

## **GIL Insurance Limited and others v. Commissioners of Customs and Excise (Case C-308/0) ECJ, 29 April 2004**

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**This article was first published by De Voil Indirect Tax  
Intelligence – June 2004**

**Insurance Premium Tax, even where charged at a higher rate identical to the standard rate of VAT and even where that higher rate is only applied to insurance contracts connected with the provision of certain services, is compatible with the Sixth Directive. The IPT scheme introduced by the UK, with a higher rate applicable only to selected insurance contracts, does not constitute a state aid measure within Article 87(1) of the EC Treaty**

The ECJ has given judgment on the questions referred to it by the VAT and Duties tribunal in July 2001. The result was a comprehensive victory for the UK, in obtaining rulings which establish: (1) the compatibility of insurance premium tax (IPT), including the higher rate, with the Sixth Directive; and (2) that the enactment of higher rate IPT applied to parts of the domestic appliance insurance sector did not involve a state aid. This judgment also casts very serious doubt over whether the decision of the Court of Appeal in *R v. Commissioners of Customs and Excise ex parte Lunn Poly Ltd* [1999] STC 350, holding that imposition of higher rate IPT in the travel sector resulted in a state aid, was correct.

The GIL case concerns the introduction of the new higher rate of insurance premium tax (IPT) at 17.5% by the Finance Act 1997. A standard rate had previously applied generally to the receipt of insurance premiums by an insurer or taxable insurance intermediary. The higher rate, corresponding to the standard rate of VAT, was applied only to insurance premiums relating to motor cars, domestic appliances, and travel. It was initially applied only where there was a connection between the insurance and the supplier of goods or services to which the insurance related. For insurance of domestic appliances, in basic terms, the higher rate applies only where the insurer is connected to the supplier of the appliance, the insurance is arranged through the supplier, or the

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supplier is paid commission on provision of the insurance (see Finance Act 1994, see Schedule 6A, paragraph 3). Similar insurances sold through insurance brokers or directly by insurers are subject only to standard rate IPT.

The ECJ recorded that the purpose of IPT, when introduced in 1994, had been to check the trend for suppliers of domestic appliances to cease offering contracts for repair and maintenance of machines, subject to standard rate VAT, whilst offering contracts of insurance, that were exempt from VAT, in their stead. The introduction of standard rate IPT did not reverse the trend. The reason given by the UK for the introduction of higher rate IPT was to prevent "value-shifting". Where there was a connection between the supplier of the appliance and the insurance the Commissioners believed suppliers of appliances could, by manipulating the prices of the goods and insurance, take advantage of the VAT exemption for insurance services and avoid VAT.

GIL and the other appellants provided insurance or related services for domestic appliances and had paid the higher rate of IPT. When their claims for repayment of higher rate IPT, made after the *Lunn Poly* case, were refused by the Commissioners, they appealed to the Tribunal. They alleged that higher rate IPT was contrary to the Sixth directive and gave rise to an unlawful state aid. The Tribunal referred a number of questions to the ECJ.

The ECJ first considered whether a tax on insurance premiums such as IPT is compatible with Article 33 of the Sixth Directive. Article 33, prohibits the introduction of taxes which can be characterised as turnover taxes, but expressly permits member states to introduce taxes on insurance contracts which are not turnover taxes. The ECJ reminded itself that taxes are prohibited if they exhibit the essential characteristics of VAT, even if not identical to VAT in all points, but noted that Article 33 does not preclude the introduction of a tax that does not display one or more of the essential characteristics of a turnover tax. The ECJ concluded that IPT is compatible with Article 33 because it lacked two of those essential characteristics. Firstly, IPT is not a general tax as it does not attach to all economic transactions in the UK. It applies only to a specific service, the supply of insurance. IPT at the higher rate is of even more limited application. Secondly, IPT is not levied at each stage of the production and distribution process, since it is charged once only on conclusion of an insurance contract, and does not apply to the added value of the services. The ECJ remarked that differential rates for taxes on insurance contracts are permissible under Article 33.

It can be seen that the ECJ followed what might be described as a conventional approach by examining the objective characteristics of the challenged tax. It was unimpressed by the taxpayers' argument that it should proceed to examine compatibility with Article 33 by having regard to the purpose and effect of higher rate IPT and considering whether it compromised the functioning of the common system of VAT to such an extent that it must be held to be incompatible.

The next question concerned whether the exemption of insurance transactions from VAT under Article 13(B)(a) of the Sixth Directive precluded the introduction of a tax such as IPT at a special rate identical to the standard rate of VAT, in the absence of a derogation granted under Article 27. The ECJ held that as IPT did not constitute a turnover tax that was enough to ensure that it was not incompatible with Article 13(B)(a). No derogation was required..

The further questions referred all concerned state aid. They sought answers on points concerning the concept of affect on trade between member states. The Tribunal had assumed that the existence of the two different rates for IPT involved a state aid within the meaning of Article 87(1) of the EC Treaty.

Taking its lead from the AG, the ECJ found it necessary to consider whether the underlying assumption was correct; did the system of IPT, with two different rates, constitute a state aid? The ECJ approached the issue by identifying "the favouring of certain undertakings or the production of certain goods" (the condition of selectivity) as a necessary element of the concept of state aid in Article 87(1) and considering whether it was exhibited by the IPT system. The key point for the ECJ was that the condition of selectivity is not satisfied by a measure which confers an advantage on its recipient if that measure is justified by the nature and/or general scheme of the system of which it is part.

The ECJ did not leave it for the Tribunal to determine whether the application of higher rate IPT to selected insurance contracts was justified. It was, unsurprisingly, prepared to work on the assumption that that higher rate of IPT involved an advantage. However, it concluded that the application of the higher rate of IPT to selected types of insurance contract, previously subject to the standard rate, must be regarded as justified by the nature and the general scheme of the UK's system of taxation of insurance contracts. In reaching that conclusion the ECJ made reference to the Tribunal's finding that the object of the introduction of the higher rate was to prevent price manipulation in the domestic appliance sector and value shifting between appliances and associated insurance which had given rise to losses of VAT revenue. It also observed that the higher rate was not intended to confer an advantage on those subject to standard rate IPT, which had originated as a revenue raising measure applicable to all insurance contracts. IPT remained a tax scheme that did not favour a specific sector. It accepted the AG's characterisation of the higher rate IPT as having the appearance of a regulatory charge intended specifically as a deterrent to the conclusion of connected insurance contracts. The ECJ's conclusion was that the IPT scheme, with two different rates, could not be regarded as a state aid.

It is worth remarking that the ECJ considered the VAT-related purpose of the higher rate within the IPT scheme to be irrelevant to whether it was compatible with the Sixth Directive. Objective characteristics ruled the day when considering the relationship to VAT. However, purpose was a factor in determining whether there was a state aid.

The conclusion on state aid casts severe doubt on the *Lunn Poly* case. Although the ECJ examined the selectivity condition with particular reference to the domestic appliance insurance sector, the ECJ's reasoning appears to be generally applicable across the entire IPT system. The scheme of the higher rate could be seen to be essentially similar across all sectors. In particular it is difficult to see how the Court of Appeal's reasoning in relation to the condition of selectivity can any longer be considered good law. The fiscal nature and aim of the measure were prominent considerations in the ECJ's judgment, whilst the Court of Appeal appears to have considered them relevant but of little weight. It is also noteworthy that whilst the Court of Appeal was much concerned with objective justification, based on detailed evidence, there was no express consideration by the ECJ of the proportionality of higher rate IPT, which might suggest that it was taken for granted or that the ECJ was prepared to allow member states a greater margin of appreciation..

However, the ECJ did point to findings that tax avoidance had occurred in the domestic appliances sector. Thus it was faced with a tax measure which had an anti-avoidance purpose where there was avoidance to be countered. The Court of Appeal, on the other hand, found that, in the travel sector, there had been no tax loss which could provide an objective justification for the higher rate of IPT, even though it did not doubt that the intended purpose of the higher rate IPT was as an anti-avoidance measure. If a measure, such as a differential tax rate, is introduced for a fiscal purpose, such as anti-avoidance, but that purpose is entirely misconceived, there must remain doubt as to whether such a measure could be justified, even on the broader approach of the ECJ.

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