



National Insurance Brokers Association.



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AFTS Secretariat
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Dear Sir

Australia's Future Tax System

The National Insurance Brokers Association (NIBA) welcomes the opportunity to provide comments to the Review of Australia's Future Tax System (AFTS). NIBA's submission concentrates on the adverse effect that State taxes and charges have on the cost of insurance and their consequential adverse effects on Australian individuals and businesses taking out insurance.

There is nothing in this submission that is confidential.

Summary of Submission

There is no doubt that the multi taxes and charges that apply to insurance in Australia add significantly to the cost of insurance products and that the current system is badly in need of reform. This proposition by NIBA is well supported by a number of recent reviews by well know and well respected authorities.

Treasury in the August 2008 Discussion Paper (page 293) stated;

"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.”

There are three taxes and charges that may apply to the insurance policies taken out by Australian residents and businesses, namely:

- Fire services levy
- GST
- Stamp duty.

These three taxes and charges are cascading. That is, one tax is applied to another tax. There are in fact taxes on taxes on taxes!

The cascading effect of the various taxes and charges can be seen by considering the taxes and charges levied on the property insurance policies of businesses in NSW. For every \$100 dollars of basic insurance premium that is paid by a NSW business a further staggering \$63.06 is paid in taxes and charges. The calculation is as follows:

\$100.00	Basic premium
<u>38.00</u>	36% Fire services levy
138.00	
<u>13.80</u>	10% GST
151.80	
<u>13.66</u>	9% NSW stamp duty
<u>165.46</u>	Total

The rate of fire services levy varies between states and territories, so too does the rate of stamp duty. NSW is not, however, the highest taxing state in relation to insurance. This award goes to Victoria in relation to non-metropolitan business insurance. The taxes and charges applicable there are an incredible \$91.18 for each \$100 of basic premium charged.

Having a single broad-based tax such as the GST applying to insurance is reasonable. Having three taxes (two of which are specific insurance taxes), on top of one another, is inappropriate and places an unjust burden on those who are prudent and insure.

Such a system of cascading taxes and charges is inequitable and cannot be justified on any economic or efficiency grounds. It penalises those people who take positive action to protect themselves and their assets by way of insurance. No other industry or activity is treated in such an unfair way. Such an archaic system requires urgent adjustment and NIBA is pleased that this is being reviewed as part of the AFTS process.

Indications are that with changing weather patterns the number and severity of severe weather events (storms and floods) are likely to increase over time. If individuals are not

to be discouraged from taking out insurance as a means of protecting their property from such events this unjust tax burden on insurance must be speedily removed.

The National Insurance Brokers Association (NIBA)

NIBA is the national association for insurance brokers in Australia. NIBA members are responsible for the placement of around 90% of all insurance for commercial purposes in Australia.

Insurance brokers represent the interests of the purchasers of insurance, the policy-holders, and not those of insurance companies. Consequently the comments made in this submission are made not on behalf of insurance companies but on behalf of the public that purchases insurance.

The Fire Services Levy

The Governments of NSW, Victoria and Tasmanian funds their fire services largely through a levy on property insurance. In NIBA's view such funding arrangements are unjust, inequitable, non-transparent and violate all basic principles of taxation.

The base to which the tax applies is narrow. Those that do not insure their property make no contribution while still enjoying the services provided by the fire services authorities of the state. Those that under-insure do not make an adequate contribution for the services that they receive.

Not only are the current funding arrangements unjust and inequitable but they add to the cost of taking out insurance and work against self protection of the community by way of insurance.

Inadequate property insurance is a significant problem in Australia, particularly for householders and small businesses. This becomes evident after each Australian national disaster. The Australian Securities and Investment Commission prepared a special report on the problems and suffering caused by inadequate insurance after the Canberra 2003 bushfires. Cyclone Larry is a further example.

The system has been heavily criticised by a number of recent official inquiries. The HIH Royal Commission was critical of fire services levies and recommended (Recommendation 56) that **“those states that have not already done so abolish fire services levies on insurers”**.

The Independent Pricing and Regulatory Tribunal in NSW (IPART) recently undertook a review of NSW taxes. At the time of making this submission the final Report of the Review had not been released but in a draft Report of June 2008 it was stated on page 104:

“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.”

The Tribunal’s draft report went on to recommend (Recommendation 7 on page 104):

“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”.

NIBA considers that a completely new approach to funding fire services is required. A far broader contributing population base than simply property insurance policies is needed. Consideration might be given to making the new approach consistent with the arrangements that have recently been introduced in South Australia and Western Australia. The abolition of the fire services levy on insurance in NSW, Victoria and Tasmania would not necessarily mean an increase in government expenditure in those states as the fire services levy could be replaced by a more efficient and effective charge on all those who are protected by the fire and emergency services.

State Stamp Duty on Insurance

Stamp duty in Australia has long been criticised by academics and economists as an unjust and an inefficient way for governments to raise revenue. For this reason there has been a significant move away from such taxes generally in Australia. While stamp duty has been reduced or eliminated from many goods and services no such action, however, has been taken in relation to the duty payable on insurance policies.

It is not surprising that a Victorian Review of State Business Taxes (*Review of State Business Taxes: summary report*, Government of Victoria, Melbourne, 2001, page 13) stated:

“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.”

or that The HIH Royal Commission recommended (*Recommendation 55*):

“That state and territory governments abolish stamp duty on general insurance products.”

and (*Recommendation 57*):

“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.”

The NSW IPART June 2008 draft report on the Review of NSW Taxes stated on page 101:

“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.”

The case for the abolition of state and territory stamp duty is overwhelming.

It may not be practical to immediately abolish stamp duty on insurance. NIBA would, however, welcome an acknowledgement that the stamp duty payable on insurance is an unjust, discretionary tax that hampers business development. NIBA would also like to see the AFTS Review recommend that after a relatively short period of time all specific insurance industry imposts be removed.

Insurance Protection Tax Act 2001

In 2001 the NSW Government introduced an insurance protection fund in order to pay claims against the failed insurer HIH for compulsory third party insurance policies and home warranty.

At the time the estimated liabilities for those claims was \$600 million. The tax raises \$69 million a year. The Insurance Protection Act 2001 contains a most unusual provision in that it does not permit the tax to be passed on to policyholders.

Now is an appropriate time for the basic intention of this legislation to be reviewed. There does not appear to be any sound economic reason for its continuation.

Implications for Climate Change

Over the last year financial year in Australia severe weather events cost the Australian community an estimated \$2.2 billion in insurance losses. With weather predicted to become more severe, improving the community's ability to withstand and recover from such severe weather events is vital.

If an unnecessary burden is not to fall on governments, it is important that the community is encouraged to have in place appropriate insurance for their property.

This will necessitate the removal of unjust and inequitable taxes and charges on insurance.

Prudent behaviour needs to be encouraged by all governments in Australia and not discouraged, as it currently is.

Conclusion

There is no doubt that the way in which state and territory governments apply specific taxes and charges to insurance policies is unjust and fails all basic principles of taxation.

The AFTS Review is welcomed by NIBA as it provides an ideal opportunity to rectify the situation.

NIBA believes that the AFTS Review should recommend that:

1. Fire services levies on insurance be replaced by a broader-based charge on the users of fire and emergency services. Consideration could be given to funding emergency services along the lines of the systems that were recently introduced in South Australia and Western Australia.
2. Stamp duty on insurance be abolished within a relatively short period of time.

If you would like further information about any of the issues covered by this submission, please contact me, npettersen@niba.com.au or 02 9459 4305.

Yours sincerely



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