THE ARTHUR ANDERSEN CASE ON THE SCOPE OF EXEMPTION FOR "RELATED SERVICES PERFORMED BY INSURANCE BROKERS AND INSURANCE AGENTS"

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The ECJ gave its judgment in this case[2] on 3rd March 2005, following an Opinion delivered by the Advocate General on 12 January. As widely expected, the Court followed the Advocate General in finding that outsourced activities of the kind provided by Arthur Andersen in the Netherlands to Universal Leven NV (UL) did not fall within the exemption provided in Article 13B(a) of the Sixth Directive for "services related to insurance transactions by insurance brokers and insurance agents".

Although the result was the same, there were some significant differences in emphasis and reasoning between the Advocate General and the judgment of the Full Court, which arguably leave member states slightly more freedom of manoeuvre in implementing the judgment than if the Court had followed the Advocate General's reasoning in its entirety. In particular the Advocate General had suggested that the definition adopted for VAT purposes in the Sixth Directive of the term "insurance broker and agent" had to depart from (in a sense of being narrower) than the definitions of those terms to be found in Article 2 of the Directive of 13 December 1976 on freedom of establishment[3] ("Directive 77/92/EEC"). The Advocate General had suggested that while those definitions

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2 Case C-472/03

3 77/92/EEC

had to be taken into account to avoid the risk of losing "all contact with the legal and practical reality in the field of insurance law", he preferred the narrower definition as developed by the ECJ in *Taksatorringen*[4], where it was held that the related services performed by insurance brokers and insurance agents in Article 13B(a) refers only to services provided by professionals who have a relationship with both the insurer and the insured, it being stressed that the broker is no more than an intermediary. This definition emphasised the external activity of the insurance broker or agent acting as intermediary bringing the insured and insurer in contact with each other. The ECJ judgment on the other hand cited Directive 77/92/EEC as part of the legal background, and made no explicit disavowal of the definitions it contained. It is clear that the ECJ was more concerned with the fact that in this case Arthur Andersen was providing UL with a comprehensive end-to-end outsourced service and that it must be regarded "as a contract for sub-contracted services under which ACMC provides UL with the human and administrative resources which it lacks". The ECJ was particularly concerned that "the staff of UL corresponds to only 2.9 FTS, whereas AIS has 17 FTS working on the "back office" activities, and that the staff of AIS and UL share the same premises".

So what were the basic facts in the Arthur Andersen case? UL, a life insurance company in the Netherlands, and Andersen Consulting Management Consultants (ACMC) signed a "cooperation agreement" in 1997 under which ACMC agreed to perform various "back office" activities on behalf of UL. These comprise the acceptance of applications for insurance, the handling of amendments, contracts and premiums, the issuing, management and rescission of policies, the management of claims, the setting and paying of commission to insurance agents, the supply of information to UL and to insurance agents and the drafting of reports for insured parties and third parties. When based on the information provided by applicants for insurance a medical examination was required, UL decided on the acceptance of risks, but otherwise that decision was made by ACMC and binds UL. The division of ACMC, Accenture Insurance Services (AIS) shared premises with UL, and maintained almost all contact with the insurance agents active in selling life policies.

Under Article 13B(a) of the Sixth Directive, exemption is provided for "insurance and re-insurance transactions, including related services performed by insurance brokers and insurance agents". It was not really in dispute that ACMC was not itself carrying out insurance transactions – it did not take risk as underwriter and unlike Card Protection Plan, which had successfully attracted the main exemption. However, it was not an underwriter, nor did it buy block policies and make them

4 *Assurandør-Societetet (acting on behalf of Taksatorringen) v. Skatteministeriet* (Case C-8/01) [2003] All ER (D) 274

available to the insured on an individual basis, and indeed had no contractual relationship with the insured. The only question therefore was whether the services provided by ACMC fell within the related services exemption.

In referring the case, the Dutch Court (the Hogeraad) had said it was unsure as to the concept of "services performed by an insurance agent" within Article 13B(a), noting that while the requirement for a direct link between the taxable person and the insured party appeared to be lacking in the present case, many of the activities in question constituted services relating to insurance transactions in which ACMC intervenes to a great extent as an agent, in particular handling the insurance applications sent by agents to UL, very often finalising them in the name of UL, and also acting between insurance agents and insured parties on behalf of UL during the lifetime of the insurance contract and when it is rescinded. In its pleadings, ACMC contended in particular that its activities fell within the definition of insurance agent in Article 2(1)(b) of Directive 77/92/EEC, as opposed to Article 2(1)(a) which dealt more with the concept of an intermediary acting as broker. Article 2(1)(b) refers to "professional activities of persons instructed under one or more contracts when empowered to act in the name and on behalf of or solely on behalf of one or more insurance undertakings in introducing, proposing and carrying out work preparatory to the conclusion of, or in concluding, contracts of insurance, or in assisting in the administration of performing such contracts, in particular in the event of a claim". While there is reference to "introducing", implying the need for at least some intermediary role, there is clear reference in the definition to administrative work preparatory to, in conclusion of, or in concluding contracts of insurance, as well as the day-to-day administration of the contracts, in particular in the event of a claim, strongly suggesting that the role of insurance broker and insurance agent can and should be differentiated in terms of function. This was why the Advocate General felt it necessary to disavow explicitly the relatively wide definition of the agents function in Article 2(1)(b) of Directive 77/92/EEC.

Part of ACMC's case for exemption was that in line with the definition of an insurance agent in that Directive it had the power to bind its principal ("to act in the name and on behalf of, one or more insurance undertakings"), and the Court accepted this, noting that the professional activity described in Article 2(1)(b) "involves the power to render the insurer liable in respect of an insured person who has incurred a loss". However, following the Advocate General, the Court held that the existence of a power to bind could not be the determining criterion for recognition of an insurance agent within the meaning of Article 13B(a) but rather it was necessary to examine what the activities in question comprise. Looking at these activities in more detail, the Court found that the type of administrative back office functions in question – handling insurance applications, assessing the risk to be insured, issuing, managing and rescinding insurance

policies and making amendments to contracts and modifying premiums, receiving premiums, managing claims, setting and paying commission for insurance agents and maintaining contact with them, handling aspects relating to insurance and supplying information to insured parties, insurance agents and others were "not services that typify an insurance agent". This analysis does not square readily with what it said in Article 2(1)(b) of Directive 77/92/EEC, a point the Court glosses over. However the Court did find that specific aspects, such as the setting and payment of commission for insurance agents, the maintenance of contact with them, the handling of aspects relating to re-insurance and the supply of information to insurance agents and the tax authorities were "quite clearly not part of the activities of an insurance agent". Does this mean that had those comparatively minor aspects been excluded, the services in question, falling as they did largely within Article 2(1)(b) of Directive 77/92/EEC would have attracted exemption"? It is difficult to follow the Court's reasoning here, since the predominant services provided by ACMC clearly did fall within the definition of insurance agent in Article 2(1)(b). The objection clearly goes deeper and has a "political" dimension. The Court was clearly uneasy in following the Advocate General and rejecting the case for exemption based purely on the fact that ACMC did not have a direct relationship in all cases with both insurer and insured, the relationship with the insured being through insurance agents with whom it communicated. Although noting that this was a requirement by the case law for recognition as an insurance agent according to paragraph 44 of *Taksatorringen*, the Court puts the question on one side ("irrespective of whether as part of its activities ACMC has a relationship with both the insurer and insured parties") and concentrates on two main points. First it notes that "essential aspects of the work of an insurance agent, such as the finding of prospects and their introduction to the insurer, are clearly lacking in the present case". Secondly it finds that ACMC is essentially carrying out sub-contracted services which would normally be carried out by the insurer but for its lack of the human and administrative resources to do so – and quotes by analogy Case C-235/00 CSC Financial Services. The Advocate General had made rather more of this analogy drawing a parallel between "related activities" and the term "negotiation" where it occurs in Article 13B(d)1-5 in the financial services exemption. In carrying out front office and applications processing activities for Sun Life in the sale of PEPS, it had been held in CSC that CSC was not providing the distinct act of mediation required by the term "negotiation", but rather occupying the same position as the party selling the financial product in helping to fulfil the main contract. This read-across is somewhat misleading, as an insurance agent habitually occupies the position of the insurer in carrying out certain delegated tasks – for example processing of applications, administration of claims and variations of policies. It is clear that the predominant activities of the insurance broker as defined in Article 2(1)(b) of Directive 77/92/EEC can and often are carried out by the insurer himself in other circumstances, and go well beyond "a distinct act of mediation". They are essentially administrative back

office services, including claims handling with the power to bind. The Advocate General at least tried to square this circle by concentrating on the intermediary role and the relationship with insured and insurer; the Full Court judgment leaves a gaping inconsistency.

This analysis gives the VAT authorities of the member states something of a headache in deciding how precisely to apply the judgment. For example how rigid is the requirement apparently laid down by the case law in *Taksatorringen* that the insurance broker or agent should have a relationship with both insured and insurer? Must this relationship be direct in all cases, or can it be through a chain of brokers, as is common practice in sophisticated insurance markets such as the UK and the Netherlands? Agents active in the market habitually act through a chain of non-Lloyd's brokers, and in any case have their relationship not directly with the insurer but with the managing agent for the insurance syndicates, the individual names being strictly speaking the underwriters. How will the judgment apply to that situation?

A fundamental problem with the judgment is that it suggests that exemption depends to some extent on the extent of the back-office services provided – a question of degree – and whether some of them, for example controlling relations with insurance agents, go beyond what is typical of or proper for, an agent to undertake. It is clear by inference that it was the scale of the outsourced activity which most troubled the Court – but basing VAT liability on such an imprecise criterion is bound to cause practical difficulties.

It is clear however that the extent of exemption accorded at present to related services of insurance brokers and insurance agents varies between the member states. For example in Germany claims handling services even with power to bind the principal are not accepted as exempt; in the UK at present they are. The question in the UK will be how far the main thrust of the judgment can be assimilated without causing extensive commercial damage to the existing commercial market, including the Corporation of Lloyd's. A consultation exercise is already underway, in which the trade associations representing the insurance sector have expressed grave misgivings about the possible impact of the judgment. The UK VAT authority will clearly use the judgment to narrow the scope of exemption in areas where it believes the UK courts have gone too far – a clear example being the *Century Life Case*[5] which extended exemption to pensions mis-selling reviews. At a minimum it seems likely that claims handling and other administrative services performed during the life of insurance contracts will attract exemption only if the insurance agent providing such services also provides introductory services as an intermediary as Article 2(1)(b) of Directive 77/92/EEC

5 *Century Life plc v. Commissioners of Customs and Excise* [2001] STC 38

appears to require. This will require some re-drafting of existing contracts to widen the scope of services, but should not be an insurmountable obstacle to continued exemption. The ECJ therefore has left some room for manoeuvre, though some changes to present practice will be necessary.

What is clear, however, is that major end-to-end outsourcing of back office services by insurers will no longer benefit from the related services exemption once the Court judgment is implemented, because this type of service provision, where the great bulk of the job of running an insurance company is delegated to another was very clearly in the Court's sights. How this question of degree can best be expressed in national legislation will be a matter for the authorities in each member state to decide. What is clear is that an insurance agent can perform administrative tasks which might otherwise be performed by the insurer, because he is not simply confined to "negotiation" unlike his financial services counterpart in Article 13(b)(d)1-6. This in an important distinction between the two exemptions which the insurance sector will be at pains to maintain.