TAX BRIEFING NOTE
INSURANCE PREMIUM TAX

DECEMBER 2017

What is it?

Insurance premium tax (IPT) is a tax on general insurance premiums. It was introduced in 1994 at a single rate of 2.5 per cent. A second higher rate was introduced in April 1997 on travel, household appliances and some motor vehicle insurance. The history of the rates is shown below. Dates vary between years.

Rate	1994	1997	1999	2011	2015	2016	2017
Standard	2.5	4.0	5.0	6.0	9.5	10.0	12.0
Higher	-	17.5	17.5	20.0	20.0	20.0	20.0

What's the problem with it?

False equivalence to VAT. Most economists agree that taxes should normally treat different economic activities neutrally, to minimize the harm a tax system imposes on an economy. The problem is that insurance premiums are not the equivalent figure to neutrally compare, economically speaking, insurance with other activities. The economic value of a tomato, for example, is found in the whole price of that tomato. All the costs and profit involved relates to bringing the tomato to the retail outlet. But the economic value of insurance does not relate to the whole premium. Much of the price of insurance premiums is merely akin to making deposits into a savings account, with the insurance function there to make sure everyone has enough 'saved' for when they need the money. It's just as irrational to think of insurance premiums as equivalent to normal goods and services in this way as it would be to do so to regular bank accounts.

The problem is that chancellors have done exactly that. Philip Hammond said IPT was 'half the rate of VAT' in his 2016 autumn statement, as if to explain the next sentence in his speech: a rise from 10 to 12 per cent. But over half the value of insurance premiums is accounted for by payouts, so the equivalent rate should have been cut, not raised, to make it equivalent to VAT.

The problem is the same with any arbitrary tax on specific items. As well as making holidays, homes and electrical goods more expensive for households to insure, over-taxing insurance means that there will be too little insurance. The increase to 12 per cent in June 2017 exacerbates this problem.

Another problem is that sectors with high payout ratios are disproportionately taxed. The rate of IPT required to be genuinely equivalent to VAT at 20 per cent in property insurance would be around 8 per cent, for example, while in motoring insurance, the equivalent rate would be 3 per cent.

What should be done?

1. Scrap the rise to 12 per cent and instead cut the rate to make it equivalent to VAT.
2. Scrap the higher rate of 20 per cent.
3. Reform IPT by allowing insurers to deduct their payouts from their total VAT base while raising the rate to the same as VAT.