IPT – don't take the rise

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Chancellor George Osborne's decision in his July Summer Budget to increase the basic rate of IPT came as a surprise to most in the insurance industry. They were surprised both that it went up and also that it went up by so much – from 6% to 9.5%, or by more than half.

Since then, we have heard the occasional grumbling from across the general insurance sector, and perhaps especially from medical insurers but, so far as the man or woman in the street is concerned, this is a done deal and if their insurance premiums go up a bit well, isn't that what happens with insurance anyway?

In this article I want to look at four things:

1. Was the rise really so unexpected?
2. Where might the rate of IPT end up?
3. Will IPT be removed from health insurance and/or will it be applied to long term protection insurance?
4. What should or could insurers do now?

1. Was the rise really so unexpected?

It was not that long ago that the ABI (Association of British Insurers) regularly reminded the Chancellor just before every Budget that insurance was a positive benefit to UK plc, that the industry was working hard to keep costs down and that other territories charged less tax anyway. In short, 'hands off' was the message.

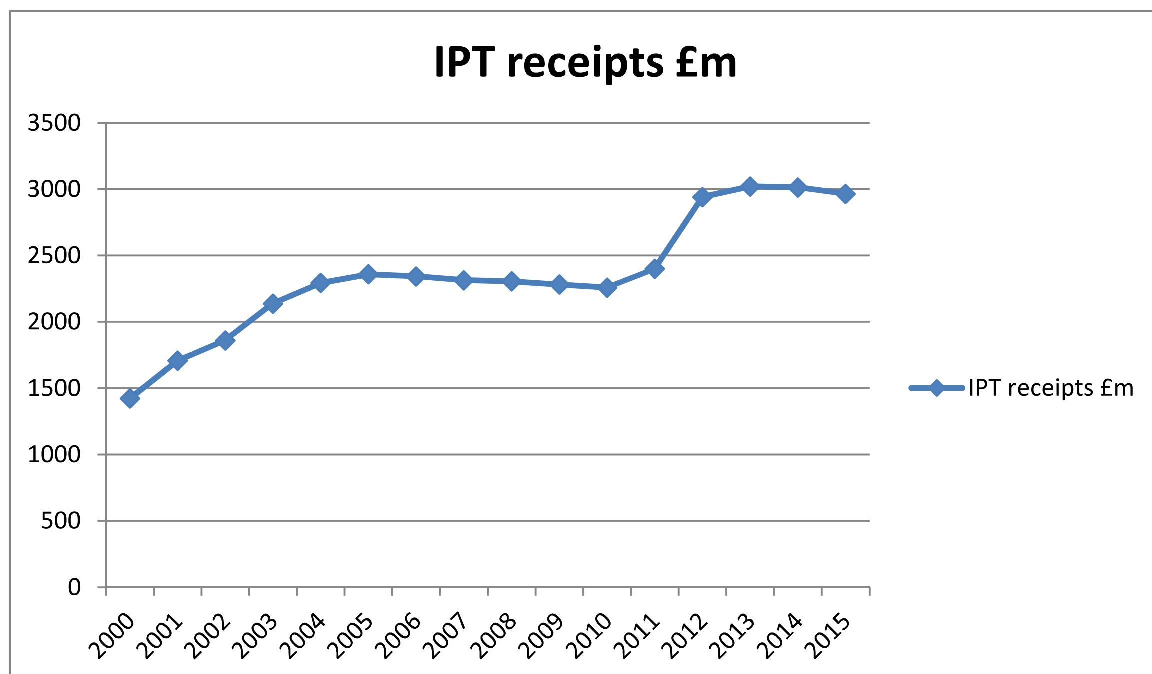
It seemed to work. OK the tax originally started back on 1 October 1994 at just 2.5% but most years it was left alone. Here's how it developed from 1994:

- On 1 April 1997 the standard rate went up from 2.5% to 4%. At the same time a new higher rate of IPT was introduced and that was set at 17.5%. It applied to certain types of insurance arranged through certain suppliers of other goods and services. So, travel insurance as part of your holiday package attracted the higher rate of tax. Although the rate of IPT was the same as that for VAT, you could not reclaim it if you were VAT registered.
- From 1 August 1998 the higher rate was extended to all taxable travel insurance, regardless of the type of supplier.
- On 1 July 1999 the standard rate was increased from 4% to 5%.
- On 4 January 2011, the standard rate was increased from 5% to 6% and the higher rate from 17.5% to 20%.
- From 1 November 2015 the standard rate will rise to 9.5% on new policies, with transitional rules applying to existing policies yet to renew.

IPT is an important tax to the Government, raising over £2 billion a year. It applies equally to individuals and businesses and other organisations.
To put some numbers on it, in 2014/15 total HMRC tax receipts were £477.767bn (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/461726/Jul15_Receipts_Bulletin_v1.pdf). Of that, £2.965bn came from IPT (it peaked in 2012/13 at £3.021 billion). Since 1999/2000 the tax take from IPT has roughly doubled. It raises more income than all betting and gaming taxes (£2.116bn in 2014/15) and in future should overtake all customs duties (£3,007bn), spirits duties (£3.023bn), beer duties (£3,310bn) and air passenger duty (£3.175bn).

It now makes up around one half of one percent (0.62% in 2014/15) of all tax receipts but putting the standard rate up from 6% to 9.5% will bring it closer to 1%. Moreover, despite the economic issues from 2008, IPT receipts have been a consistent performer, so it's a reliable source of income for the Government too:

Table 1. IPT receipts £m. Tax year ending end April.



For big firms, the rate of IPT is a factor when considering whether to tie up their own capital in meeting insurable claims or the capital of insurers and reinsurers. Some products, such as alternative

risk transfer vehicles, effectively avoid IPT, although the main reason for their use is in optimising capital management rather than as tax avoidance.

In the health insurance space, ABI data shows that at the start of 2015, there were some 707,000 subscribers for UK healthcare trust schemes, covering 1.23 million people. Using such a trust primarily to avoid tax would negate the use of the trust but IPT is clearly a factor (although any stop loss insurance to reduce the risk does attract IPT). HMRC still benefits from the P11D tax charge on employees for the benefit and receives NICs too so it appears to be fairly relaxed about 'losing' IPT income too (straws and camels backs…).

We have also seen the growth of large corporate deductible schemes. Here the customer – usually a large group PMI scheme – works out that its PMI scheme is costing say £1.2m a year. It could decide to 'self-insure the first £1m of claims, effectively through the use of a large deductible, and then pay an insurer both to manage those claims and to cover the whole risk above £1m a year. There are more sophisticated variations available but that is the essence. The bottom line is that the employer pays a lot less IPT, still covers the risk of excessive claims in any year and even gets VAT back (if it qualifies) on the fee the insurer charges to manage the non-insured claims. The concept has been slow to take off, but that could change from November.

To date though, many customers have probably seen IPT as an irritation rather than as something to try to avoid. Could that change with such an increase in the tax?

2. Where might the rate of IPT end up?

To answer that question we need to know three things:

- What do we think it could go up to?
- What do other countries do?
- What are current and future Chancellors likely to think and do?

Anecdotally, most people I spoke to seem to think the tax could rise ultimately to 20%. There is a sort of logic to that – VAT is at 20% and individuals and those not VAT registered have to pay the whole 20%. But that logic is deeply flawed – and there is no guarantee 20% would be the upper limit anyway (as some other countries' tax rates illustrate).

Evidence to date seems to suggest that both individual consumers and employers haven't really taken on board yet what the effects of the IPT rise will be. Some insurers have promised to absorb the tax too - a noble gesture but one that suggests insurers are making too much money and so can afford to do so. That could come back to bite us…

The ABI's own data suggests the rise to 9.5% IPT will cost of the average householder £9.48 a year on their household insurance (combined buildings and contents) and £12.25 a year on the average comprehensive motor insurance policy. Hardly likely to break the bank is it?

But any rise in IPT changes the sometimes delicate balance of when it makes sense to insure and what to insure for. So, if IPT is very low, a health cash plan or dental insurance can be ideal as a form of budgeting for everyday health bills. If IPT were to take up a fifth of the premium payable however, customers may decide simply to budget for themselves and either cancel existing policies or at least not take out new ones. The knock-on effects could include people avoiding necessary health treatments, more work for the NHS and possibly lower productivity at work too.

What other countries do is interesting and complex. We contacted both the ABI and HM Treasury to find out what other countries do. ABI no longer keeps a central record of other countries' IPT equivalent rates, but referred us on to Insurance Europe.

Insurance Europe monitors tax rates and policy adviser Richard Mackillican referred me to its 104 page March 2015 publication *Indirect taxation on insurance contracts in Europe (see* http://www.insuranceeurope.eu/indirect-taxation-booklet).

The report also revealed that tax changes for this year's publication came from Denmark, Finland, France, Germany, Greece, Italy, Malta, Netherlands, Poland, Portugal, Slovenia and Spain so this is clearly an area where many governments are looking to introduce reforms. The table below shows some of the taxes payable. Tax can be complex, so this is very much a simplified table, but we have added notes where they are especially pertinent to life or health insurances. The table also focuses mainly on Western European countries and only the larger territories. Additional taxes and exemptions may also apply – the detail on a country can run to some pages in the Insurance Europe publication and even that is just a summary.

Table 2. Premium taxes in 15 major Western European Countries, 2015

Country	Life	Health	Accident	Motor
Austria	4%/11%	1%	4%	11%
Belgium	2%	9.25%	Varies	9.25%
Denmark	Exempt	1.1%	1.1%	42.9%
Finland	Exempt	Exempt	Exempt	24%
France	Exempt	7%	9%	18%
Germany	Exempt	Exempt	19%	19%
Greece	Exempt	10%	10%	10%
Ireland	1%	3%	3%	Exempt
Italy	Exempt	2.5%	2.5%	12.5%
The Netherlands	Exempt	Exempt	Exempt	21%
Portugal	Exempt	5%	5%	9%
Spain	Exempt	Exempt	6%	6%
Sweden	Exempt	Exempt	Exempt	32%
Switzerland	Exempt	Exempt	Exempt	Exempt
UK	Exempt	9.5%	9.5%	9.5%

Source: www.insuranceeurope.eu.

Notes:

1. In Austria life insurance tax is usually 4% but can be 11% for some types of policy e.g. term insurances over 15 years (10 years for older lives) and unit linked policies.
2. In Belgium non-individual life policies are subject to tax at 4.4%.
3. In Greece, life policies with a term less than ten years are subject to 4% tax.
4. In Switzerland, some life insurance policies are subject to a 2.5% premium tax.
5. For the UK, the new IPT rate is shown.

We also contacted HMRC, whose VAT deductions & financial services policy adviser made the point that: "IPT is a UK tax and so each EU country may or may not have an equivalent tax of their own, also there may be significant differences especially in the definitions of what constitutes a type of insurance so it is hard to compare anything accurately and with authority."

She also listed countries that apply a premium tax to income protection (permanent health insurance) policies. These include:

- Austria 1%.
- Cyprus: policies are subject to stamp duty.
- France 14%.
- Greece 10%
- Ireland 3%.
- Romania 0.3%
- Slovenia 8.5%

That is a concern if the Government is wondering whether to make IP premiums subject to IPT. Impossible? Read on.

We also found helpful information on IPT type taxes at https://crystal.lloyds.com. These relate specifically to Lloyd's contracts and so may be different for insurance written outside of Lloyd's.

3. Will IPT be removed from health insurance and/or will it be applied to long term protection insurance?

Reference to the above shows that answering the apparently simple question: 'What IPT rates apply in other European countries?' is far from straightforward. Our summary does however highlight a number of issues or potential issues for insurers:

- Most European countries apply a premium tax broadly equivalent to the UK's IPT.
- Rates vary from (taking motor insurance as an example) being exempt up to 42.9%.
- The IPT equivalent rate can vary considerably between contract types. As a general rule, life and health policies are most likely to be exempt, and motor insurance is likely to be taxed highest – but there are wide variations.
- Some countries apply a range of taxes. We have not been able to show the effects of all of these in Table 1. In the UK for example, an employee may have to pay income tax and NICs on the premium their employer pays, which itself is subject to IPT. In effect therefore tax is being charged on tax as well as on the risk premium.
- Based on what other countries do, a strong case can be made to continue the exemption from IPT that life and other long term protection insurance policies are subject to.
- One particular risk is income protection. Superficially, it resembles short term ASU (accident, sickness and unemployment) type policies such as the now much loathed payment protection insurance (PPI). The two types of contract are very different, but the argument to keep IP exempt from IPT is not helped by ASU insurers calling their policies 'income protection' too. The industry needs to ensure that people outside the industry know what the differences are and why they're important – an argument long put very eloquently by the Income Protection Taskforce (IPTF) for example. See www.iptf.co.uk for more.
- Again based on what other countries do, a strong case can be made for making health and accident insurance premiums exempt or subject to a much lower rate of IPT can be made.
- The worst case scenario would be for life (including IP and CI) policies to lose their exemption and for all policies to be subject to an even higher rate of IPT, with no certainty that the tax need stop rising if it were to reach 20%.

The Chancellor cited other European countries as part of the justification for raising the rate of IPT from November. Without examining that in detail, it is not easy to rebut that sentiment – I cannot recall any major press articles that tried to do so, for example.

The ABI's director general, Huw Evans, did say on 8 July: "Insurance Premium Tax is a tax on people and businesses at the point at which they buy a general insurance product. So it's very disappointing to see a more than 50% tax increase being imposed on consumers, especially when the insurance industry and the Government has worked so hard in recent years to bring down the cost of essential insurance."

He's right but, that argument can be turned round too – because insurers have been successful in keeping costs low, it is only fair that financial services providers (note my switch so that insurers can now be grouped along with banks – something the Chancellor also did back in July) help contribute to repair the damage their industry caused in the past. Unfair? Wasn't it the banks that screwed the economy in 2008? Yes, but weren't the insurers responsible for PPI, for endowment and pensions misselling and for rejecting 20% of critical illness insurance claims before they were shamed into taking action to halve that rate? I'm playing Devil's advocate, but you take the point.

Remember the floods of 2007? They badly affected parts of Gloucestershire, where I live. Insurers paid out more in VAT on the claims they settled than the Government gave the regions most affected by the floods, yet the perception is that the Government helped flood victims, while insurers did everything they could to unfairly reject claims from their policyholders. Unfair? Yes again, but it does illustrate the importance of getting your PR and lobbying right – something the insurance industry hasn't always done in the past (and my colleague Kevin Carr is your guru on PR and our friends at Cicero can help you on lobbying!).

4. What should or could insurers do now?

There are two aspects to answering this question:

- What actions should insurers take now?
- What product design changes and trends can we expect to see in future?

The first of these is probably the most important issue to address now. First, we have to accept that IPT is going up to 9.5%. That will happen and insurers must make sure they comply with what is not that simple an exercise.

Second, collectively and individually insurers need to influence the policy agenda. This could include:

- Lobbying to prevent or restrict any future rises in IPT.
- Lobbying to keep the exemption that long term protection insurance policies and especially income protection currently have.
- Lobbying to secure an exemption for health and accident insurances.

The first two are political objectives and others are much better placed than me to suggest how best to do that. Again, Cicero and other similar organisations can doubtless help if you want to know how best to do that! Certainly, we need to get behind our industry representatives such as the ABI and IPTF to ensure that policymakers are aware of the arguments and are not tempted to introduce a poorly thought out adverse tax change with little or no warning. Any public announcement is invariably too late, so action needs to be taken now. Initiatives such as Seven Families

(www.7families.co.uk) are also illustrating that IP is not just about money, it is just as much about the help and support insurers can (and do) give to help customers get back to work. Industry initiatives such as the Vitality programme also illustrate how insurers can influence customers not becoming another claims statistic in the first place too.

The third is also political but it requires us to make an even stronger case I would suggest. HM Treasury is very much against tax exemption creep – it does not accept the clever arguments often put to it that it would actually save the Government money if it were to reduce tax or to give tax benefits to certain actions.

But it may be more likely to be influenced by the fact that many other countries do apply an exemption to certain types of policy. This can get tricky politically – no UK Government wants to be accused of being disloyal to the NHS and, giving a tax break to the 'better off' to subsidise them opting out of the overcrowded and under press NHS, is a sure-fire vote loser.

But a case can be made for employers buying such policies to ensure they maintain or improve their competitiveness, and that neatly bypasses the 'them and us' NHS arguments. So, where PMI, a health cash plan and/or dental or accident insurance is part of a wider employee benefits package, then a case can be made that the wider economy will benefit by supporting those employers who act responsibly by looking to insure against such risks. A sub-benefit of that is that the potential growth of IPT avoidance schemes (including healthcare trusts in this context it could be argued) is curtailed.

Such exemptions could apply to all employers, including the self-employed. Extending further to older, retired people, especially those who may have enjoyed PMI cover when they were working, could also be workable, especially if the savings generated (e.g. to the NHS) can be identified and ploughed back into investment to benefit the whole community.

The second part of the question assumes that IPT will continue to be high and could even go higher. We have already considered healthcare trusts and other forms of self-insurance, including large corporate deductibles. The case for all such arrangements simply becomes ever more compelling, the higher the rate of IPT. Moreover, such schemes will start to cascade down to smaller firms too. There can be dangers in that if the risk pool is too small for example, but stop loss and contingency insurances can help mitigate such risk – or else small businesses (typically) simply find out the hard way if it all goes pear shaped.

Other actions insurers might see or could encourage include:

- Encouraging customers to self-insure more of their risks. That can include having an excess (or increasing an existing one) and optimising cover so that only unacceptable losses would be insured. For example, a customer may choose to have a basic PMI policy that excludes outpatient treatment or has a high excess.
- Separating the insurance risk element of a product from the non-insurance risk. For example, a customer could pay say a risk premium of £1,000 a year for their PMI cover. Or they could be offered a policy that only costs £800 a year plus they would pay £200 a year for club membership benefits. VAT can be an issue (but maybe not to VAT registered businesses) and HMRC would inevitably jump on unfair cross-subsidies, but there is no reason why your £100 or whatever a month to Bupa or AXA PPP all has to go into an insurance policy. The growth of policy add-ons – where utilising the benefit is not necessarily linked to any insurance event - is clear evidence that the insurer/customer relationship is slowly changing for the better and becoming more service rather than purely financially

orientated. Pure (money only) ‘insurance’ can be part of the solution but increasingly it is not the whole solution.

- Lobbying for tax breaks on health and welfare savings. The Fortune Account concept, devised many years ago by the Adam Smith Institute, is rightly gaining ground as a potential solution to the need to encourage people to both save and to insure.
- Increasing the number of non-financial benefits included in what we now call a policy of insurance (should we no longer even call it insurance?).
- Changing policy benefits over time to better reflect people’s needs and budgets as they get older. For example, why do PMI policies still include childbirth benefits for customers too old to have children?
- Greater segmentation of policy benefits so that customers can choose which packages best suit their needs and budgets.
- Removing some benefits that are very costly to provide. For example, is it better to have a PMI policy with full cancer cover and a premium that attracts IPT or would it be better to exclude the cancer cover, but to provide that separately through a long term critical illness policy that does not attract IPT? These can be strongly emotional issues and so are often best offered as an option rather than being mandatory. They may also require life and general insurers to cooperate to develop combined packages that are seamless to the customer, despite their underlying contractual and technical differences. Such initiatives haven’t always worked well in the past and JVs are always difficult to manage but that shouldn’t stop us trying. If car rivals Fiat and Ford can cooperate to design, build use a single platform for their 500 and Ka cars respectively, for example, is there any reason a customer should not be able to buy a WPA/LV= combined PMI and CI package?

One thing is certain. The IPT rise – a 58.3% rise in tax – needs to be grasped as an opportunity to do things differently and better rather than to be bemoaned as another unfair tax on an already hard-pressed industry. Don’t we owe that to our customers to think smarter and act better, even if the catalyst for that is something none of us ever wanted to come about – another rise in IPT?