

25 September 2009

The Executive Officer  
Economic Development and Infrastructure Committee  
Parliament of Victoria  
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## **Introduction**

Thank you for your letter of 27 August in relation to the Inquiry into State Government Taxation and Debt. Insurance Australia Group (IAG) welcomes the Inquiry into State Government Taxation and Debt by the Economic Development & Infrastructure Committee. IAG believes that it is timely to undertake a review of the impact and effectiveness of increased State Government taxation in Victoria.

## **Who is Insurance Australia Group?**

IAG is an international general insurance group, with operations in Australia, New Zealand, the United Kingdom and Asia. Its current businesses underwrite more than \$7.8 billion of premium per annum. It employs more than 13,500 people of which around 9,300 are in Australia. IAG operates some of Australia's leading insurance brands including NRMA Insurance, CGU, SGIO, SGIC and Swann Insurance. IAG also distributes insurance in Victoria through the RACV brand. IAG insures approximately one in three motor vehicles, and one in four homes, in Australia.

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:

- Providing affordable products that price the risks underwritten realistically.
- Promoting risk awareness and risk reduction both for policyholders and in the community generally.
- Investing in robust risk control frameworks and management mechanisms that reduce operating expenses, make claims costs more predictable and facilitate sustainable profitability for shareholders.
- Committing to, and supporting, on a continuing basis, a comprehensive and clearly defined regulatory framework that ensures that customers understand what they are buying when they purchase a policy and protects policyholders against financial failure of an insurer.

## **What is IAG's Interest in the Victorian Inquiry?**

IAG argues that there is a clear social and economic case for eliminating or at least reducing State insurance taxes and charges as a priority for any reform of Victoria's taxation system.

This case is based on recognition of the essential benefits of insurance to the Victorian economy and community generally and of the role of the tax system in encouraging insurance coverage.

## Taxation Burden on Insurance Sector

IAG notes the Federal Treasury's *Architecture of Australia's Tax and Transfer System Paper* (August 2008) highlighted:

*"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 these taxes increases the cost of premiums relative to other products, which may encourage people to take up less insurance than otherwise.*

*An additional efficiency cost arises where a taxable product is used as a business input, since the tax can encourage businesses to use a less efficient mix of inputs. In addition, such input taxes cascade through the production chain to affect the market price of the final product, reducing international competitiveness."* (page 293)

Australian Bureau of Statistics (ABS) data indicate that nationally, taxes on insurance totalled \$4,250 million in 2007-08 up \$566 million or 15.4% on 2006-07 and accounted for 1.2% of total taxation revenue collected in Australia in 2007-2008. Taxes on insurance in Victoria totalled \$1,156 million in 2007-08.

	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	2007-2008	Change 2006-07 to 2007-08	Contribution to total taxes 2007-08
	\$m	\$m	\$m	\$m	\$m	\$m	%	%
<b>Taxes on Insurance</b>	3 144	3 231	3 502	3 550	3 684	4 250	15.4	1.2

Source: ABS (2009), *Taxation Revenue Australia* 2007-08, Cat.No. 5506.0, April 2009.

### Taxes on Insurance 2007-08

	NSW \$m	VIC \$m	QLD \$m	SA \$m	WA \$m	TAS \$m	NT \$m	ACT \$m	TOTAL \$m
<b>Insurance companies contributions to fire brigades</b>	521	<b>401</b>	-	-	-	15	-	-	<b>937</b>
<b>Third party insurance taxes</b>	116	<b>126</b>	58	44	-	3	-	-	<b>347</b>
<b>Taxes on insurance nec</b>	1 209	<b>628</b>	391	258	372	38	25	45	<b>2 966</b>
<b>TOTAL</b>	1 846	<b>1 156</b>	449	302	372	56	25	45	<b>4 250</b>

*nec not elsewhere classified*

*na not available*

Source: ABS (2009), *Taxation Revenue Australia* 2007-08, Cat.No. 5506.0, April 2009.



## Impact of Government Taxes and Charges on Insurance Premiums - Victoria

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 in Victoria (and a comparison with the other States). 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	34	13.40	13.26	160.66	60.7
<b>VIC*</b>	<b>100</b>	<b>47</b>	<b>14.70</b>	<b>16.17</b>	<b>177.87</b>	<b>77.9</b>
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 non-metropolitan Victoria the fire services levy is 49%, with the total cost of a \$100 premium \$180.29 as a result of Federal and State Government taxes/charges.*

### 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	19	11.90	11.78	142.68	40.7
<b>VIC*</b>	<b>100</b>	<b>19</b>	<b>11.90</b>	<b>13.09</b>	<b>143.99</b>	<b>44.0</b>
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 non-metropolitan Victoria the fire services levy is 20%, with the total cost of a \$100 premium \$145.20 as a result of Federal and State Government taxes/charges.*

Source: Derived from Insurance Council of Australia data (2007).

The Victorian Government should recognise the essential benefits of insurance to the Victorian economy and community generally and implement a taxation system which does not penalise insurance relative to other more discretionary purchases.

IAG believes the current regimes for the taxation of insurance in Victoria are an historical anachronism that is indefensible upon the generally accepted principles of taxation of simplicity, efficiency and equity. These tax regimes are inappropriate, regressive and based on historical circumstances rather than any concept of tax equity. These regimes contribute to under-insurance and non-insurance, with consequential negative fiscal impacts when the public purse is inevitably called upon in times of climate related disasters.

### **Insurance Taxation - International Comparison**

A study by the Centre for International Economics, *The General Insurance Sector: Big Benefits But Overburdened* (2005) indicates by international standards, taxes on general insurance in Australia are high. Indeed, "taxes on property insurance in most Australian states and territories are higher than in the majority of the comparator countries. International taxes as a proportion of premiums are as low as 2 per cent in Ireland and Singapore and 2.4 per cent in the USA (California)".

The Report noted, "Australian taxes on property insurance are particularly high compared with international competitors in the area of business insurance..." (page 24). The Report is available at:

<http://www.insurancecouncil.com.au/Portals/24/Submissions/International%20Economics%20Submission.pdf>

### **Non-Insurance and Under-Insurance**

The Insurance Council commissioned study *"The Non-insured: Who, Why and Trends"* (2007) into non insurance by Dr Richard Tooth and Dr George Barker of the Centre for Law and Economics at the Australian National University considered the effect of State Government based insurance taxes on non-insurance. The Report found:

*"Rates of non-insurance are found to be closely correlated with insurance taxes when examined over time and across jurisdictions. Following the removal of the Fire Services Levy in Western Australia (which came into effect 1 January 2004), the level of non-insurance in both building and contents (as measured from the Roy Morgan Research data) declined while rates climbed elsewhere.*

*The Roy Morgan Research data and the Australian Bureau of Statistics (ABS) Household Expenditure Survey (HES) data support the finding that states with higher tax rates on insurance premiums have higher rates of non-insurance for both building and contents insurance." (p.4)*

The Report is available at:

<http://www.insurancecouncil.com.au/Portals/24/Issues/The%20Non%20Insured%20-%20Report.pdf>

### **Taxation Reform – A Case for Insurance Taxes Reform**

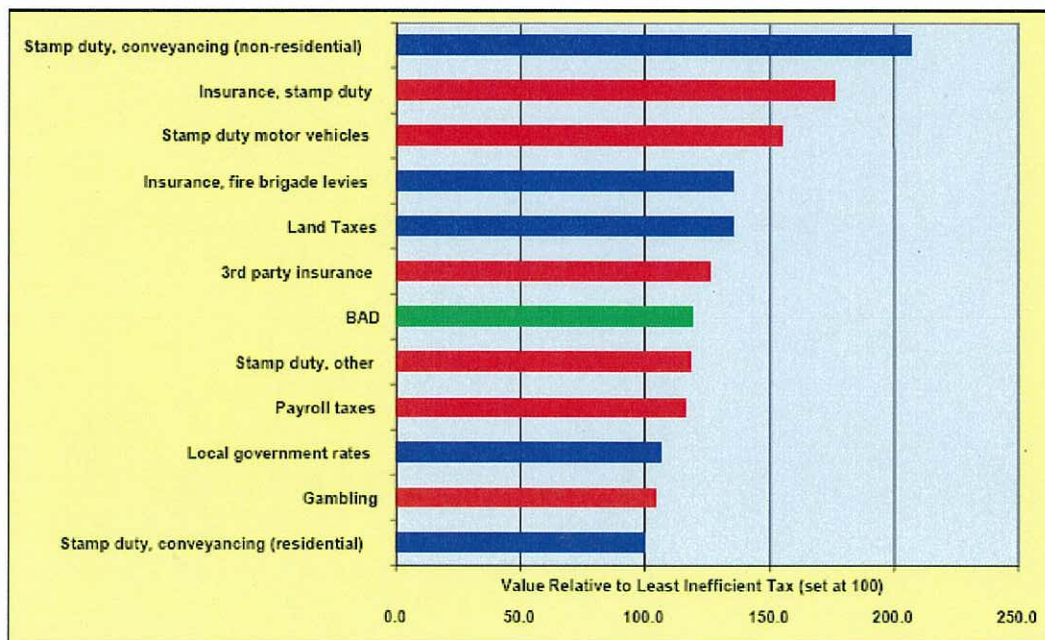
Access Economics' 2000 Review of the State taxes and charges on general insurance post GST (*The Overwhelming Case For Cutting State Taxes and Charges On General Insurance Post-GST, September 2000*) found a clear economic case for reducing State insurance taxes ahead of many other taxes, in particular 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 (*Axing the Alcabala: A Program for a 21<sup>st</sup> Century State Tax System*) noted that for insurance taxes there is a strong efficiency case for further state tax reform. The welfare efficiency results from the Access Economics modelling are summarised below.



Source: Access Economics (2004).

The Access Economics 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".

[http://www.bctr.org/content/documents/AEconomics\\_State\\_Business\\_Tax\\_Reform\\_Nov\\_2004.pdf](http://www.bctr.org/content/documents/AEconomics_State_Business_Tax_Reform_Nov_2004.pdf)

In its submission to the Independent Pricing and Regulatory Tribunal (IPART) New South Wales *State Taxation Review*, the Insurance Council highlighted the relative inefficiencies of State insurance taxes. These efficiency rankings, developed by Access Economics indicated the relative inefficiency of insurance taxes vis-à-vis other taxes. Importantly, IPART noted that "on economic efficiency grounds, there is a compelling case for abolishing stamp duty on insurance and making up the revenue foregone from consolidated revenue or other sources".(IPART p.101)

IAG believes the findings of the New South Wales IPART *State Taxation Review* would be of use to the Economic Development & Infrastructure Committee for the current Inquiry into State Government Taxation and Debt. IPART's *State Taxation Review* noted in relation to insurance taxes:

### **Insurance Duty**

*"Insurance duty is a highly inefficient tax that creates disincentives for appropriate insurance. This suggests that the State should seek to reduce its reliance on this duty over the long term."*(p.61)

*"Insurance duty is a highly inefficient tax. By adding to the price of insurance, it encourages underinsurance and non-insurance in a market that already exhibits significant market failures. The effect on consumer and business behaviour is amplified because the duty is applied on top of the embedded fire services funding contributions and the GST. The Royal Commission into the collapse of HIH recommended governments throughout Australia review their taxes on insurance."*(p.61)

*"The ad valorem nature of insurance duty means that individuals with more assets to protect pay higher premiums, to the extent that the risk related to those assets is the same. However, risk plays a significant role in determining insurance premiums so the link is very weak. Furthermore the equity impacts are confused by the incentive to underinsure."*(p.61)

*"In principle the insurance duty should be a reasonably stable source of revenue – the changes in the revenue collected would largely reflect changes in the condition of insurance markets. However, in practice, it may be less robust due to the incentive to underinsure. Furthermore, tax rates have been subject to significant changes."*(p.62)

### **Fire Services Funding Contributions**

*"The Fire Services Contribution by insurers is effectively a levy on insurance and creates disincentives for taking out appropriate insurance. On this basis, its removal should be a priority."*(p.65)

*"Fire services funding contributions by insurers (known as the 'fire services levy' – FSL – by policy holders) is a relatively inefficient tax. The extent to which insurers pass through the cost of their contributions to policy holders acts as a disincentive to insure. This may lead to underinsurance and non-insurance in a market that already exhibits market failures. The effect on consumer and business behaviour is amplified because the FSL becomes part of the base premium to which the GST and insurance duty are applied."* (p.66)



*"The FSL may be seen to be neutral or progressive because it is based on property values (albeit indirectly through house values). However, the opportunities for avoidance and minimisation through underinsurance means its horizontal equity is poor. Those who underinsure or don't insure avoid contributing via insurance policies to the cost of operating the fire services while they still receive the benefit of these services in the event of fire affecting their property." (p.66)*

While IAG notes and supports the above IPART findings we would reinforce that the fire services levy is a poorly targeted mechanism for distributing the cost of fire services and not considered equitable. Indeed, data shows there is no correlation between the average levy collected and the incidence of fire callouts. This reflects the fact that the levy is imposed on the total premium - which includes the full range of perils including storm and theft - and not just that proportion associated with fire.

As IAG highlighted in its submissions to IPART the proportion of premium attributable to each kind of risk varies considerably from post code to post code based on local factors and claims experience. At an individual household level the premium level, and thus the levy paid, is ultimately determined by the insured value of the home and/or its contents as well as factors such as loyalty and no claim discounts. This means that areas with very low fire risk can contribute substantially more on a per household basis to total levy collections than the more bushfire prone areas of the State.

IAG notes the views of the Australian Consumers' Association that the fire services levy is "an illogical rule that deters consumers from taking out home building insurance (due to higher price)" and this "should be replaced with a levy by all building owners rather than only those who prudently insure" (p.21, *ACA submission to Taskforce on Reducing the Regulatory Burden on Business, December 2005*).

The New South Wales Treasury in its submission to the New South Wales Public Accounts Committee Inquiry into Fire Services Funding (2003) 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 (in) resource allocation" (*NSW Treasury submission, page 14*).

[http://www.parliament.nsw.gov.au/prod/parliament/committee.nsf/0/e5fea4093a03babeca256dec001570b5/\\$FILE/Treasury%20submission.pdf](http://www.parliament.nsw.gov.au/prod/parliament/committee.nsf/0/e5fea4093a03babeca256dec001570b5/$FILE/Treasury%20submission.pdf)

The Treasury (2003) noted, "It seems reasonable to expect that high tax rates would contribute to non-insurance and under-insurance – price increases generally lead to a reduction in demand for goods and services." (*NSW Treasury submission, page 14*).

The Treasury (2003) also noted:

*"The principle underpinning the Fire Services Levy is to ensure beneficiaries of the fire services contribute to funding the service. However, the presence of non-insurance and under-insurance indicates that a significant proportion of beneficiaries are either not contributing to funding the fire services or are under contributing.*

*As a means of matching contributions to fire risk, the levy performs poorly particularly for householders. Fire risk is only one element of insurance policies, and it is evident that there is not a strong correlation between fire risk and fire services levy contributions.*

*A weakness of the current arrangements is that the government is not able to ensure the extent of recovery from each type of insurance policy category is appropriate. However, even if this were addressed, the fact remains that insurance policies are much broader in scope than fire so that the premiums will substantially reflect risks other than fire risk.*

*It is also apparent that insurance is relatively highly taxed – with the fire services levy the highest impost. High tax levels are likely to discourage insurance and lead to under-insurance with adverse consequences for resource allocation and economic growth.” (NSW Treasury submission, page 20).*

Put at its simplest, the current fire services levy regime in Victoria imposes a tax on people who protect their property, businesses and personal possessions by insuring them. It is their taxes that pay for the fire fighting and protection services provided to the entire community. A fairer and more rational system would see all Victorian property owners pay for these services, spreading the burden equitably.

### **State Government Reforms**

A number of State and Territory Governments have taken steps to remove fire services levies and replace these levies on insurance with a broader tax base – in most cases, property.

#### **Western Australia**

The Western Australian Government replaced Fire Service Levies with a property based funding system in 2003-04.

The Sigma Plus Consulting's *Emergency Services Levy Insurance Compliance Review: Final Report* in relation to the effect of the phase-out of the Fire Services Levy (FSL) in Western Australia indicated the removal of FSL in Western Australia contributed to Western Australia having one of the most price competitive insurance markets in Australia in 2003 and consumers responded to cheaper insurance by increasing their insurance cover to more adequately protect themselves.

[http://www.fesa.wa.gov.au/internet/upload/93510369/docs/insurance\\_Compliance\\_Rprt\\_April\\_2004.pdf](http://www.fesa.wa.gov.au/internet/upload/93510369/docs/insurance_Compliance_Rprt_April_2004.pdf)

IAG agrees with the Western Australian Government statement in the *State Tax Review Interim Report*:

*“The former FSL on insurance premiums suffered from the drawback that some property owners avoided the levy through non-insurance, underinsurance or offshore insurance (receiving a ‘free ride’). By contrast, the ESL is levied on all property that may require fire and emergency services, making it broader-based and fairer. Previous funding arrangements through insurance premiums and local government/community-based funding arrangements also suffered from lack of transparency.*

*It is not valid to make a simple comparison between the amounts paid under the old FSL and new ESL, as the former covered only 75% of the costs of providing emergency services. The increase in levies reported by survey respondents might be due in part to avoidance of the former levy as described above.” p.284-285*



### **Australian Capital Territory**

The Australian Capital Territory introduced a fire and emergency services levy on all residential, rural and commercial properties from 1 July 2006. Residential and rural properties are charged a fixed levy of \$84 per annum per property. For rateable commercial properties, the levy is imposed as a percentage (0.4875%) of the average unimproved land value of the property that exceeds the threshold of \$22,000. The amount of the levy is billed and shown as part of the annual rates assessment notice issued to all property owners.

### **Federal – State Government Financial Relations**

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. Under the *Intergovernmental Agreement*, all GST revenue collected by the Australian Taxation Office is provided to the States.


In relation to **stamp duty on insurance** IAG believes it is appropriate for the Federal and State Governments to examine a new set of undertakings beyond the current *Intergovernmental Agreement* to assist further reform of State taxation. A strong case can be made that reform of insurance taxes should have a high priority.

IAG also believes a **fire services funding system**, which encourages full value insurance, would result in economic and community benefits, especially as regards under-insurance. A system that is fair, consistent and more understandable to taxpayers and the community at large is needed. IAG believes that the most effective way of achieving this end, is to implement a system that sees all Victorian property owners sharing the responsibility for funding fire services.

This submission supplements the submission from CGU and the Insurance Council of Australia.

If you wish to discuss this matter or make further inquiries please contact David Wellfare, Senior Adviser, Economics & Policy on (02) 9292 8593 or me on 9292 8026.

Yours sincerely



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