

17 March 2005

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The Hon. Dr Andrew Refshauge MP
Deputy Premier and Treasurer
Level 31
Governor Macquarie Tower
1 Farrer Place
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RE: 2005-06 PRE-BUDGET SUBMISSION

Dear Treasurer

Insurance Australia Group (IAG) welcomes the opportunity to lodge a submission in relation to the New South Wales 2005-06 Budget.

IAG argues that there is a clear economic case for reducing state insurance taxes and charges ahead of many other taxes in order to reduce the taxation impost on insurance premiums to businesses and households in New South Wales.

Insurance Australia Group

IAG is the largest general insurance group in Australia and New Zealand (by reference to premium written in these countries). It provides personal and commercial insurance products under some of the most respected and trusted retail brands including NRMA Insurance, SGIO, SGIC, CGU and Swann Insurance in Australia, and State and NZI in New Zealand.

IAG has a crucial interest in the long-term viability of insurance as a product valued by the Australian community. IAG believes that there are four principal ways in which the insurance industry can best meet these objectives. These are:

- Investing in robust risk control frameworks and mechanisms that protect policyholders and provide certainty to shareholders;
- Pricing products realistically;
- Ensuring that customers understand what they are buying when they purchase a policy, and that products do not arbitrarily advantage or penalise particular individuals or groups; and
- Committing to, and supporting, on a continuing basis, a comprehensive and clearly defined regulatory framework that facilitates more affordable premiums and more predictable claims costs.



Taxation Burden on Insurance Sector

Latest Australian Bureau of Statistics (ABS) data indicate that nationally, taxes on insurance totalled \$3,132 million in 2002-03, up \$260 million or 9.1% on 2001-02 (\$2,872 million) and accounted for 1.3% of total taxation revenue collected in Australia in 2002-2003.

	1999-00	2000 2001	2001-02	2002-03	Change 2001- 2002 to 2002-03	Contribution to total taxes 2002- 03
	\$m	\$m	\$m	\$m	%	%
Taxes on Insurance	2 139	2 403	2 872	3 132	9.1	1.3

Source: ABS (2004), *Taxation Revenue Australia 2002-03*, Cat.No. 5506.0, April 2004.

ABS data indicate **New South Wales** accounted for 41.4% of total insurance taxes collected by Government in 2002-03.

Taxes on Insurance 2002-03

	NSW	VIC	QLD	SA	WA	TAS	NT	ACT	TOTAL
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Insurance companies contributions to fire brigades	365	250	-	-	69	15	-	-	698
Third party insurance taxes	20	96	48	34	-	3	-	-	200
Taxes on insurance nec	913	496	286	220	239	28	19	33	2 233
TOTAL	1 297	841	334	254	308	46	19	33	3 132

nec not elsewhere classified
na not available

Source: ABS (2004), *Taxation Revenue Australia 2002-03*, Cat.No. 5506.0, April 2004.

Impact of Government Taxes and Charges on Insurance Premiums

By way of explanation, a hypothetical basic premium of \$100 is used to demonstrate the taxation impost of insurance taxes on final premiums to businesses and households. Details are outlined in the following Tables.

**Impact of Government Taxes/Charges on Business Insurance Premiums –
Metropolitan**

	Basic Premium \$	Fire Levy \$	GST \$	Stamp Duty \$	Total Cost \$	Impact of Govt taxes %
NSW	100	24	12.40	6.82	143.22	43.2
VIC*	100	27	12.70	13.97	153.67	53.7
QLD	100	-	10.00	8.25	118.25	18.2
WA	100	-	10.00	11.00	121.00	21.0
SA	100	-	10.00	12.10	122.10	22.1
TAS	100	28	12.80	11.26	152.06	52.1
ACT	100	-	10.00	11.00	121.00	21.0
NT	100	-	10.00	11.00	121.00	21.0

* In country Victoria the fire services levy is 40%, with the total cost of a \$100 premium \$169.40 as a result of Federal and State Government taxes/charges.

It should be noted the Terrorism Insurance Act 2003 came into effect on 1 July 2003 and was introduced by the Federal Government to provide terrorism cover under eligible commercial insurance policies. Premiums on all eligible policies will rise to reflect the cost of the terrorism reinsurance cover provided by the Australian Reinsurance Pool Corporation (ARPC). The ARPC has taken a zone approach to the reinsurance premium to be applied, based on the postcode of the risk: a 2% reinsurance premium for non-urban areas, a 4% reinsurance premium for urban areas and a 12% reinsurance premium for Central Business Districts. . Premium increases will apply to eligible policies that begin on are due for renewal from 1 October 2003. These increases are subject to government taxes and charges (such as GST and stamp duty), and any applicable Fire Services Levy.

Source: Derived from Insurance Council of Australia data.

**Impact of Government Taxes/Charges on Home Insurance Premiums -
Metropolitan**

	Basic Premium \$	Fire Levy \$	GST \$	Stamp Duty \$	Total Cost \$	Impact of Govt taxes %
NSW	100	14	14.00	6.27	131.67	31.7
VIC*	100	12	11.20	12.32	135.52	35.5
QLD	100	-	10.00	8.25	118.25	18.2
WA	100	-	10.00	11.00	121.00	21.0
SA	100	-	10.00	12.10	122.10	22.1
TAS	100	-	10.00	8.80	118.80	18.8
ACT	100	-	10.00	11.00	121.00	21.0
NT	100	-	10.00	11.00	121.00	21.0

* In country Victoria the fire services levy is 17%, with the total cost of a \$100 premium \$141.57 as a result of Federal and State Government taxes/charges.

Source: Derived from Insurance Council of Australia data.

Non-Insurance and Under-Insurance

- **Business**

A national research report *Business Insurance: A National Survey of Small and Medium Size Businesses* (July 2001) commissioned by NRMA Insurance found that while the large majority of businesses have some form of insurance, close to half (47%) either do not have relevant cover or have cover which is judged inadequate. The survey of 1,253 small/medium businesses across Australia was undertaken to provide a better understanding of the business insurance market.

A business may be underinsured because its existing cover is inadequate or if it is not covered for a significant risk for which insurance is available.

Survey results indicate that:

- While the majority of businesses have some form of insurance (91%);
- 47% of businesses do not have a relevant cover or have a cover which is judged inadequate;
- Overall cover for damage to buildings, contents and stock due to fire or other events such as storm, explosive, vehicle impact or vandalism was the most common insurance held by businesses (85% covered);
- Cover for loss of profit due to damage from fire or other defined event was the least common (53%) (business interruption); and
- The most common reason why a business was not covered by an applicable insurance was the cost of premiums. 39% of businesses stated this as the main reason, while 11% stated they do not have enough time to arrange.

- **Household**

Research commissioned by NRMA Insurance in relation to household non-insurance *Home and Motor Vehicle Insurance: A Survey of Australian Households* (October 2001), indicate that one in six Australian households do not have buildings and contents insurance. Applying the survey result to the total population, an estimated 1.2 million households are without building and contents insurance.

An estimated one in five passenger motor vehicles are not insured comprehensively.

The most common explanation householders give for why they do not have insurance relates to the cost of premiums. Similarly, the reason most frequently given by drivers for why their motor vehicles do not have comprehensive insurance or third party property damage insurance related to the cost of premiums.

Survey data suggest that a substantial reduction in the cost of contents insurance would increase its incidence, particularly in rental households. Survey results also suggest that a reduction in the cost of motor vehicle insurance would increase its incidence (see *IAG submission to Public Accounts Committee Inquiry into Fire Services Funding*).

NSW Treasury in its submission to the NSW Public Accounts Committee Inquiry into Fire Services Funding stated “..it would be undesirable if consumers and businesses were choosing not to insure, or underinsuring, because of higher prices caused by taxes on insurance. Not only could this affect the persons or businesses concerned, but overall economic efficiency and growth would be affected by the changes resource allocation” (*NSW Treasury submission, page 14*).

Moreover, NSW Treasury noted” ...it appears that insurance taxes are likely to affect the quantity of insurance demanded, particularly where the taxation levels are relatively high as they are in New South Wales” (*NSW Treasury submission, page 15*).

Taxation Reform – A Case for Insurance Taxes Reform

When the Federal Government announced that it would fundamentally reform the Australian taxation system by introducing a Goods and Services Tax (GST) it also announced that the revenue would go to the States and Territories. The stated intention was that the GST, as a growth tax, would build revenue for State Governments and as a result an opportunity should be created to reduce certain State Government taxes.

IAG understands and acknowledges that each State Government will make the decisions it believes are in the best interests of the community and that are based on sound financial management principles. However, it is worth noting in the this context that Access Economics’ 2000 review of the State taxes and charges on general insurance post GST (*The Overwhelming Case For Cutting State Taxes and Charges On General Insurance Post-GST, September 2000*) found a clear economic case for reducing state insurance taxes ahead of many other taxes, in particular payroll tax.

Using an economy wide approach, Access Economics took into account the interactions between consumers, producers and investors. They then used a highly sophisticated economic model called the computable General Equilibrium Model, which has been used to produce reports for Federal and State Governments. This model was used to estimate the economic impacts of reducing each State/Territory tax by \$100 million (in total, for all States/Territories). The result from this modelling provides a clear economic case for reducing State/Territory insurance taxes ahead of many other taxes.

Access Economics concluded that reducing stamp duties on insurance would result in gains to economic welfare, GDP and investment that are many times greater than the gains that would arise if payroll taxes were reduced by the same amount. Access Economics noted that in broad terms, the results indicate that taxes that fall on investment (such as stamp duties on non-residential conveyancing and insurance) lead to the greatest economic costs, and would therefore provide the greatest economic benefits if they were to be reduced.

Similarly, the Business Coalition for Tax Reform (2004) commissioned Access Economics report on the efficiency of State and Territory taxes in (*Axing the Alcabala: A Program for a 21st Century State Tax System*) noted that for insurance taxes there is a strong efficiency case for further state tax reform.

The report noted, "FSL and stamp duty on general insurance are inefficient enough in isolation. In combination – and even if the tax base for insurance was properly specified - the taxation of general insurance products subject to all three taxes is the most inefficient taxation treatment existing at the state level". (page 43) http://www.bctr.org/upload/AEconomics_State_Business_Tax_Reform_Nov_2004.pdf

IAG appreciates the opportunity to raise this important public policy matter with the Government.

We at IAG are happy to discuss this submission. If you wish to discuss this matter or make further inquiries please contact David Wellfare, Senior Adviser, Economics & Policy on (02) 9292 8593.

Yours sincerely

Barbara Carney
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