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Insurance premium tax

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Summary

Insurance premium tax (IPT) is charged on insurance premiums and covers most general insurance (eg, motor and household), though life insurance and most other long term insurance is exempt. The tax is forecast to raise £5.9 billion in 2017/18.[1]

IPT was introduced by the then Chancellor, Kenneth Clarke, in his November 1993 Budget, and came into effect on 1 October 1994, charged at 2.5% on a gross basis. Since 1 April 1997 there have been two rates of tax: a standard rate, initially set at 4%, and a higher rate, initially set at 17.5%, applied to a limited range of insurance usually sold with goods and services subject to VAT.

The main rate of tax has been increased five times since then. First, the then Chancellor Gordon Brown increased the standard rate to 5% in the 1999 Budget, with effect from 1 July 1999.[2] Second, in his Budget following the 2010 General Election, the then Chancellor George Osborne announced the IPT rate would rise to 6% from 4 January 2011. Mr Osborne also announced that the higher rate would rise to 20%, aligned with the increase in the standard rate of VAT to 20%, to take effect at the same time.[3] Following the 2015 General Election, Mr Osborne presented the Conservative Government's first Budget on 8 July. The Chancellor announced that the main rate of IPT would be increased to 9.5%, effective from November 2015.[4] This was estimated this will raise £530m in 2015/16, rising to £1.46bn in 2016/17.[5] In his second Budget on 16 March 2016 Mr Osborne announced that the main rate would rise to 10% to provide extra funding for flood defences.[6] The new rate would apply from 1 October 2016.[7] The 0.5 percentage point increase was forecast to raise £80m in 2015/16, rising to around £200m a year in subsequent years.[8]

Finally in his Autumn Statement on 23 November 2016 the Chancellor Philip Hammond announced that the rate of IPT would rise by 2 percentage points to 12% with effect from 1 June 2017. This is forecast to raise £520m in 2017/18, rising to £840m in 2018/19.[9]

This note provides a short description of IPT's introduction and the major changes that have been made to the tax.

Guidance on the operation of IPT, as well as statistical data on its yield, is published by HM Revenue & Customs.[10]

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1 OBR, *Economic & Fiscal Outlook*, Cm 9572, March 2018 (Table 4.6: current receipts).
2 HC Deb 9 March 1999 c186
3 HC Deb 22 June 2010 c177
4 HC Deb 8 July 2015 c326. See also, HMRC, *Insurance Premium Tax: increase to standard rate - tax information & impact note, 9 July 2015*.
5 *Budget 2015*, HC 264, July 2015 p75 (Table 2.1 – item 19)
6 HC Deb 16 March 2016 c962
7 HM Revenue & Customs, *Changes to Insurance Premium Tax: increase to standard rate: tax information & impact note (TIIN)*, 16 March 2016
8 *Budget 2016*, HC901, March 2016 p86 (Table 2.1 – item 61); HM Treasury, *Budget 2016 Policy Costings, March 2016 p59*
9 HC Deb 23 November 2016 c907. *Spring Budget 2017*, HC 1025, March 2017 p28 (Table 2.2 – item g). see also, HMRC, *IPT increase of standard rate – TIIN*, 5 December 2016.
10 *Insurance Premium Tax Notice IPT1*, February 2017 & *IPT Statistical Bulletin*, December 2017

1. The introduction of IPT

1.1 The 1993 Budget

The Conservative Government's reasons for introducing IPT were set out by the then Chancellor Kenneth Clarke in his 1993 Budget speech. He explained that his task, in terms of tax, was simple: "I need to raise revenue, but to do so in a way which does least damage to the economy." One method of doing this would be to broaden the existing tax base: "I have never disguised my personal view that the coverage of value added tax in this country is too narrow." Insurance is one service that remains exempt from VAT, and – Mr Clarke went on to note - "we have always tended to tax financial services in this country much more lightly than other sectors, including manufacturing."[11]

However extending the coverage of VAT to insurance would be contrary to European law. The scope of VAT in all Member States was determined by the sixth EC VAT directive (77/388/EEC), adopted in May 1977. Article 13 of the directive listed those goods and services which should be exempted, either for reasons of public interest, or for other purposes; alterations to this list can only be made by a subsequent EC directive. Item (a) of Article 13B was: "insurance and reinsurance transactions, including related services performed by insurance brokers and insurance agents."[12] In November 2006 Member States agreed a new principal EC VAT directive (2006/112/EC), which revised or recast both the first and the sixth EC VAT directives, though it made no change to EU or UK VAT law.[13] Item 1(a) to Article 135 of the directive reproduces this provision regarding the VAT exemption of insurance.

There are no restrictions of this nature on Member States charging excise duties on insurance premiums, and historically most Member States have charged taxes with rates significantly higher than the UK's. Clearly this was one reason why the industry were relatively unsurprised by the introduction of IPT; as the *Financial Times* noted at the time, "reaction yesterday was muted, partly because the tax brings the UK into line with practice in most of Europe and the US."[14] While opposed to the tax the Association of British Insurers stated it could "recognise why insurance was selected as we are the only country in the European Union without such taxes."[15]

Mr Clarke proposed that a new ad valorem tax on insurance premiums should be introduced from 1 October 1994. Initially it was intended that IPT be charged on a net basis - after the deduction of brokerage commission - at 3%. Following consultation this was thought too much an administrative burden to place on insurers, and the Government

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11 HC Deb 30 November 1993 c 932
12 This is implemented in UK law by Schedule 9, Group 2 of the *VAT Act 1994*.
13 Council Directive 2006/112/EC of 28 November 2006 (OJ L 347, 11 December 2006)
14 "Tax may raise premiums on vehicles and homes", *Financial Times*, 1 December 1993
15 ABI press release, *Response to Budget-premium tax*, 30 November 1993

decided that IPT would be charged on a gross basis, but at the slightly lower rate of 2.5%.[16]

When IPT was debated at the Committee stage of the Finance Bill that year, Sir John Cope, then Paymaster General, addressed the question whether insurance should be taxed at all:

> To tax something is not necessarily to say that one does not think that it should take place. After all, we tax income. We have taxed many other things that we are not trying to discourage but which nevertheless we think form a proper basis for contributions to the national Exchequer ... Applying the tax at a relatively low rate of 3 per cent across such a broad base serves to achieve as fair as possible a distribution of the tax burden ... In setting the rate, the Chancellor was able to conclude that it would be unlikely to have a significant impact on the overall cost of insurance and thus on the take-up of insurance.[17]

1.2 The scope of IPT

IPT is charged on premiums in respect of general insurance (such as buildings and contents, motor, accident and health), where the risk is located in the UK (this does not cover either the Channel Islands or the Isle of Man).

All insurance premiums are liable for tax, save where they are defined as specifically exempt. Two important exemptions are: first, the insurance of international air and sea transport and trade (including large ships and aircraft, international railway rolling stock, goods in international transit, and export credit guarantees); and, second, 'long-term' business. The intention in exempting long-term insurance was to avoid taxing those contracts taken out by people wishing to provide income for the future. In addition reinsurance is not taxable, to avoid double taxation.[18]

Historically over 80% of insurance written in the UK has been exempt from IPT.[19] In his July 2015 Budget speech the then Chancellor, George Osborne, noted the tax "applies to only one fifth of all premiums."[20]

Initially the exemption for 'long-term' business – generally speaking, policies for life, pension and permanent health insurance – was defined by reference to the classes of long term business as set out in schedule 1 of the *Insurance Companies Act (ICA) 1982*. These provisions are now incorporated in part II (Contracts of long-term insurance) to schedule 1 of the *Financial Services and Markets Act 2000 (Regulated Activities) Order* (RAO) SI 2001/544. Under these provisions, permanent health insurance may only be considered long term business if written for a minimum period of at least five years (or until the normal

16 HC Deb 24 February 1994 c 310
17 HC Deb 1 February 1994 cc824-825. Sir John's statement predated the announcement, on 24 February, that the IPT rate would be 2.5 per cent.
18 see, *Insurance Premium Tax Notice IPT1*, February 2017 (see section 5).
19 HM Customs & Excise, *Insurance premium tax factsheet*, February 2002 p4
20 HC Deb 8 July 2015 c326. The point was also made by Treasury Minister Harriet Baldwin when the House debated setting IPT at 10% (HC Deb 27 June 2016 c114).

retirement age of the policyholder) and if the contract cannot be terminated by the insurer (except in special circumstances mentioned in the contract). As such, permanent health insurance is clearly distinguished from other health insurance.[21]

On this question HMRC's guidance comments that permanent health insurance "is often described as income protection insurance because it provides a replacement income when someone is unable to work through sickness or disability."[22] Contracts providing benefits more commonly found under an annual private medical insurance or hospital cash plan type contract would be classed as medical insurance, and subject to tax. Contracts providing critical illness cover (for example, a lump sum payment on diagnosis of a serious medical condition), or cover which meets the cost of continuing care for the elderly or chronically sick, as well as permanent health insurance, would be exempt, as being long-term business.

1.3 The higher rate of IPT

In his November 1996 Budget, the then Chancellor, Kenneth Clarke, announced two changes to IPT. First, the main rate of tax would be increased from 2.5% to 4%. Second, a new higher rate would be introduced, to be set at 17.5%. The higher rate would apply to a limited range of insurance usually sold with goods and services subject to VAT (namely, insurance sold by suppliers of cars and domestic appliances, and, sales of travel insurance by travel agents and tour operators). Both changes were effective from 1 April 1997.

In justifying the increase in the main IPT rate, Mr Clarke argued that this measure went some way to balance the burden on indirect taxes across all goods and services:

> The Government recognise that low marginal tax rates on income are a spur to hard work and enterprise. Taxes on spending do less damage to effort and enterprise than taxes on income, but the balance of the taxes that we do impose on spending must be right, and I am making some changes to taxes which help to move towards a better balance for the tax system as a whole …
>
> I propose to increase insurance premium tax, which applies to most general insurance, to 4 per cent. Three quarters of all insurance – including life insurance, and other long-term insurance – will remain exempt. Insurance remains undertaxed for consumers compared with other services in this country. The introduction of the tax – I made it a very low rate – did not harm the healthy insurance industry that we have. Most companies absorbed the tax, and some premiums actually fell for a time. Even after this further modest change – which I think is lower than many people expected – the overall rate of insurance premium tax in the UK remains very low, lower than in almost any other European Union country.[23]

21 This type of health insurance would fall under classes 1 (accident) and 2 (sickness) of Part I (Contracts of general insurance) to schedule 1 to the RAO.
22 *Insurance Premium Tax Notice IPT1*, February 2017 para 5.4.2
23 HC Deb 26 November 1996 c166

There was a muted reaction to the new 4% rate. The 1.5 percentage point increase was lower than some had expected,[24] though the insurance industry was clearly disappointed, and generally companies argued that the cost would be passed on to customers. The director general of the Association of British Insurers said the industry were "surprised, saddened and disappointed."[25] Churchill Insurance, Norwich Union and Commercial Union all stated that they would not meet the increase in tax themselves; a spokesman for Commercial Union was quoted as saying, "While some insurance companies may be saying that they will absorb the tax, in reality the tax is an additional cost and will affect premiums. We prefer to acknowledge the tax for what it is and openly declare its existence."[26]

Turning to the higher rate of IPT, at the time the travel industry argued this measure was unfair, primarily because companies selling travel insurance alone were required to charge IPT at only 4%, whereas those selling insurance in a package with a holiday had to charge IPT at the higher rate. (The higher rate was extended to all travel insurance from 1 August 1998. This is discussed below.) There was also concern that it would result in fewer people buying insurance when going on holiday.[27]

The purpose of the new higher rate of IPT was to prevent a practice known as "value shifting", a technique retailers had used to avoid VAT. As noted above, unlike most goods and services insurance is exempt from VAT. So, when selling insurance with another item - such as a holiday - some retailers offered the holiday at a cut price (the part of the package charged VAT at the standard rate of VAT, then 17.5%), and recouped this by increasing the price of the insurance sold with the holiday by a compensating amount. Since VAT would not be levied on the insurance, this enabled the travel agent to cut the amount of VAT they paid. To prevent this practice, the Conservative Government proposed in November 1996 that IPT should be charged at the higher rate of 17.5% - equivalent to the standard rate of VAT at the time - on a limited range of insurance usually sold with VATable goods and services:

> Insurance is exempt from VAT. Some suppliers who sell VAT exempt insurance with their main supply of taxable goods and services are taking a high margin on the VAT exempt insurance and a low margin on the taxable goods or services. The avoidance of VAT is frequently one of the reasons for these pricing arrangements.
>
> To deal with this revenue loss and to discourage the spread of these arrangements, the IPT rate on the insurance sold by suppliers of specified goods and services (typically mechanical breakdown insurance, travel insurance and insurance sold with TV and car hire) has been raised to match the VAT rate of 17.5 per

24 Prior to the Budget, the *Guardian* suggested the industry was expecting the rate of IPT to be increased to 5% ("Insurers fear £640m tax ruse", 10 October 1996).

25 "Retailers and airlines attack rises in rates", *Guardian,* 27 November 1996

26 "Dearer motor, home and contents cover", *Financial Times*, 27 November 1996

27 The Director General of the Association of British Insurers was quoted as saying, "to have two rates for the same type of insurance depending on who sells it is unworkable and unrealistic. The 4% rate is bad, the 17.5% rate is unbelievable" (ABI press notice, *Hike in IPT condemned*, 27 November 1996).

> cent. Insurance purchased from an insurance broker or agent who is not a supplier of specified goods and most insurance purchased directly from an insurer will be taxed at 4 per cent. The VAT benefit gained in this way has also led to a distortion of competition, with those who are reducing their VAT liability being in an advantageous position compared to those who do not. This measure will level out the playing field.[28]

Initially the new higher rate was to apply to mechanical breakdown insurance (eg, on domestic electrical appliances and second-hand cars), travel insurance, and insurance sold with TV and car hire. On 6 February 1997 it was announced that the selective higher rate of IPT would not apply to ordinary motor insurance sold by car dealers or motor cycle dealers, or to home contents insurance when sold by retailers. The reliefs would be provided for by extra-statutory concessions and mean these types of insurance will be liable only to the standard rate of IPT of 4 per cent.[29] This exemption was *not* extended to the provision of insurance as part of a holiday.[30]

When the issue of travel insurance was discussed at the Standing Committee stage of the Finance Bill, the then Exchequer Secretary, Philip Oppenheim, argued that the new higher rate was likely to lead to a reduction in insurance costs, and that, despite fears voiced by the industry, travellers would be no less likely to take out insurance:

> I do not think that the move will result in a reduction in insurance sales because making the market a little more balanced will probably result in insurance costs coming down. If travel agents have enjoyed inflated margins on their insurance in the past and if people are now more encouraged to go to cheaper direct sellers, arguably more insurance will be sold and people will be better covered when they go abroad.
>
> I do not think that less insurance will necessarily be sold; it could just as easily shift more of the market, although certainly not the whole of the market, to direct sellers who will be selling lower-cost packages which, one hopes, will stimulate the market overall to grow. It is also a market which is growing rapidly at the moment. Travel insurance, even in its inflated state if bought direct, is arguably still a relatively small proportion of overall holiday costs. People will still feel that it is a wise precaution to take out a good and fairly priced holiday insurance package.[31]

1.4 The position of travel insurance

Travel insurance is not compulsory, though holiday package organisers are legally obliged to provide information on any optional travel insurance available to their customers.[32] In May 1995 the Office of Fair Trading launched an investigation into this market, over concerns that

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28 HM Customs & Excise Budget press notice C&E27, 26 November 1996

29 HM Customs & Excise press notice, *Insurance premium tax: selective higher rate*, 6 February 1997

30 under ss21-24 & schedule 4, of *FA1997*. The legislation was debated at length, but adopted without amendment: SC Deb (B) 4,6,11 February 1997 cc160-248.

31 SC Deb (B) 11 February 1997 c 202

32 Under regulation 8 of the *Package Travel, Package Holidays and Package Tours Regulations* SI 1992/3288

consumers were not getting value for money; as the then Director General of the OFT, Sir Bryan Carsberg, said at the time:

> "Travel insurance is less spectacular in terms of recent and potential growth but it is still an important market with an estimated £400 million a year turnover. Our initial work has revealed several potential consumer problems. Many travel insurance policies are sold only on a 'tied-in' basis where the consumer must buy a specified insurance policy to get a particular holiday package or a discount on such a package.
>
> Even when there is no formal tying-in of insurance relatively few travel agents offer a choice of insurer. There is also a lack of transparency in policies and their presentation. Brochures contain expressions such as 'usual policy exemptions apply', which may refer to pre-existing medical conditions, without necessarily indicating what they are and the agents often make little effort to explain the actual coverage. As a result travellers may find they are not covered for the activity they want to undertake."[33]

In the light of this inquiry the Monopolies and Mergers Commission (MMC) began a formal investigation into the supply of travel agency services in relation to foreign package holidays.[34] The reference enabled the MMC to look at the practice among travel agents of making the offer of holidays at a discount conditional upon the purchase of specific travel insurance. In December 1997 the then Secretary of State for Trade and Industry, Margaret Beckett, published the MMC's report.[35] As Ms Beckett explained, the MMC found that three practices in the trade operated against the public interest, one of which was the offer of discounts conditional on the purchase of travel insurance:

> The MMC found that the tying by travel agents of the availability of discounted holidays to the purchase of travel insurance enables travel agents to inflate the advertised discount on foreign package holidays by reason of the sometimes large margins made on the sale of insurance. Consumers are misled by the discounted offer into thinking they are receiving a greater discount on the holiday they are purchasing than in fact they are; therefore, they shop around less and obtain less value for money than they otherwise would. The MMC recommended, and the Director General of Fair Trading in his advice to me agreed, that this practice should be prohibited for both travel agents and tour operators.
>
> However, the MMC recognised that the practice occurs in only a small minority of the sales of foreign package holidays by tour operators. I have therefore decided to prohibit this practice in relation to travel agents, and also in relation to companies in the same group as the travel agent in order to prevent displacement of this activity from travel agents to tour operators in vertically integrated travel groups.[36]

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33 OFT news release, *OFT enquiries into health and travel insurance announced*, 19 May 1995

34 OFT news release, *Tour operators and travel agents referred to MMC*, 7 November 1996. The MMC was replaced by the Competition Commission in 1999, and in turn the OFT & MMC were merged to form a new single competition authority - the Competition & Markets Authority (CMA) - in 2014.

35 *Foreign Package Holidays*, CM 3813 December 1997

36 DTI Press Release P/97/858, 19 December 1997

Ms Beckett proposed that the Government would introduce an Order to, among other things, make this practice illegal.[37] Following consultation Dr Kim Howells, then Minister for Competition and Consumer Affairs, announced this legislation would take effect from 16 November that year.[38] The Order made it illegal for travel agents to discriminate against any customer in the price they charged for a foreign package holiday, or to make an additional charge if the customer did not buy insurance with the holiday.[39] Following a Court judgement that the legislation was too wide in its ambit,[40] in July 2000 the Government introduced a replacement Order, amending the terms of these rules while retaining their general purpose.[41]

In the March 1998 Budget the Government announced that the higher rate of IPT would be extended to all sales of travel insurance, with effect from 1 August 1998. One of the reasons for doing this was to take account of these developments in the insurance market:

> The higher rate of IPT, which is an anti-tax avoidance measure, came into effect on 1 April 1997. It applies to insurance sold by suppliers of cars and domestic appliances and also to sales of travel insurance by travel agents and tour operators. Since the introduction of the higher rate, the travel industry has claimed that this measure has led to their losing business to other providers of travel insurance, such as direct insurers, banks and building societies, who pay IPT at only 4 per cent. However, no firm evidence has yet been produced to link this change in buying habits, which continues a long-standing trend, to the price effect of the higher rate of IPT.
>
> There has been, though, some change in the balance in the market for travel insurance, for reasons other than the price effect of IPT, and these changes may be amplified if the Monopolies and Mergers Commission proposals to ban the travel industry practice of linking holiday discounts to the purchase of travel insurance are implemented. The higher rate of IPT has therefore been modified in anticipation of these various likely developments and will apply to all travel insurance, regardless of provider. The withdrawal of the concession that allowed tour operators and travel agents to account for standard rate IPT on free insurance recognises the fact that all providers of travel insurance will now be subject to the same rate of IPT.[42]

Provision to charge the higher rate on all travel insurance was made under section 146 of the *Finance Act 1998*. When debated at the Committee stage of the Finance Bill, the then Paymaster General, Geoffrey Robinson, said, "as far as we are aware, no evidence exists of an increase in uninsured travellers due to IPT":

> [A survey] sponsored by the Association of British Travel Agents showed that most travellers were not even aware of the existence

37 At the time the Secretary of State held the principal responsibility to remedy the adverse effects identified in a monopoly report (under ss 56 & 88 of the *Fair Trading Act 1973*). In general, this responsibility now lies with the CMA.
38 SI 1998/1945
39 DTI press notice P/98/640, 10 August 1998
40 "Law report: restrictions on tour operators beyond Minister's powers", *Times*, 12 January 2000
41 SI 2001/2581
42 HM Customs & Excise Budget press notice C&E9, 17 March 1998

> of IPT. Most travellers still choose to buy their insurance from travel agents, even if it is more expensive. It is not a highly price-sensitive commodity and the measure would add only £2 to the average cost of insurance. When taken in the context of a tour operator's package holiday, that is a relatively small percentage of the overall cost."[43]

Unsurprisingly travel agents welcomed the change,[44] though the insurance industry continued to oppose to the higher rate in principle.[45]

During this interval, when the higher rate applied only to insurance sold by travel agents and tour operators, two travel agents – Lunn Poly and Bishopsgate Travel – sought to challenge the operation of this differential rate in the courts as an unsanctioned state aid. In April 1998 the Queen's Bench Divisional Court decided in favour of the applicants,[46] and in February 1999 the Court of Appeal upheld this judgement.[47]

HM Customs & Excise discussed the implications of the case in a brief issued the next month:

> The Court of Appeal in its judgement of 26 February dismissed Custom's appeal against the Divisional Court's decision that the differential rates of IPT applied to travel insurance amounted to a state aid to those insurers liable to account for the standard rate of 4 per cent.
>
> Customs are still considering the implications of the judgement and whether to petition the House of Lords for leave to appeal. However, three points appear clear:
>
> - the judgement - that retention of the 4 per cent rate for certain suppliers of travel insurance amounted to an illegal State aid - has no impact on higher rate tax already paid or due on travel insurance;
> - the judgement is limited to travel insurance and has no effect on the higher rate of IPT paid by other sectors; and
> - the issue is historic in that the extension of higher rate IPT to all supplies of travel insurance on 1 August 1998 removed the features of the IPT legislation which were the subject of the concern raised by the Court in relation to State aids.
>
> The Court of Appeal did not consider it necessary to hear arguments on the cross-appeal from Lunn Poly. The Divisional Court's judgement therefore stands that the higher rate does not infringe other EC legislation and does not amount to an illegal turnover tax.[48]

On 31 March 1999 the department announced that it would not petition the Lords for leave to appeal:

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43 Standing Committee E 16 June 1998 cc921-922

44 "Agents cheer end of variable duty", *Financial Times*, 20 March 1998

45 ABI press notice, *Insurers condemn increase in IPT for travel insurance*, 17 March 1998

46 "Law Report: Differential insurance premium tax unlawful", *Times*, 8 April 1998

47 "Law Report: Differential insurance premium tax unlawful", *Times*, 11 March 1999

48 HM Customs & Excise Business Brief 6/99, 23 March 1999. HM Customs & Excise (HMCE) had responsibility for administering indirect taxes, including VAT. It merged with the Inland Revenue in April 2005 to form HM Revenue & Customs.

> Customs will not be petitioning the House of Lords for leave to appeal against the Court of Appeal's judgement in this case. The judgement stated that the differential rates of IPT applied to travel insurance amounted to a state aid to those insurers liable to account for the standard rate of 4 per cent. Customs are meeting with the industry to discuss implementation of the judgement.[49]

Subsequent to this change, the operation of the higher rate was raised in a Lords PQ:

> **Lord Monson** asked Her Majesty's Government: How they justify taxing travel insurance on flights and holidays, however austere, at 3.5 times the rate applicable to insurance of property, however valuable.
>
> **Lord McIntosh of Haringey:** The higher rate of Insurance Premium Tax (IPT) applied to certain providers of travel insurance was introduced by the previous government to counter VAT avoidance by suppliers of holidays who were artificially manipulating the values from the taxable holiday component of the package to the VAT-exempt insurance element. The IPT higher rate was extended in 1998 to all providers of travel insurance; this retained the anti-avoidance measure while recognising that, with proposed changes to the market, the previous selective application of higher rate IPT might be inappropriate. The opportunity for value shifting does not normally arise with property insurance.[50]

In a survey of the tax, published on its 20th anniversary, two tax practitioners noted, "in the 16 years since the extension of higher rate IPT to all travel insurance, there have been no further additions to the higher rate … this suggests that HMRC's policy in targeting perceived VAT value shifting may have been successful in its scope."[51]

As noted above, the higher rate applies to certain types of motor insurance and domestic appliance insurance when sold by a supplier of cars or domestic appliances; it also applies to these contracts if sold by persons 'connected' to such a supplier.[52] To avoid the higher rate some companies exploited a corporate form, where units within the company act as cells, separately and individually owned, with the assets and liabilities of each cell segregated from one another. In the 2003 Budget the Labour Government announced anti-avoidance legislation to ensure these 'protected cell companies (PCCs)' were included in the IPT definition of 'connected persons'.[53]

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49 HMCE Business Brief 8/99, 31 March 1999

50 HL Deb 13 December 1999 c 8WA

51 "Analysis: Twenty years of IPT", *Tax Journal*, 21 November 2014

52 Insurance sold by a person who is not 'connected' would be liable to IPT at the standard rate.

53 HMCE Budget Notice CE19, 9 April 2003. Provision to this effect was made in section 194 of the *Finance Act 2003*.

2. Increases in the main rate of IPT

2.1 The 1999 Budget: a 5% rate

In his March 1999 Budget the then Chancellor Gordon Brown announced an increase in the standard rate of IPT: "Insurance premium tax will rise by 1p in the pound from 1 July, although 80 per cent. of insurance underwritten in Britain will remain exempt."[54] It was estimated that this would raise £270 million in 1999-2000, rising to £310 million by 2000-01.[55]

The industry appear to have expected a rate rise. Indeed, the *Times* reported that the 1% rise was far lower than some had predicted: "fears that IPT would be raised from its current rate of 4 per cent on household and motor policies to a hefty 17.5 per cent - the rate charged on travel insurance - proved unfounded. Instead, the standard rate is to rise this July to 5 per cent … adding about £3 to the average motor insurance policy."[56] Nonetheless, as the *Financial Times* reported, many insurers were disappointed in the timing of this increase:

> "Under any government, IPT is a tax on prudent, law-abiding citizens," said Barry Smith, head of AA Insurance. "Insurance is not a luxury, but it is compulsory for all drivers, sensible for all householders, and relieves the state of the cost of providing support" … Last year general insurers succeeded in pushing through motor premium increases after heavy losses and are now determined to increase domestic insurance rates. Mr Smith said: "When first introduced, IPT had little effect in a climate of falling premiums, but this inflated tax on top of rising prices is inflationary"…
>
> Mark Boleat, [director-general of the Association of British Insurers] … said: "The increase in IPT is regretted. It will result in higher premiums and could further encourage some people not to insure. It will hit people on the lowest incomes hardest, and those starting up new businesses." CGU, the UK's biggest composite insurer, said: "It is estimated that one in four families in the UK do not have home insurance, due to the costs. This figure can only increase on the back of the chancellor's announcement."[57]

Both the Confederation of British Industry and the Institute of Directors were critical of the new 5% rate. In their response to the Finance Bill that year the CBI stated, "we regret the increase in the rate of IPT which will increase business costs in an area where policy considerations would suggest that full cover against risk is desirable."[58] In their response the IoD commented, "we deplore the increase in insurance premium tax. It will increase burdens on business and tempt some businesses to under-insure their assets. The rate of tax has now doubled since its

54 HC Deb 9 March 1999 c186
55 *Budget 99*, HC 298, March 1998 p113. No estimate was available of the number of insurance policies affected by this change (HC Deb 16 March 1999 c646W).
56 "Premium rate up less than feared", *Times*, 10 March 1999
57 "Increase in premium tax criticised by industry", *Financial Times*, 10 March 1999
58 CBI, *The Finance Bill 1999: CBI reactions and proposals*, May 1999 p 14

introduction. The tax has clearly come to be regarded as an easy source of extra revenue, rather like tobacco duty. But adequate insurance is manifestly for the benefit of the insured: it should not be deterred by taxation."[59] Prior to the Budget, the Association of British Insurers had argued that the tax should not be increased; rather, the Government should seek to abolish it entirely over the long term:

> IPT is a regressive tax. It imposes a disproportionate burden on the less well off individuals and the smallest businesses. These are most likely to need the protection of insurance. Insurance benefits directly those insured, but also others who deal with them whether dependants, customers, employees, third parties or creditors, and thus indirectly the economy as a whole. IPT operates as a disincentive to insurance. Unlike other goods and services liable to similar taxes there is a strong economic case for encouraging insurance.
>
> There is no economic or fiscal policy case for increasing the tax burden on insurance. Indeed there is a strong case for the abolition of IPT when public finances so permit. The justification for the introduction of IPT was that insurance was under taxed. However the imposition of IPT means that insurance is more heavily taxed than the generality of goods and services.[60]

However, as HM Customs & Excise noted at the time, the new 5% rate remained lower than the rate of tax charged in many other EU countries: "the new rate of 5 per cent for the majority of general insurance is one of the lowest overall rates of IPT in the European Union. For example, on household insurance Austria has a rate of 11 per cent, Belgium 9.25 per cent, Finland 22 per cent, France 9 per cent, Germany 14 per cent … and Italy 21.25 per cent."[61]

Provision to increase the standard rate of IPT to 5% was made under section 125 of the *Finance Act 1999*. A concessionary period up to 31 December 1998 was granted for contracts which had commenced before 1 July 1999, the premia on which may not have been written into the insurer's records until after that date. The reason for this type of delay is that much insurance is sold through intermediaries so that insurers might well have had to wait a period of time before entering premiums, set before the rate change as including only 4 per cent tax, in their records. In all cases, additional premiums relating to a *new* risk added to a contract made before the date of the rate change were taxed at the new rate.[62]

This provision was debated at the Committee stage of the Finance Bill on 15 June 1999.[63] On this occasion, the then Paymaster General, Dawn Primarolo, assured the House that the Government had no long-term aim to harmonise the rate of IPT with the rates charged in other European countries:

59 Institute of Directors, *Representation on the Finance Bill 1999*, April 1999 p19
60 "Conclusions" in ABI, *Insurance premium tax (IPT) - the case for abolition*, October 1998
61 HMCE Budget press notice C&E10, 9 March 1999. See also, HMCE, *Insurance premium tax factsheet*, February 2005. The factsheet is no longer published.
62 HM Treasury, *Explanatory Notes to the Finance Bill 1999*, March 1999 (clause 115)
63 SC Deb (B) 15 June 1999 cc640-642

> Insurance premium tax is a UK tax, not a European tax. There are no common rules for IPT as there are for value added tax. Rates vary tremendously across Europe, but they are significantly higher than in the UK, which has one of the lowest rates. The hon. Gentleman[64] also asked whether the proposal was part of the plan to increase steadily the IPT rate. The increase does not signal a future change. The previous Government introduced the tax in 1994 to raise revenue from a sector that had relatively low indirect tax. That has stood the test of time.
>
> The Government have made a clear choice about their revenue. We have been open in the application of the increase, which raises the money that the Treasury needs to invest in our education and health services and to provide safer communities.[65]

2.2 The 2010 Budget: a 6% rate

Following the 1999 Budget, the Labour Government did not increase IPT rates any further, although it made some changes to the administration of the tax - specifically the obligations placed on overseas insurers to appoint a 'tax representative' on their behalf[66] - as well as avoidance legislation to prevent the use of an 'administration fee', charged under a separate contract, by an insurer to avoid IPT on commissions or fees that are part and parcel of the contract for insurance.[67]

In the first Budget of the new Conservative-Liberal Democrat Coalition Government, the Chancellor, George Osborne, announced a series of tax measures, including raising the standard rate of VAT from 17.5% to 20% from 4 January 2011. Alongside this change, the Chancellor stated that "in line with the increase in the main rate of VAT, the higher rate of insurance premium will also rise from 17.5% to 20%, while the standard rate will increase from 5% to 6%."[68] It was estimated that the rise in IPT rates would raise £455m in 2011/12, while the increase in the standard rate of VAT would raise £12.1bn in the same year.[69]

Details of how the new rates would apply were given in a Budget Note:

> IPT is charged as an inclusive amount within premiums received under taxable insurance contracts. Section 51 of the Finance Act 1994 provides the current higher rate of IPT as 17.5 per cent, and the standard rate of IPT as 5 per cent.
>
> Finance Bill 2010 will increase the standard rate of IPT to 6 per cent and increase the higher rate of IPT to 20 per cent. For insurers using the cash receipt method to account for IPT, the new rates will have effect for premiums received under taxable insurance contracts on or after 4 January 2011. For insurers who account for IPT using the special accounting scheme the new rates

64 John Whittingdale MP had raised this concern at an earlier point in this debate (*op.cit.* c641).
65 SC Deb (B) 15 June 1999 c 642
66 under s148 of the *Finance Act 2008* (see HMRC Budget Notices 2008 BN38, 12 March 2008)
67 under s51 of the *Finance Act 2010* (see HMRC Business Brief 47/09, 11 August 2009 & HMRC Budget Notices 2010 BN18, 24 March 2010).
68 HC Deb 22 June 2010 c177
69 *Budget 2010* HC 61 June 2010 p40 (Table 2.1 : items 1 & 2)

> will have effect for premiums that are written into their records as due to them on or after 4 January 2011.
>
> There are already special measures in place to prevent tax avoidance in relation to the period between the announcement of a rate change and the date the rate increase takes effect.[70]

In his speech the Chancellor announced two other major tax measures to raise revenue: a new levy on banks from January 2011, and increasing the rate of capital gains tax on higher rate tax payers from 18% to 28%. Both measures were anticipated to raise much more than the new rates of IPT.[71] This may account for the fact that this rate rise attracted relatively little attention. Also, as with earlier IPT rises, it appears that insurers had expected a much larger rate increase, given the rates of similar taxes in other EU countries, and the state of the public finances.[72] In their reaction to the Budget the Association of British Insurers were critical of the change, as, in their words, "raising IPT is a direct tax increase for the vast majority of people who sensibly protect themselves and their families with insurance", but were generally positive about the statement, saying "the insurance industry applauds today's focus on restoring the UK's competitiveness."[73]

Provision to increase the rates of IPT was made by s4 of the *Finance (No 2) Act 2010*. This was debated briefly at the Committee stage on 15 July. Speaking for the Opposition, Liam Byrne suggested that pensioners would be particularly affected by the tax increase, although he underlined the point that the Opposition did not have "a theoretical objection" to the tax.[74] In response the Treasury Minister David Gauke argued that the new rate would "not have a significant impact on households, businesses or the insurance industry":

> Insurers … are not obliged to pass on IPT through higher premiums … [though] we expect that the bulk of [the increase] will be. The analysis of VAT, another indirect tax, shows that two thirds tends to be passed on straight away and that much of the rest is passed on over the following 12 months. However, it is not always possible to predict and it partly depends on the level of competition … Even if the increases to the standard and higher rates of IPT are passed on in full, the impacts will be very modest, costing households less than 20p a week on average and businesses an average of less than 0.01% of annual turnover, even for smaller businesses.[75]

The Minister went on to oppose reducing the tax base, to exempt either motor or medical insurance, on the grounds that this allowed the main rate to remain relatively low compared with other countries, and that it was unlikely the tax rise would stop individuals taking out insurance:

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70 HM Revenue & Customs Budget Notes 2010 BN19, *IPT: increase in the standard rate and higher rate*, 22 June 2010. For more details on the second of these measures see, *VAT : the new 20% standard rate*, CBP 5620, 3 September 2013.

71 It was estimated the levy would raise £2.3bn, and the new CGT rate £825m in 2012/13: *Budget 2010*, HC 61 June 2010 p40 (Table 2.1 : items 8 & 14).

72 For example, "Cover will go to the dogs if tax rises, say insurers", *Times*, 10 June 2010 & "Insurers welcome small IPT rise", *Financial Times*, 23 June 2010

73 ABI press notice, *ABI reaction to Emergency Budget: Competitive UK will help economy*, 22 June 2010

74 HC Deb 15 July 2010 c1120

75 HC Deb 15 July 2010 c1131, cc1130-1

> Exempting motor insurance from the IPT rise would reduce revenue by £160 million a year, and exempting medical insurance would reduce it by a further £40 million. Taken together, those figures total £200 million-nearly £1 billion over the lifetime of the Parliament … It has always been a principle of IPT that the tax applies to a relatively broad base of general insurance, with few exceptions. That broad base allows us to keep the standard rate of the tax low by international standards. Even at the new rate of 6%, the UK's standard rate of IPT is far lower than in, say, Germany, where it is 18% for property and 19% for motor insurance, or France, where it is 9% for property and 18% for motor insurance …
>
> The IPT rate increase will add only about £6 a year to the average motor insurance premium, and for those who buy private medical insurance the rise will cost less than £10 a year on average. Consequently, it is difficult to make the case that the increase will prove much of a deterrent to people taking out motor insurance or private medical insurance. Consumers are well used to insurance premiums fluctuating, and the modest effects of the rise will not act as any significant deterrent.[76]

No further changes were made to the rates of IPT for the remainder of the 2010-15 Parliament, and there was little debate over its incidence.

The tax base was considered briefly as part of a much wider review of tax reliefs completed in 2011 by the Office of Tax Simplification (OTS). The Chancellor, George Osborne, had announced the establishment of this new independent body in his first Budget.[77] In July Treasury Minister David Gauke confirmed that the OTS would undertake two reviews in its first year, looking at the existing structure of tax reliefs and at small business taxation.[78]

The OTS published reports on both of these issues just before the 2011 Budget. In its paper on tax reliefs the authors argued that, in the case of IPT, the policy rationale for exempting long-term business remained, and, indeed, the relief itself was a simplification:

> All contracts of insurance are liable to insurance premium tax ("IPT") unless specifically exempted. There are a number of exemptions, one of which is long term business (*FA 1994* Sch 7A Part 1 para 2). Long term business includes one or more of the following, but specifically does not include medical insurance:[79]
>
> - Life and annuity;
> - Marriage and birth;
> - Linked long term;
> - Permanent health (must be for a minimum of 5 years)
> - Tontines (a type of life insurance held by groups of people where the benefits are shared among remaining members of the scheme when a participant dies);
> - Capital redemption contracts;

76 HC Deb 15 July 2010 cc1131-2
77 HC 61 June 2010 para 1.64
78 HC Deb 20 July 2010 c8WS; HC Deb 20 July 2010 cc175-84; HM Treasury press notice 29/10 20 July 2010. Details of the OTS's ongoing work is on Gov.uk.
79 *Financial Services and Markets Act 2000 (Regulated Activities) Order 2001*, Sch 1 Part II (SI 2001/544)

- Pension fund management;
- Collective insurance; and
- Social insurance.

Is the policy rationale still valid, does the relief achieve it and what might be the impact of repeal?

The policy rationale is to avoid taxing the savings element within, for example, the premium for life assurance policies, and therefore discriminating against one particular means of saving. If the relief were to be repealed, policyholders would face IPT on their saving and pension contributions, and would be disadvantaged when compared to other forms of savings. Whilst it does achieve the objective and the rationale is still valid, not all insurance falling within the exemption constitutes a form of savings and some 'protection only' insurance is also covered. This type of policy, such as term assurance is indemnity insurance, like all forms of general insurance to which IPT applies.

Consideration could be given to excluding long term business from the IPT exemption. However this would raise complications such as distinguishing protection only elements within mixed contracts, addressing potential avoidance (and possibly adding a number of new insurers to the IPT register).

Taxpayer take up and awareness

There are currently 233 insurers regulated to provide long term insurance. However because insurers generally pass the cost of any IPT onto the policyholder, it is the holders of such policies who would be affected, of which there are around 69million. There are no figures for the number of individuals affected but it is expected to be a large proportion of the country. The savings due to this exemption are around £8billion p.a. if both existing and new policies were taxed. Extending the scope by removing protection only insurance from the exemption could lead to additional tax of £300-400million p.a. if both existing and new policies were taxed, however behavioural changes could reduce this significantly.

Complexity, compliance costs and administrative burden

Life insurers are not currently registered for IPT so taxing long term insurance would bring many new insurers onto the IPT register, with the associated administrative burden costs for both the industry and HMRC. It would be technically complex to tax all long term insurance products, (especially if an attempt was made to retain the exemption for savings only products as this would potentially create a new borderline that would be difficult to police).

Summary

The original policy rationale remains valid, the relief is simple to operate and there are many taxpayers affected. It would be possible to remove the protection only insurance but this may create complexity. Additionally, the relief is a simplification. We therefore recommend that this relief be retained.[80]

In a piece which appeared in the *Tax Journal* on the 20th anniversary of the tax's introduction, two practitioners noted that, "for the UK, with

80 *Review of tax reliefs: final report*, March 2011 paras M.51-62. Figures in section on take up and awareness were all HMRC estimates.

the public purse always under pressure for more tax revenue, the abolition of IPT is not on the horizon":

> Although there are a number of commentators in favour of abolition, who would like to see the back of UK IPT and EU premium taxes more generally, it seems unlikely, unless the EU could be persuaded to remove the VAT exemption for general insurance. In other words, unless member states can claw back some of the tax revenue that they would lose from an abolition of IPT, they are unlikely to either individually or collectively get rid of premium taxes …
>
> For the UK, with the public purse always under pressure for more tax revenue, the abolition of IPT is not on the horizon. In another 20 years' time, we can perhaps expect a couple more increases in the standard rate of IPT in the UK, but it will probably still be less than 50% of the standard UK VAT rate.[81]

2.3 The 2015 Budget: a 9.5% rate

Following the 2015 General Election, the then Chancellor, George Osborne, presented the Conservative Government's first Budget on 8 July. In his Budget speech the Chancellor announced reforms to both the taxation of the banking and insurance sectors – in the latter case, an increase in the main rate of IPT to 9.5% from November 2015:

> Our bank levy was introduced to raise revenue and increase the stability of balance sheets, and it has worked, but now it risks doing harm unless we change it. So I will, over the next six years, gradually reduce the bank levy rate, and after that make sure it no longer applies to worldwide balance sheets. But to maintain a fair contribution from the banks, I will introduce a new 8% surcharge on bank profits from 1 January next year. By getting this balance right, it means we will actually raise more money from the banks this Parliament, but at the same time make our country a more competitive place to do business.
>
> We have also taken action to make sure that consumers get a better deal from another important industry: insurance. The costs of premiums are down for families, and today we are announcing a major review of the regulation of claims management companies and we will cap the charges they can apply to their customers.
>
> Britain's insurance premium tax is well below tax rates in many other countries. I am therefore today raising insurance premium tax, which applies to only one fifth of all premiums, to 9.5%, effective from this November. With these measures I am putting in place an approach for taxing banks and insurers over this Parliament which is sustainable, stable and fair.[82]

The Budget report set out the increase to IPT in the context of the wider reforms to be made to the market, as follows:

> **Insurance**
>
> 1.207 The government remains committed to ensuring customers can purchase insurance at a fair price. The cost of home contents

81 "Analysis: Twenty years of IPT", *Tax Journal*, 21 November 2014
82 HC Deb 8 July 2015 c326. For more background on the bank levy see, *Taxation of banking*, Commons Briefing Paper CBP5251, 5 January 2018.

> insurance has fallen by 8% since last year, and the cost of comprehensive private motor insurance has fallen by 10% in the last 3 years. The government will reform the regulation of the claims management sector to help to drive out further unnecessary costs from insurance premiums.
>
> This Budget announces a fundamental review of the regulation of claims management companies (CMCs), led by the Chairman of the Chartered Trading Standard Institute Board Carol Brady, which will report to HM Treasury and the Ministry of Justice in early 2016. In addition, there is also a case for reform of the fees that CMCs charge consumers, particularly in those instances where consumer complaints fall within the remit of the Financial Ombudsman Service. Therefore, the government will bring forward proposals for the introduction of a cap on the charges that CMCs can apply to their customers, and will consult on how this will work in practice.
>
> 1.208 This builds on the success of previous measures including the ban on referral fees and action to address fraudulent whiplash claims. The Insurance Fraud Taskforce will report by the end of 2015 on what can be done to reduce the impact of fraud on insurance premiums. To further assist car owners, the government will extend the deadline for new cars and motorcycles to have a first MOT test from 3 years to 4, saving motorists more than £100 million per year, subject to public consultation and cost-benefit evaluation. If people compare the different options available for their insurance they can generally get a much better deal, but many people simply renew with their existing insurer without checking the price they could get elsewhere. The Financial Conduct Authority (FCA) will review what more can be done to ensure that people are encouraged to shop around when they renew their insurance.
>
> 1.209 From 1 November, the standard rate of Insurance Premium Tax will be increased from 6% to 9.5%. The Insurance Premium Tax standard rate will remain lower than that of many other EU Member States. It will, for example, continue to be much lower than the 19% tax rate that applies in Germany. Separately, the government will also introduce VAT provisions to level the playing field for insurers. This will deter insurers from routing costs via offshore associates and ensure UK VAT is accounted for an all repair services on UK insurance contracts.[83]

Although the new 9.5% rate would apply from 1 November 2015, a four-month concessionary period applied for insurers using the special accounting scheme:

> **2.133 Insurance premium tax standard rate** – From 1 November 2015, the standard rate of insurance premium tax (IPT) will be increased by 3.5 percentage points to 9.5%. From this date all premiums received by insurers using the IPT cash accounting scheme will be charged at 9.5%. For insurers using the special accounting scheme, there will be a 4 month concessionary period that will begin on 1 November 2015 and end on 29 February 2016, during which premiums received that relate to policies entered into before 1 November 2015 will continue to be liable to IPT at 6%. From 1 March 2016 all

[83] *Budget 2015*, HC 264, July 2015 pp48-9

> premiums received by insurers will be taxed at the new rate of 9.5%, regardless of when the policy was entered into.[84]

The then Treasury Minister Harriet Baldwin set out these arrangements when provision to increase the standard rate was debated in the House:

> We recognise that the insurance industry needs notice to effect the changes. We have tried to ensure a smooth implementation of the new rate by following the approach agreed by industry representatives and HMRC back in 1995. That sets out transitional arrangements required by the insurance industry to account for the tax at the new rate. The rate, as we said, comes into effect on 1 November, which provides a period of nearly four months from the date the measure was announced.
>
> There is a further four-month statutory concessionary period for insurers who have elected to account for the tax using a special accounting scheme. In simple terms, the concessionary period ensures that premiums for policies beginning before 1 November will be taxed at the current rate effectively until 1 March 2016.[85]

Insurers can account for the tax either using the 'cash receipt method', or the 'special accounting scheme' – which affects the 'tax point' – the trigger to account for IPT; HMRC's general guidance on IPT describes each of these as follows:

> The tax point is the trigger to account for IPT, and tax is due one month after the end of the accounting period in which the tax point occurs … The tax point depends on whether you are using the cash receipt method …. or the special accounting scheme … The tax point is the date the premium is:
>
> - received if you are operating the cash receipt method
> - due if you are operating the special accounting scheme
>
> **Cash receipt method**
>
> Under the cash receipt method, the tax point is when you receive taxable premium payments or when they are received on your behalf. Any premium payment received under a contract of insurance by any person on your behalf (whether an agent or not) is treated as being received by you. The subsequent transfer of a payment relating to the premium or part of a premium to you by that person will then be disregarded for the purposes of IPT.
>
> **Special accounting scheme**
>
> Under the special accounting scheme, the tax point is the date when your accounts show the premium due to you (the 'written premium' date). For example, if you make an entry into your records on 10 July showing a premium as due to you on 7 July, the tax point is 7 July.[86]

Further guidance on the tax is in HMRC's IPT Manual which explains why there are these two methods for accounting for the tax:

> When IPT was first introduced, it was envisaged that it would operate using a tax point based on the receipt of cash. Accordingly the Finance Act 1994, which is the primary legislation for IPT, was structured on that expectation. However, it soon

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84 *Summer Budget 2015, HC264, July 2015 p91*. See also, HMRC, *IPT: increase to standard rate, 9 July 2015*

85 HC Deb 8 September 2015 c313

86 IPT Notice1, February 2017 para 12.2-4

> became apparent that this would not be practical for many insurers. Therefore we agreed to a new accounting scheme - the written premium basis or "special accounting scheme". A particular cause of concern was the treatment of policies which commenced before 1 October 1994 (the date the tax was introduced), with related premiums written on or after that date, which, in theory, would have been liable to the new tax. These transitional problems were dealt with by using an Extra Statutory Concession (ESC) [subsequently withdrawn] …
>
> The special accounting scheme acknowledges the difficulty many insurers would have if they had to account for tax on a premium under the cash receipt scheme. It often takes time for the premium to pass through a chain of intermediaries to an insurer, and so the insurer may find it impossible to know what premiums had been received on their behalf at the correct date. [87]

The impact of the higher rate on tax revenues was mentioned in the Office for Budget Responsibility's *Economic & Fiscal Outlook*, published alongside the Budget:

> Growth in **insurance premium tax (IPT)** receipts has been relatively flat since the increase in the standard rate to 6 per cent in January 2011, with a fall of 1.3 per cent between 2011-12 and 2014-15. On a pre-measures basis, receipts are expected to grow by 1.9 per cent a year on average between 2015-16 and 2020-21, reflecting growth in consumer spending.
>
> The Budget measure to increase the standard rate of IPT – which accounts for around 92 per cent of tax liabilities – to 9.5 per cent is expected to increase receipts by around £0.5 billion in 2015-16 and roughly £1.5 billion a year thereafter. This estimate includes a small adjustment to reflect the expected reduction in demand for insurance products as a result of higher premiums. [88]

However, there does not appear to have been any substantive analysis on the distributional impact of this rate rise, or evidence that underinsurance has significantly increased because of the tax. In general insurance will be a progressive purchase – reflecting the fact that wealthier individuals will have more expensive goods, holidays and hobbies, which they will insure, so that one would expect the 'rich' to pay more of IPT in total.

In its 2015 General Election manifesto the Conservative Party had stated that, in government, it would "not increase the rates of VAT, Income Tax or National Insurance in the next Parliament." [89] In a speech the Conservative leader David Cameron confirmed that this 'tax lock' also meant that there would not be any extension to the scope of VAT, or an increase in the ceiling to NICs. [90] In his Budget speech on 8 July the Chancellor confirmed that the Government would legislate to "prohibit any increase in the main rates of income tax, national insurance and VAT for the next five years." [91] Provision to set a tax lock for income tax

87 *Insurance Premium Tax Manual* para 07210 & para 07605. Ret'd May 2018.
88 OBR, *Economic & Fiscal Outlook*, Cm 9088, July 2015 para 4.60
89 Conservative Party, *2015 General Election Manifesto*, April 2015 p27
90 "Cameron pledges to ban tax rises until 2020", *Financial Times*, 29 April 2015. Mr Cameron also publicised this commitment on Twitter.
91 HC Deb 8 July 2015 c336

and VAT was included in the Finance Bill introduced after the Summer Budget, and formed ss1 & 2 of the *Finance (No 2) Act 2015*.[92]

Despite the tax lock, and the significant reductions in public spending that the Chancellor announced at the time, the Budget included a series of measures to *increase* taxes, including the new rate of IPT. Taken together, tax policy measures announced in the Budget were set to raise £5.1bn by 2017/18, rising to £6.5bn by 2020/21.[93]

In his post-Budget presentation, Paul Johnson, director of the IFS, noted "the figures are quite clear though – this was a tax raising budget … we told you before the election that post-election budgets tend to raise at least £5bn in tax – and this one expects to bring in a little more than that." (This analysis was published in the IFS' *Green Budget* in February 2015.[94]) Many of the measures to raise revenues are to reduce tax avoidance or evasion, though, as Mr Johnson went on to note, there were three other big tax increases – one of which had been the increase in the main rate of IPT:

> As well as an array of anti-evasion and anti-avoidance measures there are three other big tax increases: to insurance premium tax, to VED and to the Climate Change Levy. All look more or less opportunistic. The latter, which both increases tax on business consumption of energy –already taxed more heavily than household energy consumption – and reduces the relationship between tax paid and the carbon content of the energy, seems to have little coherent rationale.[95]

There was relatively little comment on the new IPT rate in the press coverage of the Budget, though the *Financial Times* reported claims from the industry that the measure "could prompt policyholders to buy less cover and exacerbate problems caused by underinsurance":

> "The increase simply hasn't been thought through and will have unintended consequences," said Janet Connor, managing director of AA Insurance. Steve White, chief executive of the British Insurance Brokers' Association, added: "'Extremely disappointed' is a polite way of putting it." He said the "stealth tax" would hit 20m policyholders with motor insurance and 17m with buildings insurance …
>
> Adrian Smith, head of Insurance Premium Tax at KPMG, said the rise revealed on Wednesday was the largest percentage point increase on record. "All I can guess is that there were so many taxes David Cameron ruled out increasing that there weren't so many left," he said.
>
> Insurers pay the tax, but consultants said the increase would inevitably be passed on to customers. Ms Connor said the average insurance policyholder would pay an additional £17.50 as a direct result of the tax increase. "Because of intense competition, new business is usually sold at a loss," she said. "The additional burden will make insurers think again about their pricing, and I would not

92 Separate legislation establishes a 'tax lock' to the rates of Class 1 National Insurance contributions; see, Commons Briefing Paper CBP7260, 29 February 2016.

93 *Budget 2015*, HC 264, March 2015 p74 (Table 2.1: Total Policy Decisions)

94 "Chapter 10: Options for increasing tax", *IFS Green Budget*, February 2015 pp228-9 (Figure 10.1. Taxes and the electoral cycle). See also, "Taxes and elections: are they by any chance related?", *IFS Observations*, 15 March 2010.

95 "Paul Johnson's opening remarks", *IFS Summer post-Budget briefing*, 9 July 2105

> be surprised to see an overall increase of 10 per cent or more by the end of the year."
>
> David Bearman, UK Insurance Tax Leader at Ernst & Young, said the industry was concerned the increase would result in individuals taking on more risks themselves. However, Mr Osborne said the tax applied only to a fifth of all premiums. Life policies are excluded from the tax. Other types of protection, including warranties, are subject to a higher 20 per cent rate.[96]

Legislation implementing the rise in the rate of IPT was considered on the first day of the Finance Bill's Committee stage on 8 September 2015.[97] Speaking for the Opposition Barbara Keeley argued that the tax rise could have a number of negative consequences, and moved an amendment to require the Government to publish a review on the impact that any further rate rises would have on the price and take-up of insurance:

> The increase could have a number of negative consequences. Higher insurance premiums may lead to fewer families and individuals purchasing much-needed insurance to protect themselves against everyday problems, which happen much more often in some parts of the country than in others. I am talking about burglary and damage to property and possessions …
>
> Labour's amendment will ensure that the impact of any future increase is properly considered by the Government. It will ensure that there are careful deliberations—much more careful than we have seen on this occasion—on the short and long-term consequences of any further increase in the insurance premium tax and its effect on families and business.[98]

In response Treasury Minister Harriet Baldwin argued that any impact of the new rate on consumers would be 'modest', in part because it was expected that some insurers would not pass on tax rise in higher premiums:

> The new rate for the taxable insurance premiums will begin to apply with effect from 1 November 2015. In the tax year 2016-17, it will raise an extra £1.4 billion, which can be used to reduce the deficit. If insurers pass on the increase, it will affect businesses and households, particularly by increasing the cost of their property and motor insurance. However, we expect that any impact on consumers will be modest. Most households and businesses have some form of general insurance and any impact of a rate rise is therefore shared by a large number of people and organisations, as we have heard.
>
> To give some idea of what that means, if insurers chose to pass on the whole increase, the average household expenditure on insurance would increase by 70p per week. We do not anticipate that the tax increase will reduce the number of people taking out general insurance. Even if insurers choose to pass on the increase, any increased costs will be a very small proportion of the overall cost of insurance. As the insurance market is competitive, customers affected by the change can shop around to find a policy that best fits their needs …

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96 "Insurers say 37m premiums set to rise", *Financial Times*, 9 July 2015
97 This now forms s47 of the *Finance (No2) Act 2015*
98 HC Deb 8 September 2015 cc302-3

> [IPT] is a tax on insurers, not customers, and we are aware of at least one insurer … that has pledged to absorb the cost of the increase for at least one year. We think this is partly because insurers have benefited, and will continue to benefit, from the reductions in corporation tax announced in the Budget. Any such benefit might encourage more of them not to pass on this additional cost.
>
> We have investigated what the overall distributional impact would be if all insurers passed on the entire rate rise. If the entire rate rise of 3.5 percentage points were passed on, households in the top income decile would pay just over £1 a week more for their insurance, while the additional costs for those in the bottom income decile would be less than 40p a week. We calculate that almost two thirds of the overall distributional impact will fall in the top half of the income distribution.[99]

Finally, as noted, the Government had announced the rise in the main IPT rate in the context of reforms to the regulation of the claims management sector. In the Autumn Statement in November 2015 it announced measures to reduce the excessive costs from unnecessary whiplash claims.[100] The Government forecast that these changes would deliver annual savings of £40-£50 per motor insurance policy, and that the reduction in premium prices that insurers passed on would reduce total IPT receipts by £35-55m a year.[101] The wider issue of motor insurance premiums and the impact of unnecessary claims is examined in another Library paper.[102]

More recently at the time of the 2016 Budget the Government published the review it had commissioned on the regulation of claims management companies (CMCs),[103] and announced that it had accepted its recommendations to make the regime tougher, and that it would transfer responsibility for regulating CMCs to the Financial Conduct Authority.[104]

2.4 The 2016 Budget: a 10% rate

In his 2016 Budget speech on 16 March George Osborne announced that the main rate of IPT would be increased by 0.5% percentage points, to raise funds for spending on flood defences:

> To respond to the increasing extreme weather events our country is facing I am today proposing further substantial increases in flood defences. That would not be affordable within existing budgets. So I am going to increase the standard rate of insurance premium tax by just half a per cent., and commit all the extra

99 *op.cit.* c311, c313. In the event the Opposition's amendment was defeated by 308 votes to 269 (*op.cit.* c315). The impact of the tax rise was raised a few times in subsequent PQs: eg, PQ15548, 16/11/2015; and, PQ26009, 10/2/2016.

100 *Autumn Statement*, Cm 9162, November 2015 para 1.143 3.103

101 HMT, *Spending Review & Autumn Statement Policy Costings*, November 2015 p20. See also, *Spring Budget 2017*, HC 1025, March 2017 (Table 2.2 – item ba).

102 *Motor car insurance: premiums and fraudulent claims*, CBP6061, 1 December 2017

103 HMT/MoJ, *Claims management regulation review: final report*, March 2016

104 *Budget 2016*, HC901, March 2016 para 1.206. Further details are on the FCA's site.

> money we raise to flood defence spending. That is a £700 million boost to our resilience and flood defences.[105]

Further details were given in the Budget report:

> In order to fund increased investment in flood defence and resilience, the standard rate of Insurance Premium Tax (IPT) will be increased from 9.5% to 10%. This ensures that the impact of the rate increase is spread broadly across the entire general insurance industry. IPT is a tax on insurers. However, if they do pass the cost of this rate increase on to their business and household customers, the average combined home and contents insurance would only increase by £1, and the average motor insurance premium by £2 per year (HM Treasury calculations).[106] All the revenue raised from this increase in IPT will be invested in flood defence and resilience measures.[107]

The increase in the IPT rate was forecast to raise £80m in 2015/16, rising to around £200m a year in subsequent years.[108]

The Budget report also gave details of the increase in flood defence spending that the Chancellor announced in his Budget:

> Flood defence and resilience funding will be increased by more than £700 million by 2020-21, funded by a 0.5% increase in the standard rate of Insurance Premium Tax. In addition to this, the government will spend a further £130 million on repairing transport infrastructure damaged by Storms Desmond and Eva.[109]

The Government did not propose that IPT receipts would be formally 'ear-marked' for flood defence spending. 'Hypothecation', as it is known, has never been a major part of the UK tax system – and historically opponents have often made three key points:

- First, tying expenditure on individual services to the yields of individual taxes makes spending vulnerable to the vagaries of the business cycle, as tax yields rise and fall in line with incomes, profits and sales.
- Second, the use of hypothecation would no doubt encourage taxpayers to petition to avoid having to pay for a given service in the light of a particular aspect of Government policy. At present our elected government is responsible for allocating resources, and has to account for its decisions to the electorate. This shift might result in politicians focusing on lobbying voters on the future uses of tax revenues before a referendum.
- Third, the balance of government spending across different ends could be shaped by how emotive particular spending policies proved to be with the electorate. Hospitals and schools might easily argue for greater spending. Less glamorous but no less necessary services might suffer in the short run - military

105 HC Deb 16 March 2016 c962
106 In answer to a PQ on how this figure was estimated, the Treasury Minister Harriet Baldwin said, "we do not usually publish such calculations" (PQ31867, 29/3/2016).
107 *Budget 2016* HC901, March 2016 para 1.242
108 *op.cit.* p86 (Table 2.1 – item 61); HM Treasury, *Budget 2016 Policy Costings*, March 2016 p59
109 *Budget 2016* , HC901, March 2016 para 2.336, Table 2.1 –item 60 Further information on the Government's approach to tackling the risks of flooding and expenditure on flood defences is given in: *Flood risk management and funding*, Commons Briefing paper CBP7514, 22 November 2017.

> spending, say, or the costs of tax collection. If taxpayers reacted to cash crises in the Ministry of Defence or HM Revenue & Customs by having a change of heart, the end result might be a ballooning in public expenditure, something taxpayers had not bargained for when they made their first hypothecated decisions.[110]

One historical exception to this general rule was the ear-marking of receipts from vehicle excise duty (VED) for the building and upkeep of roads. From 1920 to 1936 receipts were collated in a Roads Fund for this purpose. In the Summer 2015 Budget the Chancellor announced a new banding system for VED for cars registered on or after 1 April 2017, and, associated with this reform, from 2020/21, the Government would spend all the revenue raised from VED in England on the English Strategic Road Network.[111] Carl Emmerson, deputy director of the Institute for Fiscal Studies (IFS) was asked about this approach, when he gave evidence to the Treasury Committee following the Budget:

> **Q82 Jacob Rees-Mogg:** A wonderful line from the IFS in 1994 calls hypothecation an absurdity and says that spending will be cut during recessions and increased during booms. Do the IFS stand by that view?
>
> **Carl Emmerson:** Yes. There are two kinds of hypothecation. One is where the tax is paying for part of spending on something, in which case you can never really know whether that tax is paying for that or something else. If you get tax revenue of £100 from some tax and you are spending £300 on some spending item, it is just smoke and mirrors. Or you can have binding hypothecation where the tax is £100 and the spending is £100, and then you are saying that the optimal tax rate on this thing you are taxing in all periods of time, in all states of the world, will equal the optimal amount of spending on this other thing.
>
> Do we really think the optimal amount of taxation on motorists, for example, through VED is exactly equal in every single future year to the optimal amount of spending on roads? I strongly suspect not and, in fact, VED revenues seem to be quite a lot lower than what we spend on roads anyway.[112]

Arguably revenues from National Insurance contributions is another example of hypothecation as the majority of receipts are collated in the National Insurance Fund to pay for contributory benefits – although many commentators, including the IFS, have argued that the Fund is more of an accounting exercise.[113]

Turning back to the decision to raise the main IPT rate to 10%, HMRC's tax information & impact note addressed the potential impact on households saying "the measure is expected to have a small impact on

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110 The historical debate over ear-marking taxes in this way is examined in, *Hypothecated taxation*, Commons Briefing Paper SN1480, 27 September 2011.

111 *Budget 2015*, HC 264, July 2015 para 2.145-6. See also, *Vehicle Excise Duty (VED)*, Commons Briefing Paper SN1482, 23 November 2017.

112 *Oral Evidence: Summer 2015 Budget*, HC 315, 15 July 2015 p31. The first of these points – that money is fungible – was illustrated in a piece by Stephanie Flanders, then the BBC's economics editor, on the MP expenses scandal ("Count it, don't follow it", *BBC News: Stephanomics blog*, 14 May 2009).

113 See, *National Insurance contributions: an introduction*, Commons Briefing Paper SN4517, 17 July 2017 – in particular section 2 on the NI Fund.

individuals and households purchasing insurance which is not exempt from IPT, if insurers choose to pass on the IPT rate rise to customers."[114]

In answer to a PQ about the impact on the take-up of insurance, Treasury Minister Harriet Baldwin stated, "where insurers pass on the rate increase, the increase may have a small impact on individuals and households purchasing insurance which is not exempt from IPT. This is not likely to lead to any significant change in take-up of insurance."[115]

There was relatively little press comment on this measure. The *Financial Times* reported that some insurers had anticipated the rate would rise by a full 3 percentage points. The paper quoted Paul Geddes, chief executive at Direct Line, saying, "while a further increase in IPT could be an additional increase to household finances, we are pleased that the government has committed to use the spend on flood defences, as the storms at the end of 2015 were another reminder that more needs to be done in this area."[116] The Association of British Insurers called the tax rise 'disappointing news', adding, "increased investment in flood defences is vital but should be part of core Government expenditure, not an afterthought paid for by raising taxes on people and businesses who do the responsible thing in protecting themselves through insurance. We will be examining the detail closely to ensure the revenue raised is actually spent on new flood defence schemes."[117]

Provision to set the 10% rate from 1 October 2016 was included in the *Finance Act 2016* (specifically s141). As with previous increases in the rate, a transitional period applied for insurers using the special accounting scheme. For this category, where an insurer receives premiums in respect of an insurance contract entered into before 1 October 2016, the new rate only applies to those premiums received on or after 1 February 2017.[118] This was debated on the first day of the Bill's Committee stage on 26 June. Introducing the measure Treasury Minister Harriet Baldwin argued that the impact on insurance premiums would be slight, even if insurers decided to pass on the full cost of the rate rise:

> The new standard rate of IPT will be 10% and will take effect from 1 October 2016. This change will directly affect all insurers who write premiums for general insurance. It may also affect businesses and households that purchase general insurance, if those insurers choose to pass on the additional cost of the tax on to their customers … IPT is a tax on insurers, so it is for insurers to decide whether to adjust their prices in response to this rate change.
>
> Many factors affect the cost of insurance. These include the insurer's assessment of risk, competition in the market and how well insurers' investments are performing. Insurers' costs also

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114 *Changes to Insurance Premium Tax: increase to standard rate*, 16 March 2016
115 PQ31863, 29 March 2016
116 "Flood defence spending eases insurers' pain", *Financial Times*, 17 March 2016. See also, "Budget targets insurance premiums to raise £700m for flood-hit regions", *Guardian*, 17 March 2016
117 ABI press notice, *Budget 2016: ABI reaction on IPT, lifetime ISA and CMC regulation*, 16 March 2016
118 "Clause 129: Insurance premium tax – standard rate", *Finance (No.2) Bill 2015-16: Explanatory Notes (Bill 155 EN)*, 24 March 2016

> affect pricing and, in common with other businesses, they have benefited from cuts to corporation tax. Even if insurers decide to pass on the entire impact of the rate change, this would add only about £1 to the average home and contents insurance policy and £2 to the average motor insurance policy.
>
> Increasing the standard rate of IPT by 0.5% will raise revenue to invest in flood defence and resilience, which will enable us better to protect against floods such as those we saw last winter. This clause should therefore stand part of the Bill.[119]

Speaking for the SNP Kirsty Blackman raised concerns about the prospects for further increases in the IPT rate: "although 0.5% is a fairly minor hike, if the amount continues to rise year on year there will be an additional problem for household budgets, and a negative impact every year."[120] Similarly, speaking for the Opposition Richard Burgon noted that insurance companies' concerns about future rate rises, and the cumulative impact that past increases would have had on premiums:

> This is the third increase in insurance premium tax under the current Chancellor ... This year's 0.5% increase to 10% is … comparatively smaller [than past increases]. Some insurance companies have welcomed the fact that it was not larger, but it follows hot on the heels of the previous change. The frequency of increases is picking up, and that frequency is causing concern ... Perhaps the Minister will put us straight on whether the Government expect to hold the current rate where it is after the Finance Bill, for the next five years or for just one year—or will we see a further change in the autumn statement? …
>
> The latest increase brings the standard rate of the tax up to a total of 10%, which is a doubling—a 100% increase —since 2011. Cumulatively, these three rate rises being passed on to customers would have a real impact on disposable incomes and on policy uptake. We understand that this change will have an impact on 26 million drivers and 20 million households. It will also hit 3 million pet policies and 3 million private medical policies. Our concern is that the industry will pass on this cost to its customers.[121]

In response the Minister declined to say anything as to the likelihood of future rate rises, simply saying, "I will have to give … the standard Treasury Minister answer … the Government keep all taxes under review."[122] The clause was agreed without a division.

2.5 The 2016 Autumn Statement: a 12% rate

In his Autumn Statement on 23 November the Chancellor Philip Hammond announced a new 12% IPT rate, to apply from June 2017:

> Insurance premium tax in this country is lower than in many other European countries, and half the rate of VAT. In order to raise revenue, which is required to fund the spending commitments I am making today, it will rise from 10% currently, to 12% from next June. At the same time, I can confirm the Government's commitment to legislate next year to end the compensation culture surrounding whiplash claims, a major area of insurance

119 HC Deb 26 June 2016 c114
120 HC Deb 26 June 2016 c116
121 HC Deb 26 June 2016 cc116-7
122 HC Deb 26 June 2016 c120

> fraud. That will save drivers an average of £40 on their annual premiums.[123]

At the time this was forecast to raise £520m in 2017/18, rising to £840m in 2018/19.[124] In its *Economic & Fiscal Outlook* published with the 2017 Budget, the OBR commented on the trend in IPT receipts in future years:

> Receipts from **insurance premium tax (IPT)** are expected to rise by around 33 per cent in 2016-17, as the standard rate was increased from 6 per cent in October 2015 to 10 per cent in October 2016. Receipts rise by around 16 per cent in 2017-18, reflecting another rise in the standard rate to 12 per cent in June 2017. Underlying growth in IPT receipts over the rest of the forecast is modest. Relative to November, our weaker outlook for consumer spending reduces receipts by around £0.1 billion in 2021-22 …
>
> The Government's recent announcement of a reduction in the personal injury discount rate is expected to boost IPT receipts by around £0.1 billion a year due to the knock-on effect from the lower discount rate to higher insurance premiums.[125]

The 'discount rate' mentioned by the OBR is used when calculating lump-sum awards in respect of financial loss due to personal injury. In February 2017 the Ministry of Justice announced that the personal injury discount rate would be reduced from 2.5 to minus 0.75 per cent (in inflation-adjusted real terms). [126] As the OBR explain, a lower discount rate increases the net present value of projected future flows, leading to higher awards, and that it is anticipated that the increased costs for the insurance industry, particularly in the motor sector, will be passed on in higher premiums.[127]

Draft legislation for the 2017 Finance Bill was published in December, including provision for the 12% rate, along with a series of tax information & impact notes (TIINs) on the measures set out in the Bill. In the case of IPT, the 'TIIN' gave details of HMRC's assessment of the impact of the new rate …

> **Economic impact** The changes to IPT will have a small positive impact on Consumer Price Index inflation. The costing is adjusted for behavioural responses resulting from any change associated to prices of general insurance products. It also takes into account a small reduction in the demand for standard-rated insurance and a small increase in tax planning activity by insurance companies.
>
> **Impact on individuals, households and families** The measure is expected to have a small impact on individuals and households purchasing non-exempt insurance if insurers choose to pass on the IPT rate rise to customers. The measure is not expected to impact on family formation, stability or breakdown.

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123 HC Deb 23 November 2016 c907

124 *Spring Budget 2017*, HC 1025, March 2017 p28 (Table 2.2 – item g).

125 OBR, *Economic & Fiscal Outlook*, Cm 9419, March 2017 para 4.83

126 For more details see, *Motor car insurance: premiums and fraudulent claims,* CBP6061, 1 December 2017 (see Section 3: The discount rate).

127 *Economic & Fiscal Outlook*, Cm 9419, March 2017 p96 (Box 4.2). see also, "Insurers hit as ceiling for personal injury claims is raised" & "Why are UK car insurance premiums set to soar?", *Financial Times*, 27 February & 2 March 2017.

> **Equalities impacts** This measure will not impact on those disabled people who are eligible for the Motability Scheme as insurance for vehicles provided under the scheme is exempt from IPT. No other impacts affecting those sharing other protected characteristics have been identified.
>
> **Impact on business including civil society organisations** This measure is expected to have no administrative impact on businesses purchasing insurance which is not exempt from IPT, but the cost of purchasing insurance may rise, if Insurers choose to pass on the IPT rate rise.
>
> There are in the region of 1,000 insurers in the UK who will incur one-off costs in updating their systems to apply the new tax rate. The government expects this additional burden to be negligible. This measure is expected to have no ongoing administration burdens.
>
> Insurers, brokers and agents will have to change the details of their contracts but by allowing a delay to 1 June 2017 before the full impact of the rate rise is felt, the impact of this will be minimised.

… and explained that the new rate would apply to all premiums from 1 June 2018, regardless of when the commencement of cover begins under the contract:

> Legislation will be introduced in Finance Bill 2017 to amend section 51(2) of FA 1994 to change the standard rate of IPT to 12%. The new standard rate will be due from 1 June 2017 on premiums received on or after 1 June 2017 which relate to risks for which the period of cover under the terms of an insurance contract begins on or after that date.
>
> There will be a backstop date of 1 June 2018 from which all premiums received will be subject to the increased standard rate of IPT regardless of whether they are received in respect of new or existing risks and regardless of when the cover for those risks begins under the contract.
>
> The anti-forestalling provisions will be reviewed and any changes will be announced at Budget 2017.[128]

Subsequently in Budget 2017 the Government confirmed that these anti-forestalling provisions would be amended accordingly.[129] Provision with regard to both of these measures was included in the *Finance Bill 2017* published after the Budget.[130]

Following Mr Hammond's statement, the insurance industry was strongly critical of the proposed rate rise. Director General of the Association of British Insurers Huw Evans argued the 12% rate would "hit consumers and businesses alike, hurting those who buy business, motor, property, pet and health insurance. It marks a doubling of Insurance Premium Tax since last year and to claim a consultation on whiplash reforms which hasn't even gone before Parliament yet will

128 HMRC, *IPT increase of standard rate – TIIN*, 5 December 2016; see also, HMT, *Overview of Tax Legislation & Rates*, March 2017 para 1.27

129 HMRC, *IPT: anti-forestalling – TIIN*, 8 March 2017. It was not anticipated that this measure would have an Exchequer impact.

130 These provisions now form ss17-18 of the Finance Act 2017.

offset this just won't cut it."[131] Subsequently the ABI published comparative data on IPT rates across EU countries to illustrate the relative tax burden on insurance purchased in the UK.[132] The *Financial Times* cited estimates by the consultancy Deloitte that the new rate would "cost a family with a house and two cars an extra £21 per year, leaving them with a total annual IPT bill of £126. Before the first of the recent increases, which took effect last October, Deloitte says that the annual bill was £63."[133] The *Times* reported concerns from the Motor Insurance Bureau (MIB) and the AA that the rise would lead to more drivers being uninsured, particularly younger drivers:

> Ashton West, chief executive of the MIB, [said] "We believe our efforts in recent years to tackle the problem [of uninsured drivers] have made a real difference. Now that progress is being undermined. Ultimately, the bill for uninsured driving is paid by all honest motorists who fund the compensation for thousands of victims each year who are involved in accidents caused by uninsured drivers." …
>
> Ian Crowder of the AA said: "Insurance premium tax disproportionately penalises those who pay the highest premiums — typically young drivers who are least able to afford the first premium for their first car, which could be £2,000 or more. The tax burden on such a driver will be about £240 … We fear the hike in IPT will be the last straw for many young drivers who will choose not to bother about cover. The number of uninsured cars will rise and the cost to the industry will increase, thereby pushing premiums up further."[134]

Similarly the *Guardian* quoted Amanda Blanc, group CEO of AXA, as saying, "the affordability of insurance is being fundamentally threatened. The country is already underinsured and ever rising insurance taxation could have the unintended consequence of making this situation even worse."[135]

In its presentation on the Autumn Statement, Paul Johnson, director of the Institute for Fiscal Studies, was critical of the Chancellor's case for raising the IPT rate:

> Mr Hammond wasn't guilty of too many fiscal infelicities yesterday, but the way in which he announced the increase in IPT was certainly one of them. It is half the rate of VAT, he said, as if in explanation of the rise. Well, so it should be - in fact it should be lower. It's only the value of the insurance – premiums net of pay outs – which one should think of as being VATable. That would imply an IPT rate much less than 10%, not more.[136]

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[131] ABI press notice, *"A hammer blow for the hard-pressed" - insurers reveal impact of Autumn Statement IPT rise on policies*, 23 November 2016

[132] ABI press notice, *UK now has sixth highest Insurance Premium Tax in Europe*, 25 November 2016

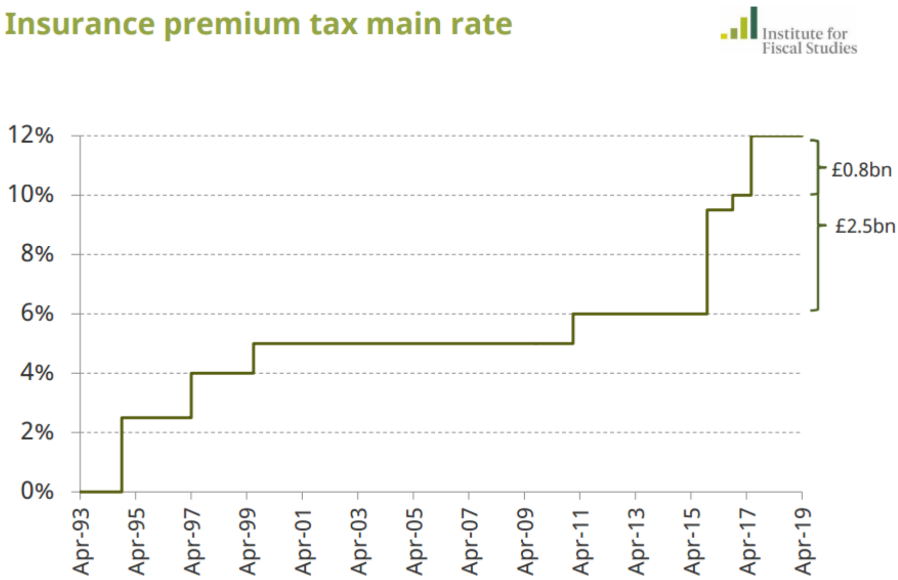
[133] "Insurers angered by premium tax increase in Autumn Statement", *Financial Times*, 23 November 2016

[134] "Hamstrung Hammond hits insurance again", *Sunday Times*, 27 November 2016

[135] "Insurance premium tax is increased again in autumn statement", *Guardian*, 23 November 2016

[136] "Paul Johnson's Opening remarks", *Autumn Statement 2016 : IFS briefing*, 24 November 2016

In his presentation on tax and benefit reforms in the Autumn Statement, IFS economist Stuart Adam, chartered the increases in the rate of IPT since the introduction of the tax …



… before making the case that without a major reform to the way insurance was taxed, the rate of IPT should remain much lower than the standard rate of VAT:

> **Insurance is exempt from VAT; IPT intended to substitute for it**
>
> **Ideal: tax premiums less payouts (and other costs) at the main VAT rate**
>
> - Exclude business users (or allow them to reclaim IPT paid)
> - Mirrlees Review shows how this can be achieved
>
> **If taxing premiums alone, rate should be much lower than VAT rate**
>
> - Appropriate % of VAT rate = value added / premiums
> - 12% (60% of VAT rate) surely too high
>
> **Business use of insurance should be completely untaxed**
>
> - Or make tax reclaimable – like can reclaim VAT paid on inputs
> - IPT skews economy away from production involving insurance
>
> **Problems with IPT much more severe with 12% rate than 2½% rate!**[137]

The Mirrlees Review of the UK tax system, mentioned by Mr Adam, was published by the IFS in 2011.[138] One chapter looked at the case for applying VAT to financial services, currently VAT-exempt, noting that

137 "Tax and benefit reforms," *Autumn Statement 2016 : IFS briefing*, 24 November 2016 (slides 6,7)

138 For more details see, Treasury Committee, *Principles of Tax Policy*, 15 March 2011, HC 759 of 2010-12

one solution, taxing cash flows, could apply "not only to simple bank deposits and loans, but also to insurance and to more sophisticated financial products."[139] Paul Johnson reiterated the case for reforming this aspect of VAT in the context of the UK's decision to leave the EU in a piece for the *Times* in December

> As a financial service, insurance is exempt from VAT. The EU gives us no choice on that. That means that there is no VAT on the purchase of insurance but also that insurance providers cannot reclaim VAT paid on any inputs they buy in the normal way — a cost they will largely pass on to their customers. That's why exemption (as opposed to zero rating, where VAT on inputs can be reclaimed) is so damaging.
>
> Exemption distorts commercial decisions, such as whether to purchase inputs or produce them in-house, and often creates phenomenal levels of complexity. Exemption also means that financial services are cheaper than they should be for households, relative to a world in which VAT is applied at the normal rate, and more expensive than they should be for firms, which ought to be able to claim back any VAT incurred in the production of the service. Anything produced by firms that use financial services will have irrecoverable input VAT built into the price on top of the usual 20 per cent VAT.
>
> IPT was introduced to compensate for the VAT exemption of insurance. Without IPT households would be paying too little for insurance and firms too much. Broadly, the "correct" tax on insurance for households would be 20 per cent of the difference between premiums and payouts. Since IPT is levied on premiums alone, that would roughly equate to a low single-digit tax rate. So a 12 per cent tax on premiums is much higher than the appropriate rate on households, let alone on businesses which were being overtaxed on their use of insurance even before IPT was introduced.
>
> All of that would have been true even in the absence of Brexit but what makes it so much worse is that freed of the constraints imposed by membership of the European Union we actually have an opportunity for a fundamental reappraisal of the way in which we tax financial services, including insurance. This is not an easy task. It is hard to apply VAT, or something that does same job as VAT, to services whose value is not measured by how much you actually pay for them, as is the case with bank accounts and loans, for example. But it is not impossible to design an appropriate system, and a number of options do exist.[140]

Mr Johnson also raised these concerns when he gave evidence to the Treasury Select Committee on the Autumn Statement.[141] In a later session George Kerevan asked the Chancellor why he had decided to use IPT as the means to raise extra revenue:

> **George Kerevan:** As a result of the Autumn Statement, insurance premium tax will have effectively doubled in 20 months. It is a highly regressive form of taxation. Is the increase of that tax

139 "Chapter 8: VAT and financial services", *Tax by Design: the Mirrlees Review of the UK tax system*, 2011 p199
140 "We must seize the chance to rewrite Britain's tax rules", *Times*, 13 December 2016
141 Treasury Committee, *Autumn Statement: Oral Evidence* , HC837, 29 November 2016 see, Qs41-9

simply because you needed the revenue, or was there some specific reason to light on IPT?

Mr Philip Hammond: I was very clear in the Autumn Statement. Perhaps I was not clear enough. I said explicitly because we need to raise revenue to fund the commitments that I will be making today, because we have made a decision that non-capital spending commitments would all be fully funded, I needed to raise insurance premium tax further. I accept that that imposes a burden on insurers. Whether they choose to pass that burden on to their customers will be a marketplace decision for them. It probably is worth noting that the impact on household budgets is very small, because the proportion of household budgets spent on insurance is very small, and is smaller at the lower end of the income distribution than at the higher end, for obvious reasons ...

George Kerevan: In the Autumn Statement you seemed to try to justify randomly raising this tax because it is the one you can raise, if I have interpreted you correctly, with reference to VAT. You seem to suggest that the 12% tax measures quite well compared with a 20% rate of VAT on other kinds of products and services.

Mr Philip Hammond: I simply pointed out that insurance premiums are not subject to value added tax, and people should bear that in mind, as they should when looking at APD on air travel. That also is not subject to value added tax. It is something that people ought to bear in mind when looking at the tax position of a given product area in the round …

George Kerevan: But in fact this is a sales tax ...

Mr Philip Hammond: It is no more a sales tax than corporation tax on a manufacturer is a sales tax on his product.

George Kerevan: The revenue consequences are equivalent if it had been a sales tax. Whereas if it was VAT, the VAT would be levied not on sales but on the difference between what the consumer pays on their premium and what is paid out. Even if you charged 20% on that, the net return to the Treasury would be less than you are going to get with the 12% that you are posing on the insurance premiums themselves.

Mr Philip Hammond: I understand the difference between a specific tax and a value-added-tax type structure. I am not sure that I agree with the calculation of what a value added tax on insurance premiums would look like. It is notorious that it would be very difficult to construct one, but there are a number of elements in the business model of an insurer that would need to be taken into account. It goes a little bit wider than just premium income versus claims paid out. There is also the timing differential between receipt of premiums and payment of claims, which of course is not an insignificant part of the insurer's business model.[142]

Following the Autumn Statement, the impact of the 12% rate on consumers, and the possibility of reducing the burden of the tax on charities, was raised a few times in PQs; for example,

Asked by Phil Boswell : To ask Mr Chancellor of the Exchequer, what plans he has to assess (a) trends in the incidence of people purchasing insurance coverage and (b) levels of insurance

[142] *Autumn Statement: Oral Evidence* , HC837, 12 December 2016 see, Qs351-7. The timing of the 2017 General Election meant that the Committee did not publish a final report on the Autumn Statement.

coverage purchased after the rise in insurance premium tax announced in the Autumn Statement 2016.

Answered by: Jane Ellison : The Government does not have any plans to carry out such an assessment. Trends and the levels of insurance purchased are subject to a number of influences. These include the price of insurance. Price is set by insurers and is subject to a wide range of factors, of which tax is just one part. Other factors include inflation, changing assessment of risk, the performance of insurers' investments and costs. It is therefore difficult to isolate and then analyse the impact of any one of these factors.

The Government has no evidence to suggest that this level of change to Insurance Premium Tax will lead to changes in the number of uninsured vehicles. The estimated number of uninsured vehicles in the UK has fallen from 2 million in 2005 to 1 million today.[143]

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Asked by Danny Kinahan : To ask Mr Chancellor of the Exchequer, what estimate he has made of the effect on the household income of UK citizens of increasing insurance premium tax from 10 to 12 per cent.

Answered by: Jane Ellison : Insurance Premium Tax is a tax on all general insurance. It is paid by insurers and it is up to insurers to decide whether to pass on any tax paid.

If insurers choose to pass on the full cost of the rate rise this would increase the average household's spending on insurance by £18 per year. This is calculated using data from the Office for National Statistics. This takes into account the fact that only a third of households have two cars and only 11% of the population have medical insurance.[144]

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Asked by Dan Jarvis : To ask Mr Chancellor of the Exchequer, whether he has considered setting a special rate of insurance premium tax for charitable organisations.

Answered by: Jane Ellison : Insurance Premium Tax (IPT) is a tax on the insurer, and there is no obligation to pass the increase on to the customer.

All tax policy is kept under review, however, it would be challenging to implement an exemption for insurance purchased by any specific group. Any such legislation would be very difficult for insurers to implement since this would require them to differentiate between customers who were buying the same type of insurance products.

Charities are a vital part of our society and the Government continues to support them and their donors, including through tax reliefs worth over £5 billion in 2015-16.[145]

Subsequently in the Spring 2017 Budget the Government confirmed its plans to set at 12% IPT rate, although the Chancellor did not mention this tax increase in his Budget speech.[146] In general most commentary

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[143] PQ55820, 6 December 2016
[144] PQ58349, 9 January 2017
[145] PQ67024, 13 March 2017. See also PQ59661, 18 January 2017
[146] *Spring Budget 2017*, HC 1025, March 2017 para 3.38

on the Budget focused on other issues, such as the proposal to increase the rates of National Insurance contributions paid by the self-employed – a decision that the Chancellor reversed a few days after the Budget statement,[147] although related concerns about the cost of car insurance for young people have continued to be raised in the House.[148]

As noted above, provision to set the 12% rate, and amend the anti-forestalling provisions, was included in the *Finance Bill 2017* published on 20 March (specifically, clauses 58 & 59). Following the Prime Minister's announcement, on 18 April, of the Government's intention to call a General Election on 8 June, the House completed all of the remaining stages of the Bill in the Commons on a single day, 25 April, and the *Finance Act 2017* received Royal Assent on 27 April. With cross-party support the Government removed a series of clauses from the Bill, with the intention of legislating for these at the start of the new Parliament, but this part of the Bill was retained, and now forms ss17-18 of the Act.

On this occasion Treasury Minister Jane Ellison summarised the changes to be made to IPT as follows:

> Clause 58 legislates for the increase in the standard rate of insurance premium tax from 10% to 12% as the Chancellor announced in the autumn statement 2016. This change will be effective from 1 June this year. Clause 59 will make minor changes to anti-forestalling provisions, so that insurers cannot artificially avoid paying the new rate of insurance premium tax by adjusting contract dates.[149]

George Kerevan asked Ms Ellision if she would "justify why the Government are proposing this third increase, which actually increases the rate by 20%—well above the rate of inflation." In response the Minister said:

> The Government have worked to eliminate the deficit and to invest in Britain's future … By increasing insurance premium tax, we will ensure that we can maintain the balance between that investment and controlling the deficit ...
>
> IPT is a tax on insurers. They are not in any way obliged to pass on the tax through higher premiums. However, if insurers do choose to pass on the increase, it will be spread thinly across a wide range of people and businesses. In line with the informal agreement between the Government and the Association of British Insurers, firms have been given more than six months' notice, which gives time to implement the change. The agreement aims to give insurers proper warning of a rate change and to ensure that the correct rate of tax on a policy is known when the policy is arranged.
>
> The changes made by clause 58 will raise approximately £840 million each year to reduce the deficit, while ensuring that we can fund spending commitments. That really is the answer to the

[147] *Spring Budget 2017: a summary*, Commons Briefing paper 7919, 17 March 2017
[148] There have been two debates over the last year: HC Deb 20 March 2017 cc221-52WH & HC Deb 5 March 2018 cc24-40WH. See also, the Library briefings prepared for these debates: *Cost of car insurance for young people*, CDP2017-88, 16 March 2017; *Motor insurance: car or driver?*, CBP8241, 1 March 2018.
[149] HC Deb 25 April 2017 c1030

> intervention by the hon. Member for East Lothian (George Kerevan). Insurance premium tax is a tax on insurers, not consumers. It will be insurance companies' choice whether to pass on the 2% rate increase. Even if the increases were passed on in full, the impact would be modest, costing households less than 35p a week on average.[150]

In the event the provisions were agreed, unamended, without a division.

Following the introduction of the new 12% rate, there has been some mention of the impact this may have on consumers, particularly young drivers. In October the Social Market Foundation published a paper on the tax which argued that successive increases in IPT rates had been implemented "despite a lack of published evidence around its impact on consumer behaviour and household finances, especially with respect to the distributional consequences of changes in [the tax]":

> IPT is a regressive form of taxation; lower income households spend a greater proportion of their disposable income on insurance (excluding IPT-exempt life insurance) than the richest households.
>
> Despite the scale of the increases in IPT observed, survey analysis undertaken as part of this research suggests a significant lack of awareness about the existence of the tax. [Survey research undertaken as part of this study] … of 2,000 adults showed about half (48%) of individuals unaware of the existence of IPT – significantly higher than any of the other taxes and duties we asked them about.[151]

Commenting on the report the ABI's Director General, Huw Evans, said "having doubled this tax in two years, it is time for the Government to stop raiding the responsible and commit to no further increases in this Parliament."[152]

In November Nigel Evans tabled an EDM which suggested that "a further rise in IPT would effect those people least able to pay increased insurance costs such as young drivers", and called on the Government "to freezing the rate of IPT for the rest of the 2017 Parliament in Budget 2017."[153] Mr Evans also raised this issue in PQs; for example:

> **Asked by Mr Nigel Evans** : To ask Mr Chancellor of the Exchequer, what assessment he has made of the potential effect of a rise in insurance premium tax on the affordability of motor insurance for young drivers.
>
> **Answered by: Mel Stride** : Insurance Premium Tax (IPT) is a tax accounted for and paid by insurers based on the insurance premiums they receive. Pricing is a commercial decision for insurers, affected by a wide range of factors, such as repair costs, investment returns and risks posed. The taxes that they pay are only one of these factors.[154]

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[150] HC Deb 25 April 2017 cc1031-2

[151] Social Market Foundation press notice, *Insurance premium tax now raising equivalent of £179 for each UK household*, 30 October 2017

[152] ABI press notice, *ABI comments on SMF report on impact of IPT*, 30 October 2017

[153] EDM 543 of 2017-19, 15 November 2017. 17 Members have signed this to date.

[154] PQ112367, 15 November 2017. See also, PQ4505, 17 July 2017 & PQ7657, 12 September 2017.

However, the Chancellor made no reference to the tax in his Autumn Budget on 22 November, and Ministers have not made any public commitments regarding the rates of IPT since then. In an opinion piece on the prospects for tax changes affecting the industry in 2018 the ABI's David Jordonson noted, "IPT was the dog that didn't bark in November's Budget, but whether this is a rethink or more likely a pause is uncertain – despite the standard rate being doubled within two years, it's too early to call time on further increases, and the ABI will advocate accordingly."[155]

[155] "Tax: What to expect (or not) in 2018", *ABI blog*, 31 January 2018

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