Submission to Australia's Future Tax System

Owners corporations &

- *Mutuality, levies, GST*

- *Tax year [SAP]*

- *Stamp duty on insurance [& Fire Services Levy]*

As part of their review

By

Owners Corporations Victoria Inc.

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About Owners Corporations Victoria Inc.
OCV, formerly IBCMV, is the pre-eminent professional association of the owners corporation industry, and was formed in 1990 to provide a forum for improved standards and education in the industry. Supporting more than 80% of all owners corporation managers it is the only organisation solely focussed upon representing this increasingly significant industry, and reaches and represents 300 owners corporation professionals who manage approximately 250,000 lots. It also represents industry suppliers and owners corporations, making it the voice of all with an interest in the management of owners corporations. Members benefit from representation, promotion, establishment of professional practice guidelines and ethical standards, and professional development through education seminars, conferences and regularly publishing bulletins on items of professional interest. OCV is an affiliate member of the National Community Titles Institute, which represents practitioners throughout Australia. More information about the Associations are available at www.ocv.org.au and www.ncti.org.au

About the owners corporation or strata title industry in Victoria.
Changing lifestyle choices of Victorians and demographic shifts have led to rapid growth in higher density dwellings and the strata industry. With 65,000 owners corporations and 500,000 lots in Victoria and about 1,000,000 Victorians or 1 in 4 people living in or affected by owners corporations, it represents the management of property worth $48 billion. More than $1 billion per year is collected and spent. They comprise residential properties ranging from 2 units in a suburban street to many hundreds of units in an urban tower block. Owners corporations also encompass commercial, retail, lifestyle resorts, retirement villages, car parks, storage facilities, industrial and, increasingly, mixed developments comprising more than form of development.

Strata and Community Title Managers deal with:

- The management of people in a community living environment
- Manage billions of dollars of other people’s money on an on-going and not a single transaction basis
- Manage entire communities and their current and future assets and facilities

About the strata and community title industry in Australia
The industry continues to grow rapidly in Australia with around 250,000 owners corporations comprising 2,000,000 lots Australia wide. It represents the management of property worth more than $500 billion. There are approximately 2,500 owners corporation managers in Australia; with 3.5 million people living or working in owners corporation schemes. Conservatively, it is estimated 20,000 Australians work in and derive their income from the strata title industry. Urban planning policies around Australia are targeting annual growth of more than 10% for the next 15-25 years, so the prevalence and importance of this sector is increasing.

Issue 1 – Mutuality, levies, GST

Inclusion of owners corporation levies as part of the GST turnover test used in determining the need to register for GST.

OCV is concerned regarding mutuality and believe the ATO is wrong in not exempting owners corporation [or body corporate] levies on lot owners from the GST income threshold of $75,000.

Owners corporation levies on lot owners is the primary source of scheme funding.

Levies are correctly considered as mutual [non-assessable] income for income tax purposes; consistent with the principle that one cannot make a profit out of oneself.

However, levies are currently incorrectly being treated as forming part of the turnover for determining whether an owners corporation is obliged to register for GST.

This wrongly penalises lot owners in owners corporations with a significant cost burden of administrative compliance, and it is not equitable.

This will become an increasing issue for owners corporations, which play an important role in maintaining property and sustaining residential property values in Australia.

Perversely, this may also have other unintended consequences at odds with the policy intent of most Australian states and territories, for long term maintenance planning [or sinking funds]. Where it is optional, owners corporations may choose not to adopt a sinking fund or to reduce the amount raised accordingly so as not to go over the $75k GST threshold.

OCV requests your help in resolving this matter for the good of owners, and is seeking to resolve this social justice issue.

Issue 2 – Tax year [SAP]

A more flexible approach by the Commissioner when exercising his discretion to grant leave to adopt a substituted accounting period [SAP].

This issue OCV raised has been shortlisted by the Inspector General of Taxation [IGT] as a potential review topic for its forward work program for 2009-2010.

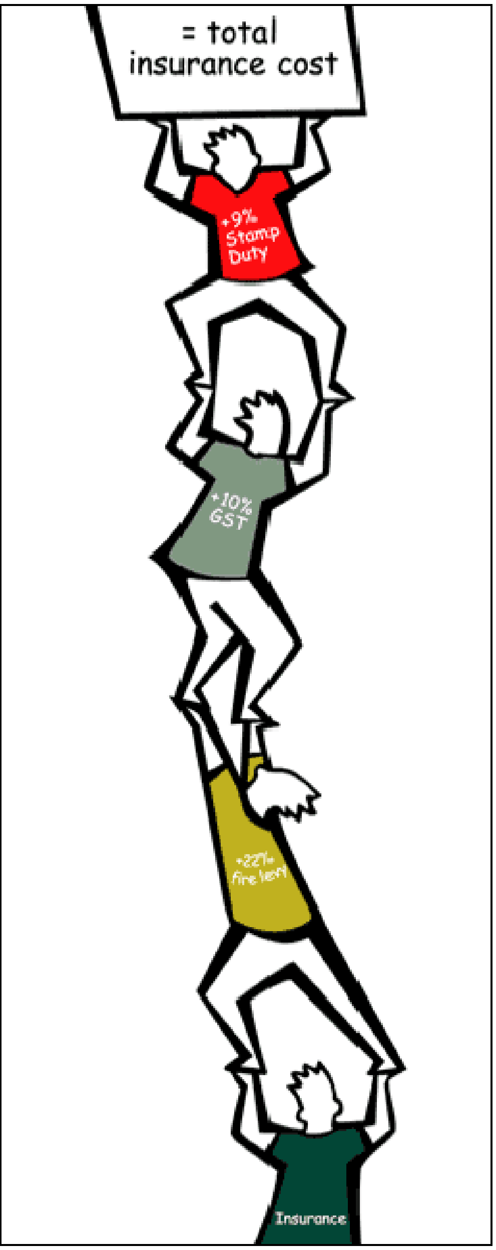
The inability to change the tax year of owners corporations means that two sets of books have to be kept. Although the ATO has the ability to accept different tax years, apparently owners corporations are not currently allowed to do so.

Most owners corporations are not created with a financial year 1 July. Most have a different financial year that relate to when it was created [and which is useful because spreading them out makes them more manageable eg AGMs]. This means they must maintain financial records for reporting to members based on the owners corporation financial year and then reconstruct the accounts for reporting on the 1 July tax year.

The ATO allows for a change instead of using the standard 1 July tax year, but have refused to recognise an owners corporation financial year as a tax year.

The ATO should allow an owners corporation to change its tax year from 1 July to instead coincide with its financial year.

Preparing only one set of accounts would significantly streamline the administrative compliance requirements of owners corporations.



Issue 3 – Stamp duty on insurance [& Fire Services Levy]

In every state and territory, governments place stamp duty on insurance products, thus increasing the cost of insurance to consumers through higher premiums. These tax rates range from the highest of 11% in South Australia, to the lowest of 7.5% in Queensland. NSW's rate lies in the middle at 9%.

At a time when underinsurance and non-insurance are a major issue, as it is estimated that 9 out of every 10 Australians are not fully insured, these taxes are not encouraging consumers to cover themselves adequately. These taxes can be seen to be inefficient in three ways:

- Firstly, taxes should be imposed on **activities we wish to discourage** - this is the rationale for charging 'sin taxes' on alcohol, cigarettes and gambling. Insurance is a benefit to the consumer in the event of a disaster. However, taxes on insurance now raise more revenue than alcohol, and not much less than gambling and tobacco.
- Secondly, stamp duty imposes a **'tax on tax effect'**, namely onto the goods and services tax (GST), thus breaking one of the most fundamental principles of taxation. In NSW and VIC, an additional 22% fire services levy (FSL) is imposed on premiums to fund fire-fighting services. After the levy is charged, followed by a 10% GST, followed by stamp duty, a basic home insurance premium in NSW of $100 can end up costing $146.28.

Fire Services Levy [FSL]

The ICA [Insurance Council of Australia] and NIBA [National Insurance Brokers Association] have lobbied successive governments for many years and have had success in Queensland, South Australia and Western Australia in having the FSL removed from insurance policies. It is only New South Wales, Victoria and Tasmania that still adopt the completely inappropriate method of funding. The **reallocation of FSL to local municipal Council rates** and not insurance is required in these states that have not already made the change.

The FSL has a tax base limited to those persons and organisations which take out property insurance. The base is further reduced in reality by under insurance. The limitations are completely unnecessary and result from poor scheme design.

This tax is inequitable in that those prudent individuals who insure and particularly those who insure fully pay for the service and those who do not insure contribute nothing and those who under insure pay only a proportion of their fair share.

The FSL should be property based [ie rates], but it also should be **charged only once per person** – not, in the case of investor owners, being charged for multiple properties.

- Thirdly, placing stamp duty on insurance keeps premiums higher, which **does not encourage the consumer to insure adequately**, if at all. The reality is, poorer people tend to live in areas with higher crime rates and are more likely to need insurance than most.

Whether it's the insurance cover the owners corporation is required by law to have, or the additional insurance the owners corporation decides it is prudent to have, all are slugged.

Surprisingly, there has not been much consumer reaction to the rise in stamp duties on insurance in NSW, perhaps because some consumers have convinced themselves they just don't need any, or much, insurance? There are three common reasons often used to justify the lack of insurance:

- There's the 'it won't happen to me' factor. Despite the recent global financial crisis, seventeen years of uninterrupted economic growth have exerted a calming influence on Australians through real wage rises and low unemployment.
- The second reason why insurance slips off the radar for some is the 'I couldn't be bothered' factor. Deciding whether or not you need to take out some form of insurance involves a complex weighing of risk.
- There's always the 'if something really bad happens to me, the Government will bail me out'. Economists call this a 'moral hazard' problem. In the case of insurance, if they think the Government will step in to cover the gap for large claims, they are likely to underinsure their property.

When the deal was initially struck between the Federal Treasurer and the states in 1999 to hand GST to the states, it was made in return for the states agreeing to 'review' a range of stamp duties. These included stamp duties on mortgages, leases, business conveyancing and hire of goods, and were to be offset by the GST. Insurance wasn't on the hit list.

As NIBA and ICA have advocated, stamp duty and FSL reform of these inequitable taxes charged on insurance policies is required.

Other reports have also recommended reform of insurance taxation, such as the:

- Australian Treasury Report "Architecture of Australia's tax and transfer system" (2008)
  - "The narrow base of many transaction taxes and their interaction with other taxes can have an impact on resource allocation in the economy. For example, insurance products are subject to GST, insurance transaction taxes and, in some States, insurance companies can also be required to contribute directly to the funding of fire services. The interaction of theses taxes increases the cost of premiums relative to other products, which may encourage people to take up less insurance than otherwise."
- HIH Royal Commission (2003)
  - "Those states that have not already done so abolish fire services levies on insurers".
  - "That state and territory governments abolish stamp duty on general insurance products."
  - "That state and territory governments exclude the cost of the GST for the purposes of calculating stamp duties or any other state or territory levies that are imposed on insurance premiums."
- NSW Independent Pricing and Regulatory Tribunal (IPART) draft report into State Taxation (2008)
  - "The fire services levy adds to multiple layers of taxation on insurance, discouraging households and businesses from acquiring an appropriate level of insurance cover. This has implications for the efficient allocation of resources within the economy."
  - "In the short term, the statutory contributions by insurance companies to fund fire services should be replaced by a corresponding increase in the contributions by local councils, with a phased implementation and accommodating increases in the municipal rate cap".
  - "IPART considers that on economic efficiency grounds, there is a compelling case for abolishing stamp duty on insurance and making up the revenue forgone from consolidated revenue or other sources."
- Victorian Review of State Business Taxes (2001) Government report
  - "The conclusion of studies (by groups including the Productivity Commission, The heads of Treasuries State Taxes Working Group, comprising representatives of all state and territory Treasuries; and Access Economics) is that stamp duties and transaction taxes are among the most distortionary of all taxes available to the states. The Committee believes that … abolishing them now would nurture business activity and growth."