EXPLANATORY MEMORANDUM TO

THE INSURANCE PREMIUM TAX (AMENDMENT OF SCHEDULE 6A TO THE FINANCE ACT 1994) ORDER 2009

2009 No. 219

1. This explanatory memorandum has been prepared by Her Majesty's Revenue and Customs ("HMRC") and is laid before the House of Commons by Command of Her Majesty. This memorandum contains information for the Select Committee on Statutory Instruments.

2. Purpose of the instrument

2.1 This instrument gives legislative effect to an Extra-statutory Concession (ESC), ESC 4.3: IPT: Insurance relating to motorcars and motorcycles, which is part of a group of ESCs which are being legislated following the House of Lords' decision in *R v HM Commissioners of Inland Revenue ex p Wilkinson [2005] UKHL 30* ("the Wilkinson case"). This case made clear that the scope of HM Revenue & Customs' administrative discretion to make concessions that depart from the strict statutory position is not as wide as previously thought. This statutory instrument preserves the tax effect of this ESC by putting it on a statutory footing.

3. Matters of special interest to the Select Committee on Statutory Instruments

3.1 This order relates to three other orders relating to ESCs, also laid before the House of Commons today. The main order, the Enactment of Extra-Statutory Concessions Order 2009, is made under section 160 of the Finance Act 2008 (c. 9).

4. Legislative Context

4.1 Section 51A(3) of the Finance Act 1994 provides an enabling power which allows Schedule 6A to the Act to be amended by Treasury order. This instrument is made using that power. It is nevertheless intended to lay this instrument to the same broad timescale as the Enactment of Extra-Statutory Concessions Order 2009, as it forms part of the same policy package.

4.2 The effect of this instrument is to remove from the charge to higher rate Insurance Premium Tax (which is dealt with in paragraph 2 of Schedule 6A) premiums which are paid under taxable insurance contracts relating to motor cars or motor cycles which are supplied by way of sale, where the insurance is for either fully comprehensive, third party fire and theft, or third party cover. "Sale", in relation to a motor car or motor cycle, means a sale where the title to the vehicle passes immediately on purchase or a sale under a hire purchase agreement by which it is intended that the title will pass at some other, specified point.

5. Territorial Extent and Application

5.1 This instrument applies to all of the United Kingdom.

6. European Convention on Human Rights

The Financial Secretary to the Treasury has made the following statement regarding Human Rights:

In my view the provisions of the Insurance Premium Tax (Amendment of Schedule 6A to the Finance Act 1994) Order 2009 are compatible with the Convention rights.

7. Policy background

- ***What is being done and why***

7.1 Extra-statutory Concessions (ESCs) have been a feature of the UK's tax system for decades and will continue to be made and withdrawn as necessary. For this purpose the term 'Extra-statutory Concession' refers to any statement made by the Commissioners of HM Revenue and Customs made before the passing of the Finance Act 2008, and having effect at that time, that they will treat persons as if they were entitled to a reduction to tax or duty, or any other concession relating to tax or duty to which they are not, or may not be, entitled in accordance with the law. Such statements might comprise extra-statutory concessions described as such in the former Inland Revenue booklet IR1 and the former HM Customs and Excise booklet Notice 48, or otherwise as a statement of practice, press release or a statement made in any other way.

7.2 The House of Lords' decision in the *Wilkinson* case made clear that the scope of HM Revenue & Customs' (HMRC) administrative discretion to make concessions that depart from the strict statutory position is not as wide as previously thought.

7.3 In light of that decision, HMRC is reviewing its published concessions and the indications are that most ESCs will be able to continue in their current form as they are within the scope of HMRC' s administrative discretion. Where an existing concession exceeds the scope of the discretion of the *Wilkinson* judgment the effect of the concession will be maintained by putting it on to a legislative basis where it is appropriate to do so. Each concession will be considered carefully and, while the aim is to retain as many concessions as possible, some may no longer be required and it may not be possible to legislate for the effect of some others.

7.4 The higher rate of IPT was introduced in 1997 as a means of counteracting VAT avoidance by shifting the value of VATable goods or services into VAT exempt insurance premiums, thereby replacing VAT at 17.5% with IPT at (what was then) 2.5%. The higher rate was set at 17.5%, the same rate as VAT, targeted at the three sectors where value shifting was felt to be most prevalent at the time (motor, domestic appliances and travel) and applied only in circumstances where insurance was sold alongside VAT standard rated goods or services (although the higher rate has since been extended to cover all travel insurance regardless of how it is sold). In the motor and domestic appliances sectors it was almost exclusively extended warranty insurance that was being used to value shift and it was this type of insurance that the higher rate was specifically intended to catch.

7.5 ESC 4.3 was introduced at the same time as the higher rate of IPT as a means of removing third party/comprehensive motor insurance, i.e. insurance taken out to satisfy s145 Road Traffic Act 1988 requirements, from the higher rate provisions unless it is supplied in connection with the hire of a vehicle (where there was some evidence of its being used for value shifting). It was accepted at the time that this type of insurance was rarely sold alongside motor vehicles and, in circumstances where it was, the nature of the product, and in particular the direct correlation between individual risk and premium, made it difficult, if not impossible, to manipulate values to facilitate value shifting.

7.6 In the period between 1997 and the present, the marketing of insurance has changed considerably and motor insurance is now often provided as a package with a motor vehicle. There has, however, been no real evidence of its being used to effect VAT value shifting and the assumptions made about the price sensitivities of this product appear to have held true. Having reviewed this concession, therefore, and finding no reason not to retain its effects, the purpose of this Order is to provide the necessary legislative provisions to remove this type of insurance from the higher rate provisions unless it is provided in connection with vehicles on hire.

- ***Consolidation***

7.7 Not applicable.

8. Consultation outcome

8.1 A 12 week consultation[1], beginning 3 November 2008, was undertaken to seek views as to whether the legislation accurately translated the effect of this and the other ESCs referred to in paragraph 2 above. The major overarching tax-bodies were consulted, as well as representative bodies from the particular sectors affected. In the case of this ESC, the principal representative body consulted was the Association of British Insurers (ABI), although this was done informally and not as part of the main consultation exercise. The ABI sought clarification on a number of aspects of the legislation and, in light of the responses given, confirmed that they were content with the legislation as drafted subject to further explanation of specific points being provided in guidance.

8.2 The consultation and responses document are published on HMRC's website.

9. Guidance

9.1 The instrument confirms existing treatment and so further guidance is not required.

10. Impact

10.1 An impact assessment has not been prepared for this instrument because there is no impact on business, charities, voluntary bodies or the public sector. The instrument puts an existing ESC on a statutory footing, and there is no change to the tax effect.

11. Regulating small business

11.1 The legislation may apply to small business but a Small Firms Impact Test has not been undertaken because the legislation does not alter the existing tax effect.

[1] http://www.hmrc.gov.uk/consultations/index.htm

12. Monitoring & review

12.1 Monitoring and review is not required as the instrument confirms existing treatment.

13. Contact

Barbara Farndell at HMRC. Tel: 0207 147 0245 or email: barbara.farndell@hmrc.gsi.gov.uk can answer any queries regarding the instrument.