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IPT: a tax on protection

The financial impact of Insurance Premium Tax and public attitudes towards it

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Executive Summary

Insurance Premium Tax (IPT) applies to a wide range of general insurance products in the UK. A standard rate of 12% applies to premiums on - among other things - car, home and pet insurance, while a higher rate of 20% applies to travel, electrical appliance and rental vehicle insurance.

When we asked the public why they bought insurance, respondents overwhelmingly said they did so because it makes them feel safer. The current cost of living crisis, however, has increased pressure to cut back expenditure wherever possible. **Based on our polling evidence, we estimate that around 900,000 households would likely cut back on home contents insurance if premiums were to rise by another 10% or more.** This could leave such households facing substantial financial costs in the event of unexpected incidents such as a fire or burglary.

In recent years, IPT has become a go-to revenue-raiser for the government, likely due to low levels of public awareness, with successive Chancellors hiking rates. According to HMRC statistics, between 2011/12 and 2021/22 alone the amount of tax revenue raised from IPT more than doubled from £2.9 billion to £6.6 billion. **Any further increases risk more people cutting back on essential financial safety nets.**

Our analysis shows that:

- **Per household costs of IPT have doubled over the past decade.** Our modelling shows that the cost of IPT in 2020/21 was equivalent to about £220 per household[1] - significantly more than per household cost of beer & cider duties, wine duty, gambling duties and air passenger duty. This is up from less than £100 in 2010.
- **The poorest 10% of households are currently spending, on average, 6.4% of their disposable income on insurance, or over three times as much as the richest households**. Around a tenth of that cost is estimated to be related to IPT on our calculations.
- **Households are worried about further increases in the cost of insurance in a cost of living crisis.** 71% of those that we surveyed with insurance said that they were worried about any potential increases in price.
- **People are already cutting back on insurance amid a cost of living crisis, reducing their protection against unexpected financial costs.** Some 18% - nearly a fifth - of

[1] IPT is paid by insurers, though a significant proportion of the tax is likely to be passed on to consumers and businesses. Economic theory suggests that a high degree of tax passthrough is particularly likely for "essential" products like motor and buildings insurance. This reflects the lower price sensitivity (price elasticity of demand) of essential products.

Businesses are in turn likely to pass on greater insurance costs to households in the form of higher prices for other goods and services.

those that we surveyed said that they know someone who has already cancelled their insurance due to wider concerns about cost.

- **Almost four-fifths of respondents think that it is unfair for the government to raise taxes on taking out insurance, even if they are trying to bring in additional income.** This is similar to the share saying that they view further taxes on wages, petrol and energy as unfair.
- **When asked what types of insurance should or should not be taxed, the majority of people said that "essential" insurance products should not be taxed.** Only 5% of people think that all types of insurance products should be taxed. When we asked respondents what rate insurance should be taxed, two-thirds of people said that it should be lower than the current standard IPT rate.

£220

per household was raised in 2020/21 by IPT

0.2%

of disposable income from the richest 10% of households is spent IPT, compared to 0.7% of the poorest households

900,000

households are likely to cancel their home contents insurance if prices raise by more than 10%

6.4%

of disposable income from the poorest 10% of households is spent on insurance

93%

of people buy some type of insurance product

18%

of people said that they know someone who has already cancelled their insurance due to wider concerns about cost

44%

of people were aware of the IPT before taking this survey

70%

of people said that they agree that the existence of the IPT discourages some families from taking out insurance

Introduction

The aim of this report is to better understand the financial impact of IPT on British households, as this tax feeds its way into the premiums faced by individuals and businesses.

To do this, we have undertaken an economic modelling exercise to explore the financial implications of IPT, including the distributional implications in terms of how the tax affects different income groups and regions of the UK.

We have complemented this with new primary research of 2,000 adults to better understand public awareness of and attitudes towards the taxation of insurance products, and insurance more broadly amid the current cost of living crisis. The poll ran from the 1st through the 7th of September, 2022. The vast majority of respondents surveyed, 93% said that they bought some type of insurance, with just 5% saying they did not buy any and 2% unsure if they had insurance. The most popular types of insurance bought were vehicle (72%), household contents (63%), and buildings insurance (52%).

Our analysis shows that IPT has a very real impact on household budgets. Further, once people are made aware of IPT, they see it as an unfair tax. Almost everybody that we surveyed agreed that it is important to keep insurance affordable and, when asked if IPT was a good way to increase Government revenue, far more disagreed than agreed.

The structure of the rest of this report is as follows:

- **Chapter 1** looks at the history of Insurance Premium Tax and examines trends over time.
- **Chapter 2** examines the financial implications of Insurance Premium Tax for households, drawing on new economic modelling and Public First survey research. It also examines the likelihood of individuals not renewing their insurance, potentially leaving them financially exposed to events such as burglaries and vehicle damage.
- **Chapter 3** draws conclusions from the preceding analysis and examines public attitudes towards the taxation of insurance.

With the Government looking to fill holes in the public finances ahead of the Autumn Statement on 17th November, IPT may seem like a tried and tested form of additional tax revenues. But there is a need to tread very carefully here: the standard rate of IPT is historically high, regressive and almost certainly far above a VAT-equivalent rate. Public opinion is also not on the side of further increases to this tax.

1. The rise of Insurance Premium Tax in the UK

The current standard rate of Insurance Premium Tax is 12%. Yet, when introduced in 1994, this rate stood at just 2.5%, implying a circa 80% lower tax burden on premiums than today. The standard rate of IPT was hiked in 1997, 1999, 2011, 2015, 2016 and 2017.[2]

Table 1: Current and historic rates of Insurance Premium Tax

Date of change	Standard rate (%)	Higher rate (%)
01 October 1994	2.5	N/A
01 April 1997	4	17.5
01 July 1999	5	17.5
04 January 2011	6	20
01 November 2015	9.5	20
01 October 2016	10	20
01 June 2017	12	20

Source: HMRC

The rapid succession of rate rises since 2010 marks a significant departure from the original purpose of IPT, which was introduced in 1994 to compensate for the VAT exemption of insurance. This has led to policy incoherence around what the tax is *for.*

Given the way insurance operates - paying out under certain events - the "correct" VAT-equivalent tax on households should be 20% of the difference between premiums and payouts. Since IPT is levied on premiums alone, that should *generally* equate to a low single-digit rate.[3] The current 12% standard rate is too high and any further increase would depart even more from the original rationale for the tax.

It seems likely that a key driver of IPT hikes is the fact that this tax is poorly understood, making it a low-profile way of raising additional tax revenues. Before participating in the Public First survey of 2,000 adults undertaken for this research, over half of respondents were not really aware of IPT (33%) or not at all aware of the tax (22%). This means that a very high share of the

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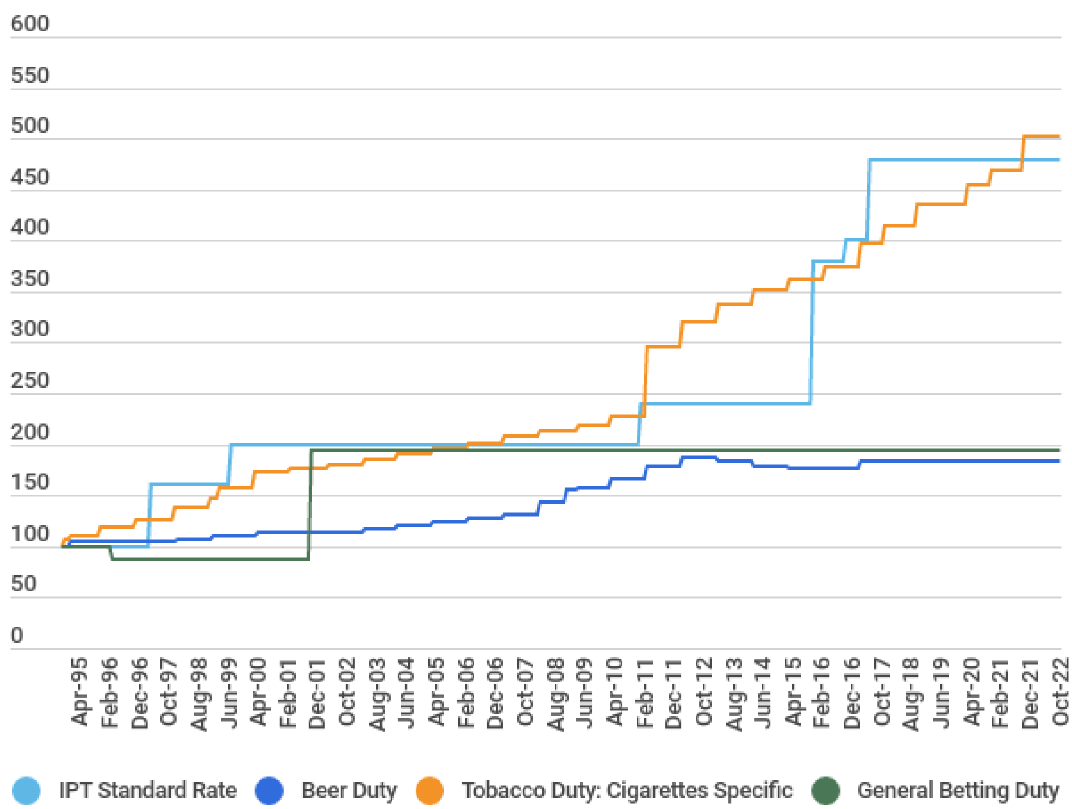
[2] https://www.gov.uk/government/statistics/insurance-premium-tax-ipt-bulletin/historical-insurance-premium-tax-rates

[3] Though there might be some exceptions to this. For example, the higher rate of IPT, set in line with the main rate of VAT, was introduced to address VAT avoidance through 'value-shifting', where businesses selling insurance with other goods could artificially reduce the price of that item and inflate the cost of the insurance.

electorate is unlikely to be aware of the extent to which IPT shapes the premiums they face for a range of products such as motoring and home contents insurance.

Beyond being an unobtrusive money-raiser for the government, it is difficult to think of a strong economic or social argument for increasing IPT rates by as much as has been the case in recent years. Despite the essential nature of some insurance products and their important role in providing financial protection for households against unexpected costs, since its introduction IPT has increased much more rapidly than even "sin taxes" applied to gambling and alcohol. It has seen comparable rises to tobacco duty, as shown in the chart below.

Figure 1: Change in selected tax and duty rates since 1994. October 1994 = 100



Source: Public First analysis of HMRC data

2. The impact of IPT on UK household finances

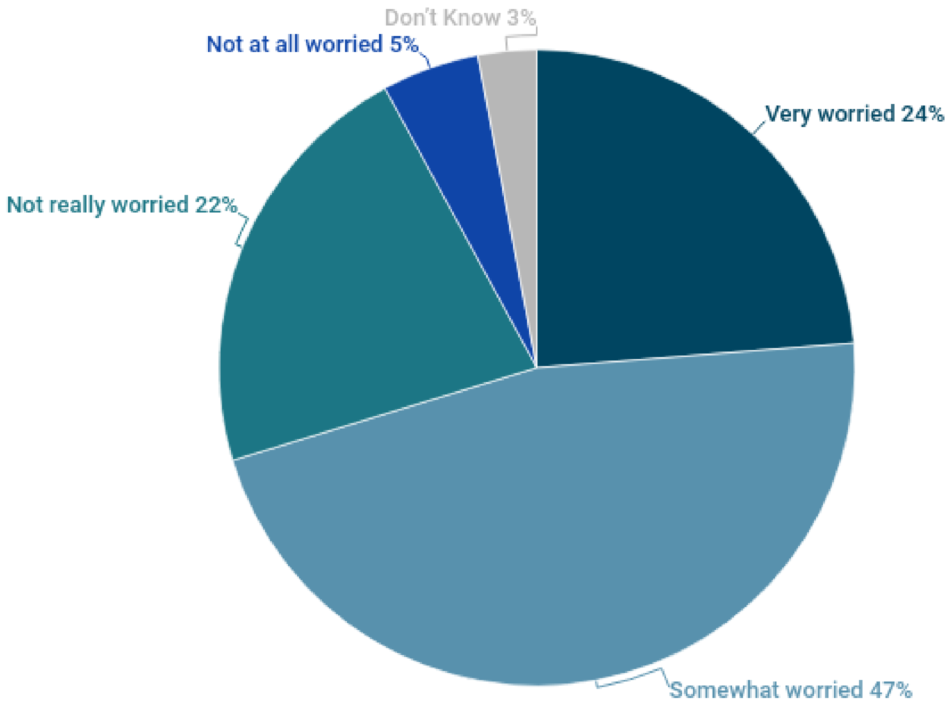
Amid a cost of living crisis, households are concerned about insurance costs

At present, there are deep concerns in the UK about the rising cost of living and the ability of households to make ends meet. In the polling we undertook for this research, close to half (46%) of respondents said that they are generally pessimistic about the future. This rises to 51% among respondents in the poorest 20% of households in terms of income.

Amid high inflation and an uncertain economy, households are tightening their belts. Some 63% of individuals that we surveyed said that they had cut back on eating out at restaurants, while two fifths (39%) said they were reducing spending on entertainment such as subscriptions, DVDs and books.

While insurance may not be the prime concern of households given the dominance of issues such as rising energy bills and grocery prices, those that we surveyed expressed significant worry about rising premiums adding to the difficulties they are already facing, with 71% of those buying insurance saying that they were worried about any potential increases in cost.

Figure 2: How worried, if at all, are you about potential increases in the cost of insurance?

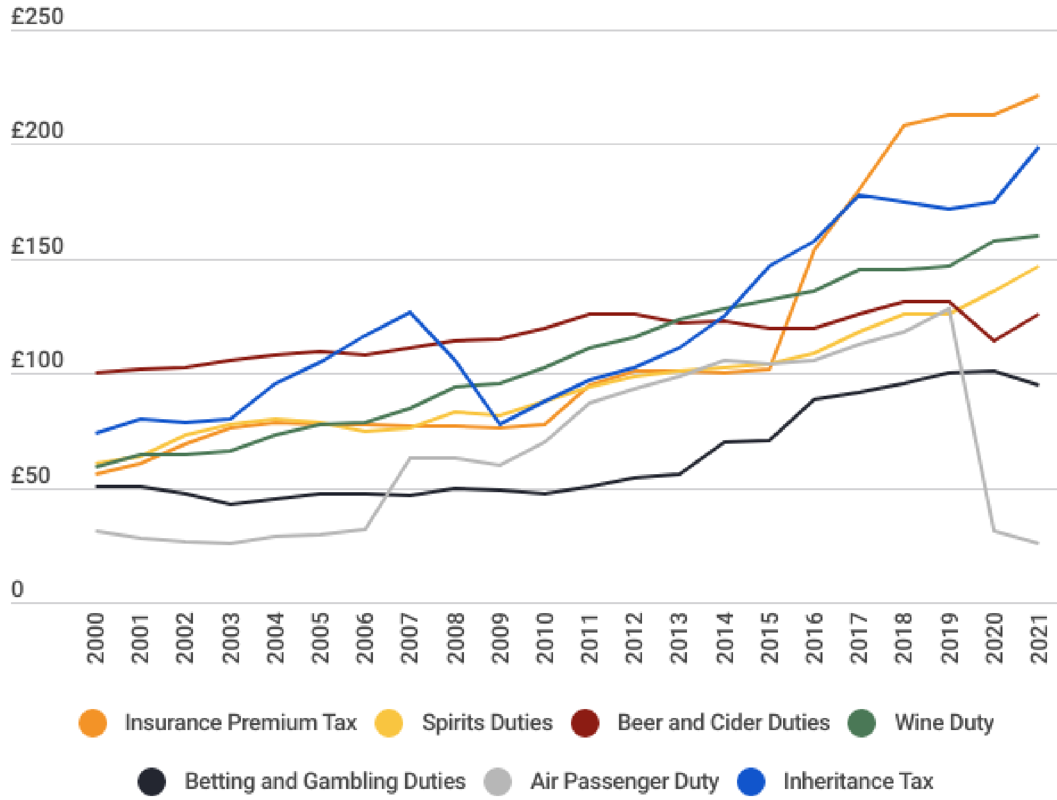


Source: *Public First survey. Base*: *all adults that buy insurance*

Per household costs of IPT have more than doubled over the past decade

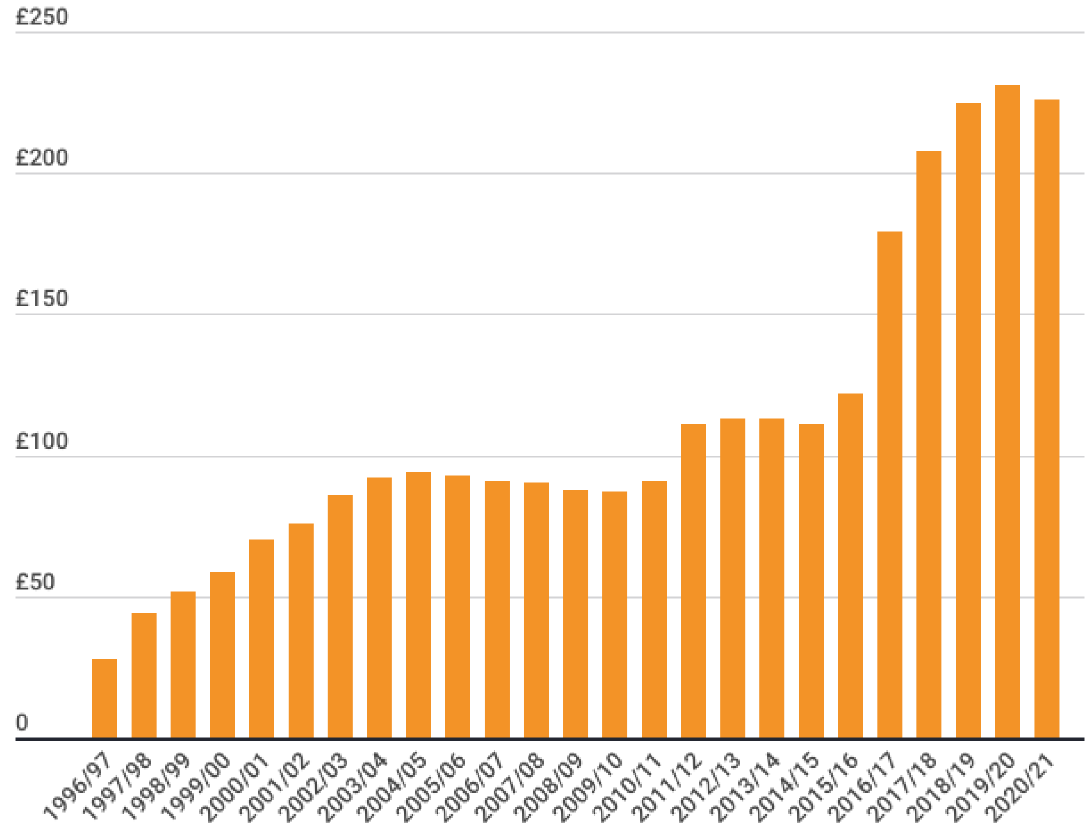
While changes to insurance premiums reflect a wide range of factors, the increase in IPT in recent years has certainly been a significant factor - likely adding to the concerns described above. **Our modelling shows that the per household cost of IPT in the financial year 2020/21 was £220 - significantly more than per household cost of beer & cider duties, wine duty, gambling duties and air passenger duty.** The per household cost of IPT has more than doubled over the past decade.

Figure 3: Annual per household cost of various taxes



Source: *HMRC and ONS tax revenue data*

Figure 4: Per household cost of IPT



Source: Public First modelling based on HMRC IPT receipts data and ONS Living Costs and Food Survey

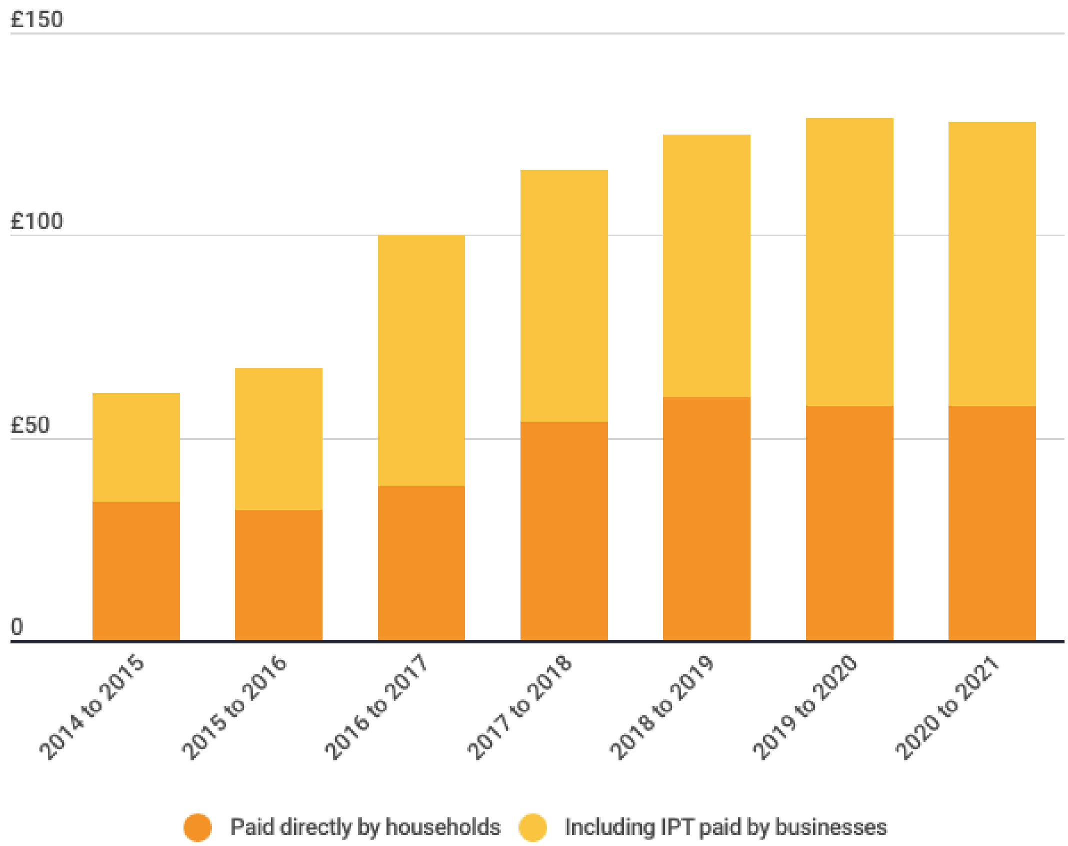
IPT is applied to both those insurance products bought directly by households, and those bought by businesses. It is possible that the insurance companies themselves are absorbing this tax as a cost of doing business, but it is likely that these costs are passed onto the consumer. This is particularly true when demand for a consumer product is relatively insensitive to price, which applies to the more essential categories of insurance such as motor and buildings insurance.

Likewise, business costs associated with IPT are likely to be at least partly passed on to households in the form of higher consumer prices for goods and services. We estimate that approximately half of all government IPT receipts are generated from household insurance products, and the other half by business.

Assuming the purchasing of insurance would be unchanged were IPT rates lower, **the cost of IPT in the financial year 2020/21 would be £120 lower per household than it actually is, were the standard rate of IPT still 5%.** Figure 4 shows how IPT cost per household has been increasing over time.

Given this, it is likely that increases to the standard rate of IPT in recent years have had a non-trivial impact on household finances. According to our modelling, the average household is currently paying £60 a year more for insurance that they have directly purchased than would be the case if the standard rate were still set at the pre-2011 rate of 5%, as shown in Figure 5.

Figure 5: Extra spending on IPT, compared with the standard rate remaining at the pre-2011 rate of 5%, on a per-household basis



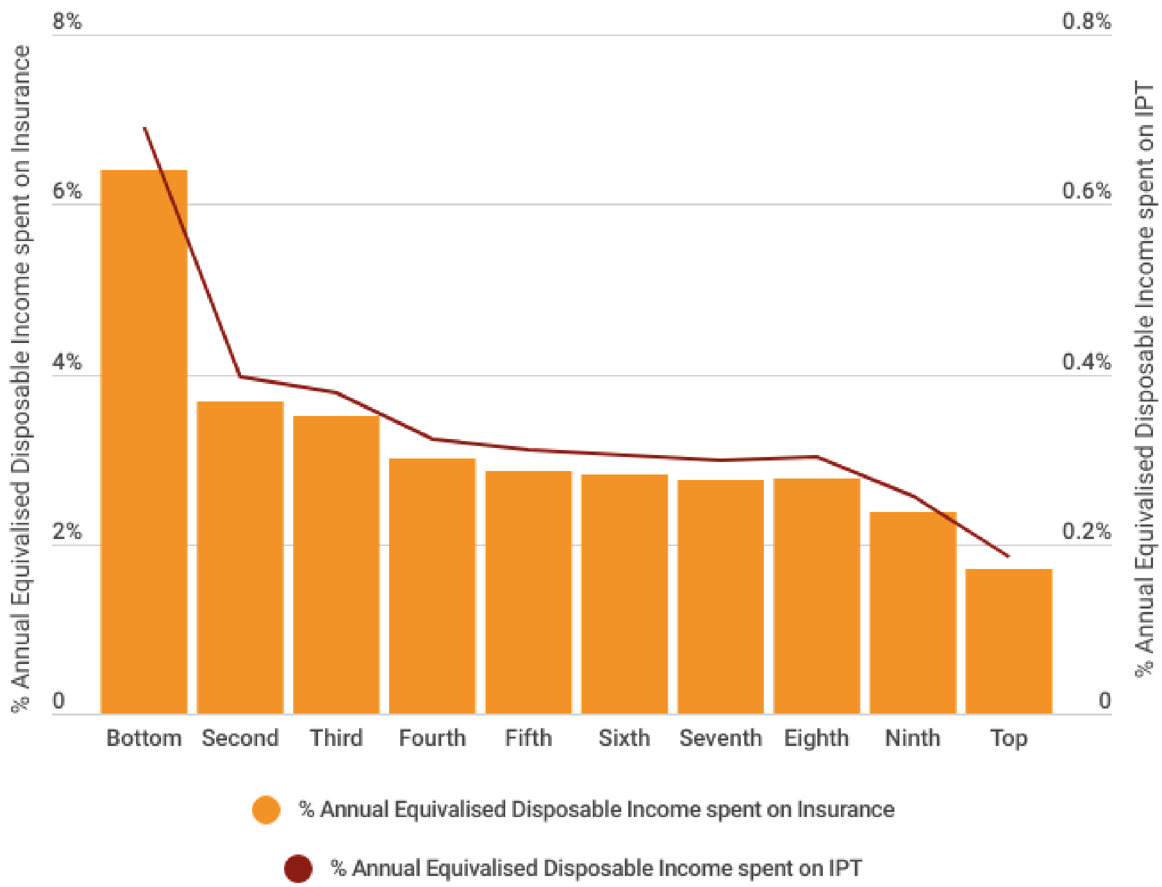
Source: Public First modelling based on HMRC IPT receipts data and ONS Living Costs and Food Survey

Poorer households pay relatively more

The poorest 10% of households are currently spending, on average, 6.4% of their disposable income on insurance, with about a tenth of that cost estimated to be related to IPT on our calculations. As can be seen in Figure 6, this expenditure is particularly dramatic compared to other households, all of whom are spending well under 4% of their disposable income on insurance.

IPT is a regressive tax, with lower earners bearing a greater cost relative to their incomes. This reflects in part the essential or near-essential nature of a range of products such as motor and buildings insurance. Anyone driving a car is legally required to hold motoring insurance, which explains why it was the most popular type of insurance bought by households in our polling. It was followed by household contents insurance. Together, these two types of insurance account for 88% of household insurance expenditure. Among poorer households, this rises to 93%, and falls to 77% for richer households.

Figure 6: Percentage of disposable income spent on insurance and IPT, by household income decile



Source: Public First modelling based on HMRC IPT receipts data and ONS Living Costs and Food Survey

Table 2: IPT-related costs by income group

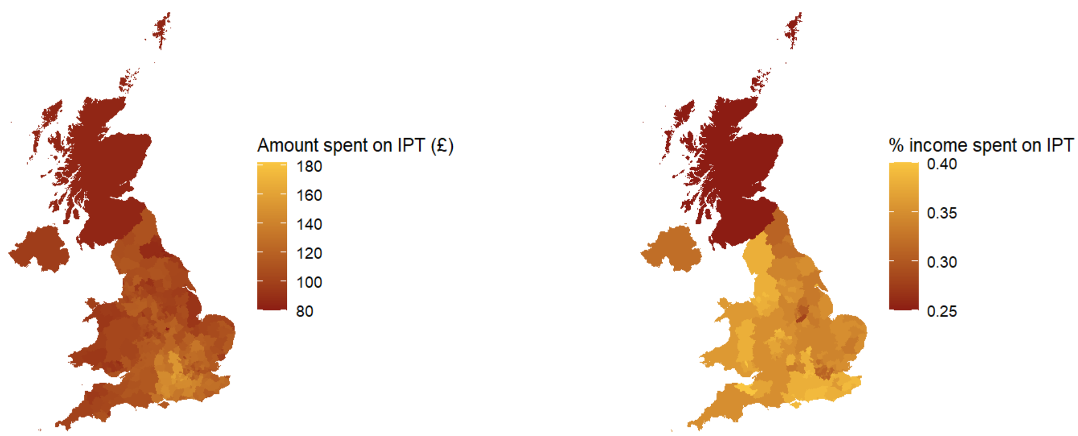
Household income decile	**IPT-related costs, as a % of disposable income**	**IPT-related costs per household (£)**	**Total IPT-related costs by all households in group (£)**
1st (lowest income)	0.7%	£60	£180 mn
2nd	0.4%	£70	£200 mn
3rd	0.4%	£80	£240 mn
4th	0.3%	£80	£240 mn

5th	0.3%	£90	£260 mn
6th	0.3%	£100	£290 mn
7th	0.3%	£120	£330 mn
8th	0.3%	£140	£380 mn
9th	0.3%	£140	£390 mn
10th (highest income)	0.2%	£190	£500 mn

Source: Public First modelling based on HMRC IPT receipts data and ONS Living Costs and Food Survey

The impact of IPT around the country

Figure 7: Absolute amount and percentage of disposable income spent on IPT, by Local Authority District



Source: Public First modelling based on HMRC IPT receipts data and ONS Living Costs and Food Survey

Across the UK, we estimate the average amount spent annually on insurance to be £1,010. This rises to £1,250 in the South East of England and falls to £790 in Scotland. The proportion of income spent on insurance is relatively similar across regions, hovering between 3% and 4%. A significant factor in this is variation in household income across the country. Table 3 shows the proportion of disposable income spent on insurance and IPT respectively.

Table 3: Insurance expenditure by region

Region	Amount spent on insurance (£)	% Income spent on Insurance	% Income spent on IPT-related costs
UK	1010	3.8%	0.4%
North East	840	3.1%	0.3%

North West	980	3.5%	0.4%
Yorkshire and The Humber	910	3.1%	0.3%
East Midlands	1010	3.2%	0.3%
West Midlands	970	3.3%	0.4%
East of England	1080	3.2%	0.4%
London	1120	2.9%	0.3%
South East	1250	3.5%	0.4%
South West	990	3.3%	0.4%
Wales	920	3.4%	0.3%
Scotland	790	3.9%	0.4%
Northern Ireland	900	3.9%	0.4%

Source: Public First modelling based on HMRC IPT receipts data and ONS Living Costs and Food Survey

The effects of the rises in IPT over the last decade have also been felt differently around the country. As shown in Figure 5 earlier, we estimate the annual average extra cost paid directly by households to be around £60 per household. Table 3 shows the regional variation in this. In our modelling, we also looked at this at the local authority level. We found that the twenty local authorities that spend the most on IPT are all in the South East of England, with the exception of the City of London. There is a little more variety in the twenty local authorities that spend the most on IPT as a proportion of their income, but the majority are still in the South East. Figure 7 shows this variation across local authorities, and Table 4 shows the top 20 local authorities by spending on IPT as a proportion of income. Those that are also in the top 20 local authorities in absolute spending terms are highlighted.

Table 3: IPT-related costs by region

Region	Amount spent on IPT-related costs (£)	Amount spent on IPT-related costs compared to 5% standard rate (£)
UK	110	60
North East	90	50
North West	110	60
Yorkshire and The Humber	100	60
East Midlands	110	60
West Midlands	100	60
East of England	120	70
London	120	70
South East	130	80
South West	110	60
Wales	100	60

Scotland	80	50
Northern Ireland	100	60

Source: Public First modelling based on HMRC IPT receipts data and ONS Living Costs and Food Survey

Table 4: The 20 local authorities where IPT-related costs are the highest share of disposable income

Region	Local Authority	Average household spend on IPT (£)	Average household spend on IPT as a proportion of income
Wales	Merthyr Tydfil	100	0.4%
South West	Somerset West and Taunton	110	0.4%
North West	Knowsley	100	0.4%
West Midlands	Wolverhampton	100	0.4%
West Midlands	Walsall	100	0.4%
North West	Wigan	110	0.4%
South East	Arun	120	0.4%
South East	Ashford	130	0.4%
South East	Milton Keynes	130	0.4%
South East	Adur	120	0.4%
South East	Isle of Wight	110	0.4%
South East	Southampton	130	0.4%
South East	Chichester	130	0.4%
North West	Liverpool	100	0.4%
South East	Crawley	130	0.4%
South East	Brighton and Hove	140	0.4%
South East	Eastbourne	120	0.4%
South East	Portsmouth	130	0.4%
South East	Canterbury	130	0.4%
South East	Wokingham	160	0.4%

Source: Public First modelling based on HMRC IPT receipts data and ONS Living Costs and Food Survey

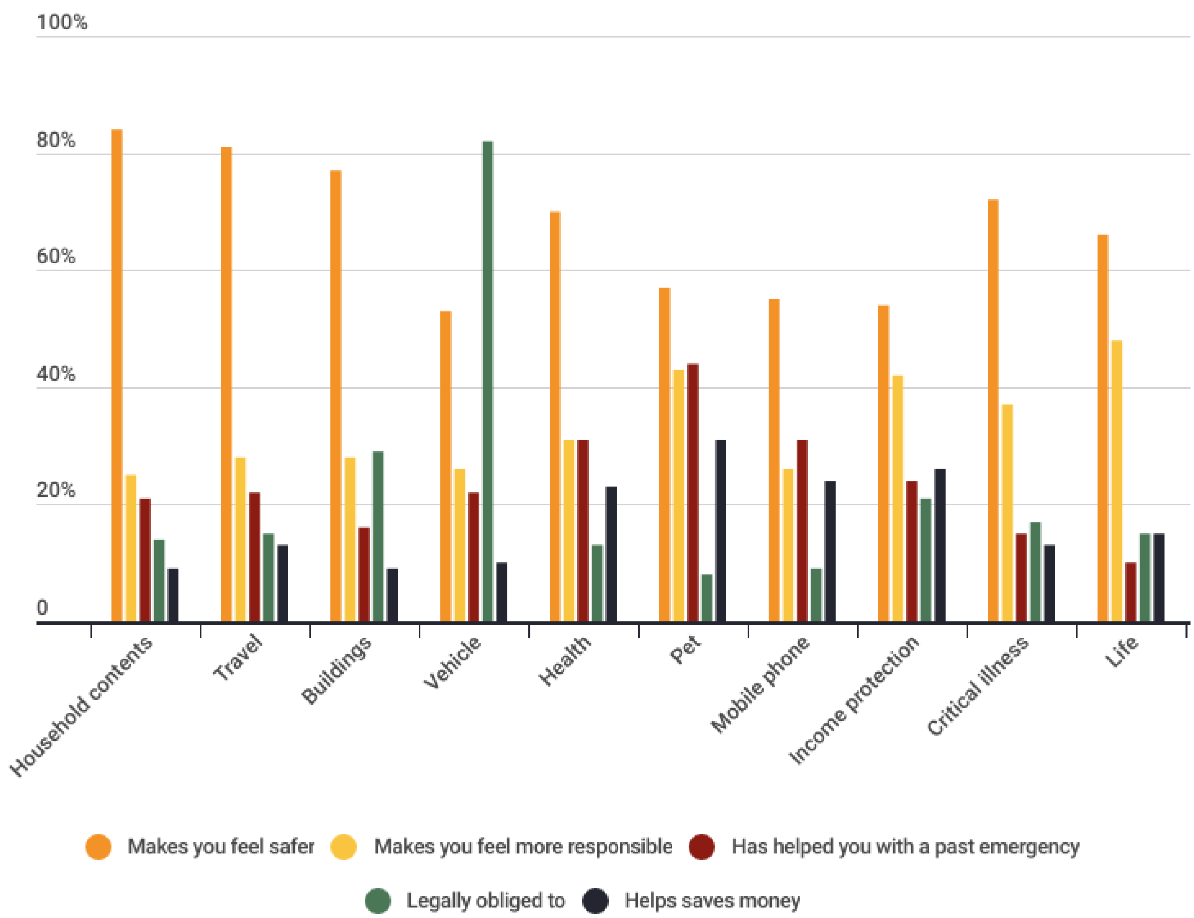
Underinsurance risks

Rising insurance costs risk eroding an important safety net

While many households will bear the financial costs of higher insurance premiums, others may choose not to renew their insurance, or increase the costs they will personally face in the event of an accident - for example, by increasing the voluntary excess on their car insurance. This raises the risk of households being underinsured, and exposed to financial shocks from events like car accidents and burglaries.

This lack of protection would be undesirable for most households, with our survey respondents very clear about why they buy insurance. For every type of insurance, excluding vehicle where legal obligations were the prime reason, respondents overwhelmingly said they purchase insurance because it makes them feel safer.

Figure 8: Which, if any, of the following are important reasons why you buy this type of insurance? Please select all that apply



Source: Public First survey. Base: all adults that buy each type of insurance.

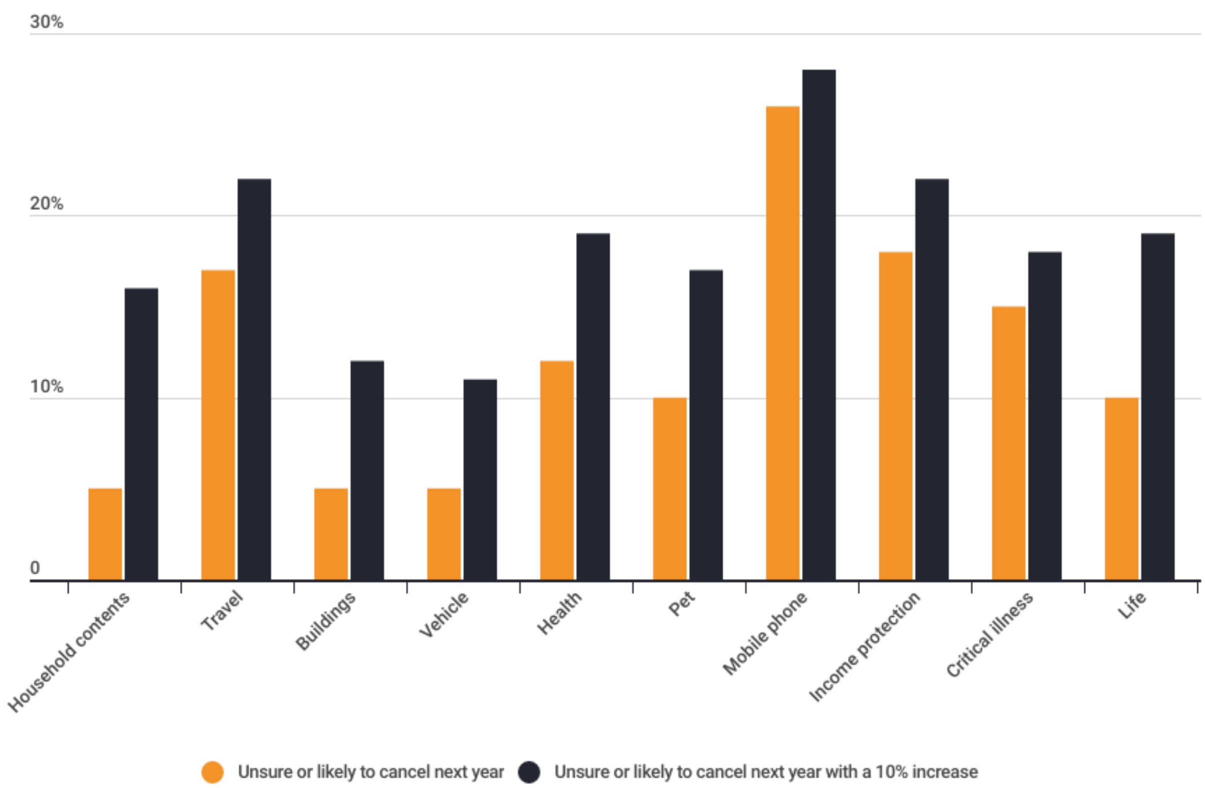
Cost pressures are leading to some households cutting back on insurance

Almost three-quarters of survey respondents think that when other bills increase, most people will likely stop paying for insurance. **More strikingly, 18% - nearly a fifth - of those that we surveyed said that they know someone who has already cancelled their insurance due to wider concerns about cost.**

Those within the poorest 20% of the income distribution are most at risk from not being able to afford insurance if prices increase. **Almost a fifth of the poorest households said that they are unsure of renewing or likely to cancel their household contents insurance if prices were to increase by 10% or more. This increases to 24% for those with travel insurance and 31% for those with life insurance.**

Across all those we surveyed, 16% said they were unsure about renewing (11%) or likely to cancel (5%) their home contents insurance if the price increased by 10%. This would imply about 900,000 households likely to cancel their home contents insurance if such price rises become a reality, rising to as much as 2.8 million if "unsures" also cancel. This could leave such households facing substantial financial costs in the event of incidents such as a fire or burglary.

Figure 9: And how likely do you think it is that your household will renew your insurance for the next year?



Source: Public First survey. Base: all adults that buy each type of insurance.

As the table below shows, our survey data suggests that households in Wales, London and the North East of England are the most likely to cancel their insurance if premiums increase by 10%.

Table 5: Percentage and number of households likely to cancel home contents insurance if premiums rise by 10%, by region

	% of households likely to cancel if premiums rise 10%	% of households unsure about renewing if premiums rise 10%	Number likely to cancel if premiums rise 10%	Number unsure about renewing if premiums rise 10%
Total	5%	11%	884,142	1,945,112
London	8%	16%	117,063	234,126
South East	5%	10%	128,651	257,301
South West	5%	7%	79,893	111,850
East of England	4%	7%	74,506	130,385
East Midlands	2%	13%	26,048	169,312
West Midlands	7%	10%	100,038	142,912
Yorkshire and the Humber	4%	9%	53,694	120,812
North East	8%	12%	60,632	90,948
North West	4%	14%	82,186	287,651
Scotland	4%	16%	75,270	301,080
Wales	9%	8%	84,672	75,264
Northern Ireland*	0%	8%	0	38,438

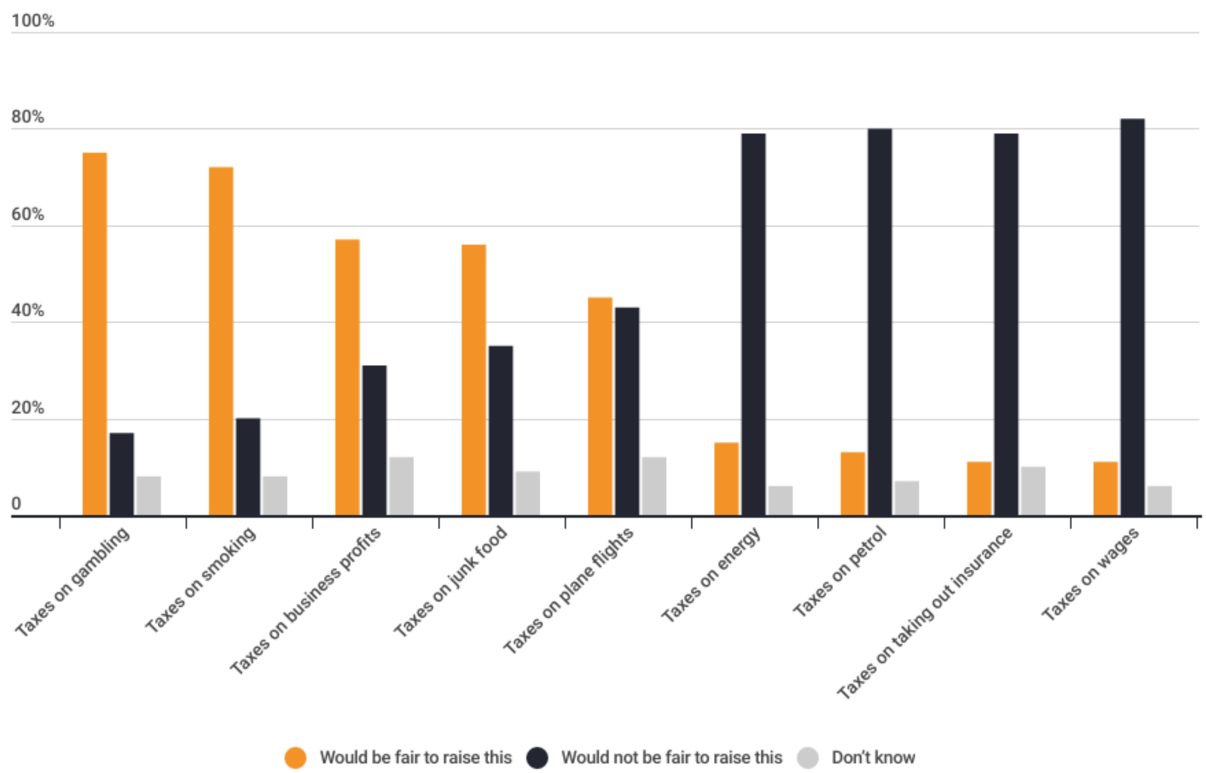
Source: Public First survey, Statistica data on number of households by region.
**Figures for Northern Ireland based on a small survey sample (<50) so should be treated with caution*

3. Where next for IPT?

The electorate see insurance taxes as unfair

While there is relatively low public awareness of IPT, as discussed earlier, the public is strongly against taxes on insurance in principle. This is perhaps unsurprising given the reasons why most people purchase insurance - primarily to feel financially safer. Almost four-fifths of respondents think that it is unfair for the government to raise taxes on taking out insurance, even if they are trying to bring in additional tax revenues. This is similar to the share saying that they view further taxes on wages, petrol and energy as unfair.

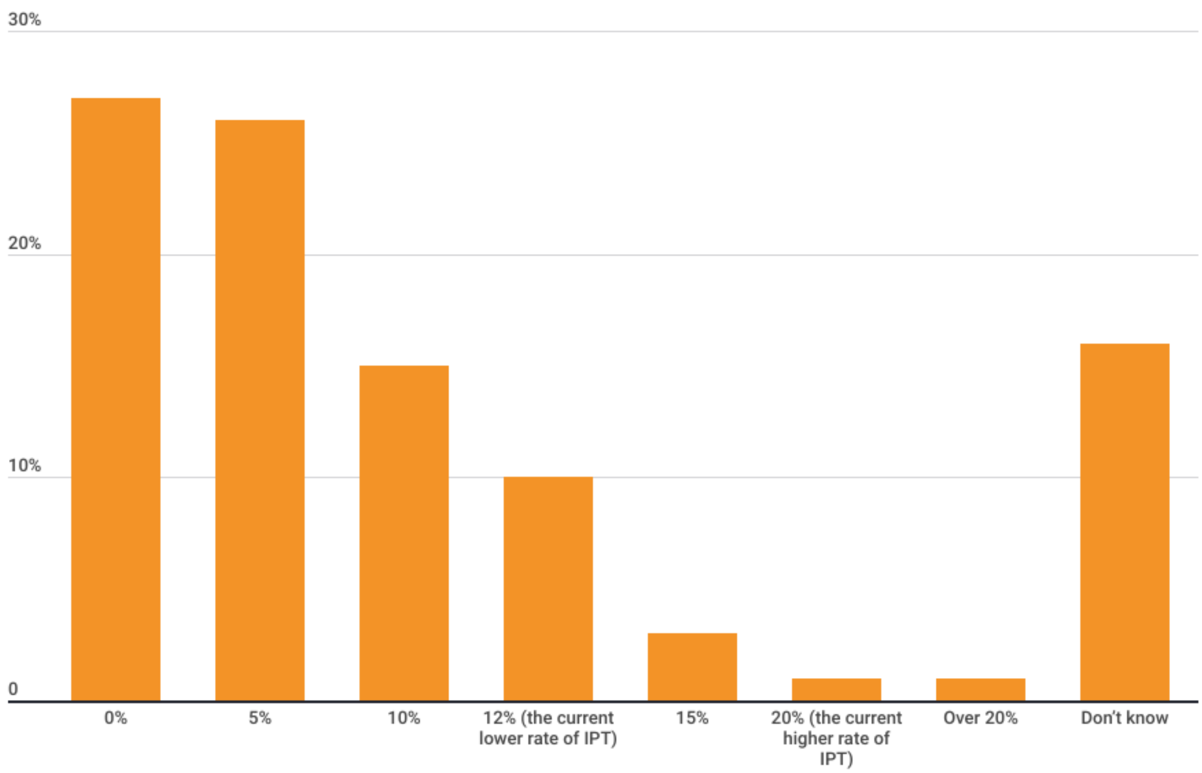
Figure 10: Suppose the Government was looking at which taxes to raise to bring in additional income. Which, if any, of the following kinds of taxes do you think it would be fair to raise?



Source: Public First survey. Base: all respondents.

When asked what types of insurance should or should not be taxed, the majority of people said that "essential" insurance products should not be taxed. Only 5% of people think that all types of insurance products should be taxed. When we asked respondents what rate insurance should be taxed, two-thirds of people said that it should be lower than the current standard IPT rate.

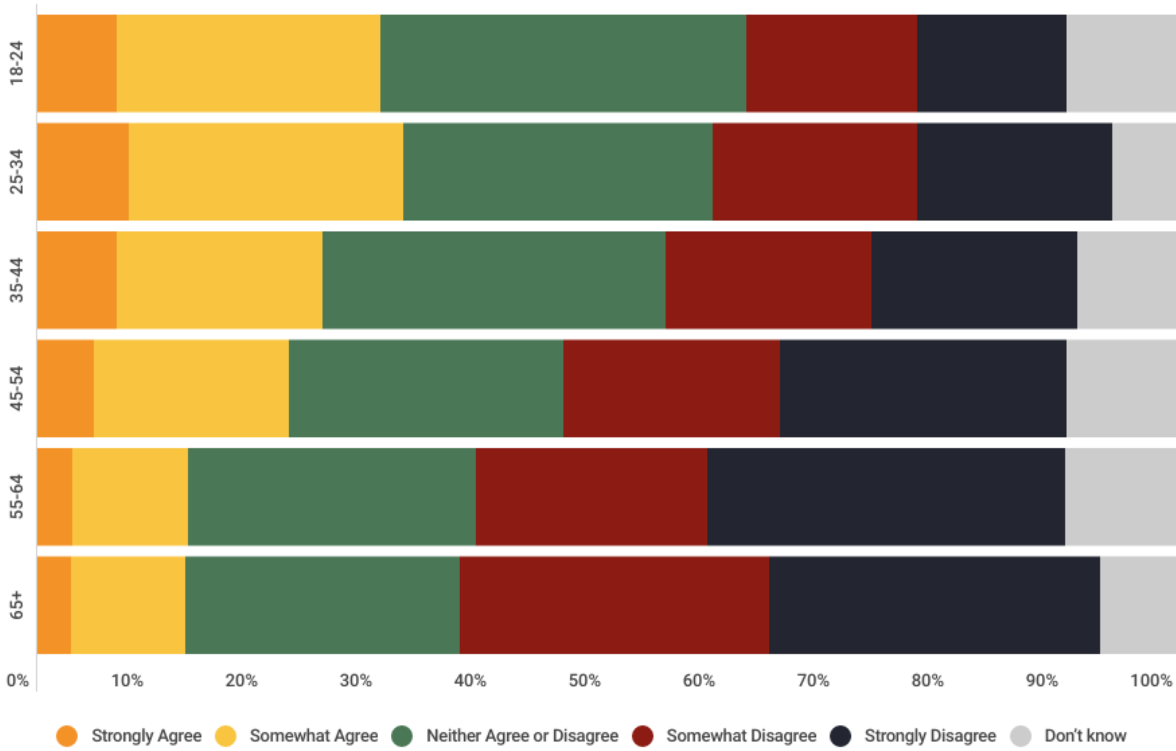
Figure 11: And what do you think the rate for taxing insurance should be?



Source: Public First survey. Base: all respondents.

It is not only that people do not want to pay more for insurance, they do not believe that increasing IPT would be a good way to raise additional government revenue. Overall, 42% of people disagreed that IPT would be a good way to increase government revenue, compared with just 22% agreeing, but this varies drastically by age. Respondents under 25 years of age were more likely to think IPT was a good source of government revenue. They were the only age group to think like this as over 50% of those aged over 55 disagreed that it is a good source of government revenue.

Figure 12: Do you agree or disagree with the following statements?: Increasing Insurance Premium Tax would be a good way to raise additional government revenue



Source: Public First survey. Base: all respondents.

The existence of IPT makes it less likely that households will purchase insurance products. 70% of respondents in our survey said that they agree that the existence of the IPT discourages some families from taking out insurance. With low-income households the least likely to buy any type of insurance, it is important to not alienate them further through large monetary increases in premiums, especially during the cost of living crisis.

With the Government looking to fill holes in the public finances ahead of the Autumn Statement on 17th November, IPT may seem like a tried and tested form of additional tax revenues. But there is a need to tread very carefully here: the standard rate of IPT is historically high, regressive and almost certainly far above a VAT-equivalent rate. Public opinion is also not on the side of further increases to this tax.

Appendix: Methodology

Modelling

The modelling for this report drew on a range of publicly available and previously published data from HM Treasury, HMRC and the ONS.

In calculating change in tax rates and duties, October 1994 is used as a baseline as this is when IPT was introduced.

Calculations of tax revenue per household, including IPT, are derived by dividing past revenue collected by the total number of households in the UK in that fiscal year.

To model the distributional impact of IPT, Public First drew upon data in the ONS Family Spending dataset to understand how insurance spending varies across regions and income deciles.

While IPT is paid by insurers, we assume that this cost is fully passed on to customers in the form of higher premiums, allowing us to estimate the share of premiums attributable to IPT by drawing on this data on spending on different types of insurance product. Economic theory suggests that a high degree of tax passthrough is particularly likely for "essential" products like motor and buildings insurance. This reflects the lower price sensitivity (price elasticity of demand) of essential products.[4]

Businesses are in turn likely to pass on greater insurance costs to households in the form of higher prices for other goods and services.

Polling

As part of this research, we conducted a poll of 2008 UK adults in order to better understand consumer awareness of IPT and views on the appropriate tax treatment of insurance.

The poll was in the field from the 1st to the 7th September 2022, inclusive. All numbers used in this report are based on findings where the survey sample has been weighted to reflect a nationally representative audience.

The full tables are available on our website.

[4] For more on incidence of taxation and how it relates to price sensitivity see, for example, https://uw.pressbooks.pub/microman/chapter/3-6-elasticity-and-taxes/