Insurtech UK

Insurtech UK response to HMRC's call for evidence on 'The Operation of Insurance Premium Tax'

1) Introduction

Insurtech UK welcomes the opportunity to engage in a discussion about Insurance Premium Tax (IPT). However, whilst this consultation is focused on specific elements of the current IPT regime, Insurtech UK does believe it is worth raising the need for further reform of IPT in the future. Some of the proposed changes only intensify the challenging tax burden that is unique to the insurtech sector. Further reform to IPT needs to address the major issue facing insurtech intermediaries; which is that they are affected both by IPT added to insurance premiums, and the VAT on their expenses which they are unable to reclaim, putting them at a disadvantage compared to equivalent non-insurance tech businesses.

Insurtech UK has raised this issue in our consultation response and hopes that HMRC can consider these points and include them within the scope of any future reforms to IPT. It is rare for any tech startup to be unable to reclaim VAT in this way, and considering the UK Government has highlighted its ambitions for the UK to be the best place in the world to grow a tech business, it is vital to alleviate these distorting conditions being experienced by insurtech businesses in the UK.

Insurtech UK is a trade association of 78 members, associate and partner members. Our membership consists of 54 insurtech startups which cover the full spectrum of the sector; including intermediaries such as MGAs and brokers, as well as non-regulated businesses such as platforms, claims and analytics technology providers. We also have 6 associate members who are traditional insurers and 18 service partner members who are from a range of professions separate from insurance. Our mission is to transform the insurance industry through the use of technology and to make the UK the best place for innovating insurance in the world.

2) Administration fees and IPT

Insurtech UK understands the desire and reasoning by HMRC to bring administration fees into the scope of IPT. Nevertheless, this move would undoubtedly have a disproportionate impact on insurtech intermediaries.

Insurtech businesses currently do not underwrite risk using their own capacity and rely on separate insurance carriers to enable them to do this. This allows insurtech businesses to offer competitive premiums to their customers. The inevitable result of including administration fees within IPT is that underwriters will pass on these additional costs into the final premiums, which will naturally be felt by insurtechs and their customers. Increasing prices in such a price sensitive market are naturally felt more acutely by insurtech startups who are still in their infancy and are not as able as traditional insurance companies to absorb a rise in premiums.

This impact is heightened by the fact that insurtech intermediaries are unable to offset this increased IPT against their existing VAT costs.

As indicated, Insurtech UK understands the reasons why HMRC wants to incorporate administration fees within IPT. Before proceeding with this policy however, Insurtech UK believes HMRC should undertake a full assessment of how this extension will impact the insurtech sector specifically. If HMRC proceeds with this change, it will only further the need to review the wider regime of IPT and VAT for insurtech businesses. This could form part of the proposed impact assessment around the insurtech sector. Our members believe that this would be a constructive first step to fully understand the unique challenges that the current regulatory framework presents for insurtech businesses in the UK.

3) IPT Register

Insurtech UK does not believe that an IPT Register is necessary. This is because any company that is liable for IPT will be an insurance carrier provider. If they are a carrier, this means that they are regulated by the Prudential Regulation Authority (PRA). This applies to both domestic and international insurers that operate in the UK.

There is already a public register of companies which are regulated by the PRA, which therefore means that there is already a public register of companies which are potentially liable to pay IPT. An IPT Register will simply be a duplication of the existing PRA register and would be an unnecessary administrative burden for HMRC.

4) IPT and VAT

Insurtech UK understands that the scope of this consultation is limited to the operational aspects of IPT. However, as indicated, any proposed changes to IPT are interlinked with the wider tax challenges that insurtechs face. This consultation therefore presents an opportunity to consider meaningful reforms to IPT, and to make it fit for purpose for the emerging insurtech sector.

As aforementioned, UK insurtech businesses that are involved in the distribution of insurance are required to pass on the cost of IPT onto the insurance premiums that they offer customers, yet they cannot offset this IPT against VAT. IPT is applied to the entire insurance premium, which includes the net premium and the commission. This commission is used by insurtechs to pay for goods and services to build their businesses, such as costs for technology, digital marketing, design, copyright, legal and accountancy.

However, as the insurance sector is VAT exempt (and charged IPT instead), this means that insurtech intermediaries are unable to reclaim any of the VAT incurred on these goods and services. While this issue does apply to traditional insurance companies, it does have a particularly strong impact on insurtech intermediaries. This is because many of our members' business models are more heavily weighted towards investing into technology.

Our members – especially those who are B2C - invest a greater proportion of their revenue into technological services and digital marketing to enhance their business and therefore gain a competitive advantage in the industry. But the more that insurtechs invest into additional services to complement their insurance product and improve the customer experience, the more costs they face through VAT.

Traditional insurance companies tend to grow by hiring more employees (a cost which isn't liable for VAT) or diversifying their services into areas where they can reclaim VAT. Technology focused and specialised insurtech businesses do not have this option, and they are unable to escape having to pay VAT on all of their services without being able to offset it against IPT. They are essentially being penalised for innovation.

In practice, this means that these insurtech businesses are facing a 20% addition in costs on every service that they purchase. By increasing all of their costs by 20%, this inevitably makes them less competitive within the market. VAT is meant to be a consumer tax, but for insurtechs it is very much a business tax that is leading to higher costs.

The UK Government has highlighted how it wants to incentivise innovation, and one of the ways to achieve this is to create a suitable regulatory landscape for startups to flourish. It is rare to see a tech startup in the UK that is unable to reclaim VAT in this way, so Insurtech UK wants to explore a solution with HMRC to ensure that there is a level playing field between insurtechs and other sectors within the UK regulatory environment.

Insurtech UK believes that the UK can become the best country in the world for innovating insurance. The UK Government has similarly expressed its confidence in the potential of the UK insurtech sector to be a world-leading export market, but in order to achieve this, HMRC urgently needs to remove this barrier for growth.

Insurtech UK therefore recommends that all insurtech businesses that are involved in the distribution of insurance are able to offset the IPT they collect against VAT.

This solution ensures an equitable tax system, where insurtech intermediaries can avoid being affected by two separate tax regimes simultaneously. This will allow these businesses to invest a greater proportion of their revenue into goods and services, which will result in a more competitive and innovative insurtech sector and improved customer outcomes.

5) Options for short-term reform

Insurtech UK is conscious that major reform to IPT will not happen immediately, so we would also like to suggest some additional, short-term measures that will offer relief to insurtechs and accelerate growth.

5.1.) Introduce a minimum threshold in Gross Written Premiums (GWP) until insurtech intermediaries are liable to pay VAT.

Insurtech UK believes that our members would benefit from some breathing space for their businesses to reach a fixed point before they become liable for VAT. As mentioned, other insurers have been able to diversify their services once they have the available revenue to do so. By introducing a minimum threshold in GWP, this would allow insurtech startups to grow their customer base and scale their businesses to a certain point without having to pay VAT.

This would give insurtech startups the headroom to scale more effectively by investing more capital into goods and services which could further improve customer outcomes. Consequently, this would make them even more appealing to domestic and international investors, which would further improve their ability to scale and would benefit the whole UK insurance market.

This is also unlikely to create a tax deficit for HMRC, as startups would be able to use this extra revenue to further grow their business by investing in goods and services, leading to HMRC gaining more revenue in the form of Corporation Tax. Insurtech UK believes that this proposal could be a growth generative area for HMRC and the wider UK economy.

5.2.) Provide partial VAT exemptions for insurtech intermediaries during a time-limited period of trading.

Another potential option could be to provide partial VAT exemptions to insurtech intermediaries over a certain time period in their initial years of growth. This would be effective for insurtech startups as it would provide an incubator period in which they can grow without being liable for costs that can prove damaging to their ability to scale effectively. Once this is introduced, startups would be able to backdate their VAT costs and claim back these appropriate costs over this period of time. Insurtech UK would welcome further discussions with HMRC to explore how this proposal could work within existing HMRC regulatory frameworks.

5.3.) Introduce enhanced R&D Tax Credits to insurtech intermediaries

One final option to consider is to introduce enhanced R&D Tax Credits for insurtech intermediaries. Many of our members already benefit from R&D Tax Credits, but an increase in R&D tax relief could be introduced exclusively for eligible insurtechs which are unable to reclaim VAT. This increased tax relief could be offset against VAT, which would provide these intermediaries with further capacity to invest into innovation. As the UK Government has an R&D spending target of 2.4% of GDP by 2027, this measure would be extremely helpful towards achieving this target.

It is uncommon to see any other type of tech startup being unable to reclaim VAT in this way, so this proposal would not disrupt the existing operational framework of the R&D Tax Credit scheme, and it would be hugely beneficial in providing a level playing field for insurtechs within the wider tech ecosystem.

6) Conclusion

The Chancellor of the Exchequer said in a speech on the 30th April 2019 that the UK Government is committed to building the "most pro-growth and pro-innovation regulatory environment in the financial services world." However, at present the current regulatory environment presents significant hurdles which are damaging innovation in the insurtech sector. In attempts to improve customer outcomes and innovate industry practices, insurtechs are being unfairly punished by the VAT attached to the investments into services which complement their insurance product. Improving customer outcomes should be encouraged, not penalised.

Insurtech UK believes some of the proposed changes only make the existing challenges for insurtechs more acute. We urge HMRC to consider reforming IPT beyond the proposed operational changes. For insurtechs, this would mean allowing intermediaries to offset the IPT they collect on their premiums against VAT. Doing so would support the insurtech sector by allowing them to enjoy a much more level playing field with other thriving tech sectors in the UK. It would equally benefit the UK economy by accelerating growth in insurtech startups and attracting more foreign and domestic investment into the sector.

Insurtech UK would welcome an opportunity to discuss the points raised within this consultation response further with HMRC, and we look forward to continue building constructive relationships with Government to address the wider tax regime facing UK insurtechs.