

# IPTbulletin

JUNE 2010

## UK Insurance Premium Tax rate change following the UK Emergency Budget Announcement on 22 June 2010

**George Osborne, the UK Chancellor of the Exchequer announced in the emergency budget on 22 June that the standard rate of IPT applicable to most general insurance (including property, motor and medical insurance) will increase from 5% to 6% with effect from 4 January 2011.**

A higher rate of IPT applies to travel insurance, and certain insurance sold alongside motor vehicles and some household electrical goods. This higher rate was introduced at 17.5% in 1997 to block VAT avoidance schemes. The higher rate of IPT will increase from 17.5% to 20% with effect from 4 January 2011 in line with the VAT increase.

Premiums are usually quoted exclusive of IPT. But the total amount payable by the insured under taxable insurance contracts is inclusive of IPT and the insurer is responsible for accounting for IPT to HM Revenue & Customs (HMRC). Implementation of the effective date for the increase from 5% to 6% will depend on the tax accounting procedures adopted by the insurer.

### When is IPT normally due?

The tax point is the date when IPT must be applied to a taxable premium. The basic tax point is when a premium or instalment is received by the insurer, broker or any other agent of the insurer – this is often referred to as the cash receipt method. However, if an insurer opts to use the special accounting scheme the IPT tax point is created when a premium is written in the insurer's accounts. This can either be the date of physical writing or the date the premium is shown as



due. An insurer cannot alternate between these two tax accounting methods and must apply the selected method consistently for all premiums written.

## When will the new rates apply?

For insurers who account for IPT using the *cash receipt method*, the new rate will apply to premiums *received* on or after 4 January 2011. For insurers who account for IPT using the *special accounting scheme* the new rate will have effect for premiums that are *written into their records as due to them* on or after 4 January 2011.

## Will policyholders pay more tax?

The tax accounting rules for insurers mean that clients should expect to pay IPT at 6% if they pay premiums, instalment payments or additional premiums that are received or written by insurers *on or after* 4 January 2011. This applies both to existing contracts where the period of cover extends beyond the change of tax rate as well as new contracts incepting in 2011.

Clients who have *already* made a payment under an existing contract where the period of cover extends to a period beyond 4 January 2011 should carefully review their policies and contracts to determine whether the insurer can pass any increase in IPT due on to the client. The contract or policy should set out whether the premium is inclusive or exclusive of IPT.

## Are prepayments made before 4 January 2011 affected?

Yes. IPT legislation contains measures to prevent tax avoidance by insured persons who make a prepayment in the period between the Budget announcement and the date of the rate change – referred to

as "*anti-forestalling*" provisions<sup>1</sup>. Under these measures, where

- a) a taxable premium is received or written by the insurer *after* the Budget announcement but *before* 4 January 2011, **and**
- b) the period of cover begins *on or after* 4 January 2011,

the insurer must treat the premium as received or written on 4 January 2011 and therefore subject to the new rate.

### Example 1 (Cash receipt method)

- A contract is written by an insurer using the cash receipt method to account for IPT. The contract begins on 1 February 2011 but the insurer receives the premium on 1 December 2010.
- The insurer will be liable to account for IPT at the new rate as if the premium had been received on 4 January 2011.

### Example 2 (Special accounting method)

- A contract incepts on 1 February 2011 and the premium is written into the records of the insurer using the special accounting method on 1 December 2010.
- The insurer will be liable to account for IPT at the new rate as if he had written the premium on 4 January 2011.

## Are contracts providing cover for a period exceeding 12 months affected?

Yes. If a taxable premium is received or written after the Budget announcement but before 4 January 2011 and the period of cover begins before 4 January 2011 and ends on or after 4 January 2012, the *anti-forestalling* provisions require the insurer to apportion the premium to calculate the IPT due.

<sup>1</sup>Finance Act 1994, section 67A

### Example 3

- A premium relating to a contract incepting on 1 October 2010 and providing cover until 31 December 2012 is written into the insurer's accounts (or received for the purposes of the cash receipt accounting method) on 1 December 2010.
- The insurer can account for IPT at 5% on the proportion of the premium attributable to the period 1 October 2010 to 3 January 2012. The insurer must account for this amount of tax on 1 December 2010. The insurer is liable to IPT at 6% on the proportion of premium attributable to the period of cover from 4 January 2012 until 31 December 2012. The insurer must account for this amount of tax on 4 January 2011.

### Are there any exceptions to the anti-forestalling measures?

The anti-forestalling provisions will not apply if it is *normal business practice* for the insurer to either

- a) receive or write premium in advance of a contract of insurance, or
- b) provide cover for a period exceeding 12 months.

Conversely, any request by an insured to vary normal arrangements for insurance provision by making advance payments or taking out extended cover will trigger the anti-forestalling measures.

### Are any transitional provisions being introduced?

When the rate of IPT was last increased legislation introduced transitional measures to mitigate the impact of the rate change which only applied to that

rate increase. To date no transitional measures for this rate increase have been announced but Jardine Lloyd Thompson Limited will be contacting HMRC to request that a similar concession to be introduced for the rate change on 4 January 2011.

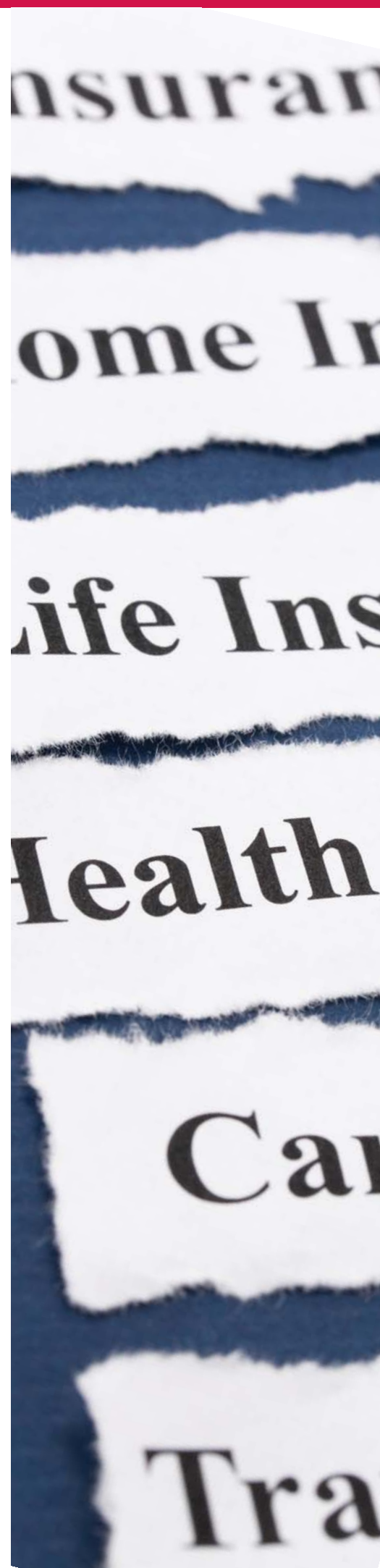
### How can the new rate be applied for new subscription business?

It is likely that different insurers will write premium into their accounts on different dates. This will make the task of applying tax to a taxable premium shared between several insurers difficult, particularly for renewals on 1 January 2011.

### How does the rate change affect *existing* insurance contracts?

A policyholder may have an *existing* contract of insurance that commenced before either the Budget announcement or the change of rate on 4 January 2011. Premiums, instalment payments or additional premiums under an existing contract which are received (if the insurer uses the cash receipt method) or written by insurers (if the insurer uses the special accounting method) before 4 January 2011 will not attract the new rate of IPT.

But if a premium due under an existing contract of insurance is received or written by the insurer *on or after* 4 January, the premium will attract IPT at the new **6%** rate. This will affect all instalments or additional premiums falling due on or after 4 January 2011 **unless** the insurer has already booked the payment in their accounts prior to the change of rate and accounted for IPT under the *special accounting method*.





## How does this affect long term policies?

A policyholder may have an existing long term contract that commenced before the June 2010 Budget and extends for a number of years beyond 4 January 2011. In these cases, the policyholder may have paid the total premium for the entire contract in the first year. The original premium payment will have attracted IPT at 5%. The insurer may be liable to account for IPT at the new rate of 6% if any part of the premium is treated as written by the insurer *on or after* 4 January 2010. If so, the terms of the policy contract should be reviewed to determine whether or not the insured is required to make a further payment to the insurer.

## Conclusion

The tax treatment will be dependent on how the insurer accounts for the premium, the length of the policy and the contractual terms of the policy to determine the liability for the increase in IPT rates. Clients should review their contractual terms to determine whether the insurer can charge any increase in IPT to the client.

Clients should seek independent tax advice in this regard if they are concerned with the tax impact of a proposal from insurers or their existing insurance arrangements.