out insurance – a problem already recognised by the Government in relation to motor and home insurance.

3. FLA CONTACT DETAILS

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