8 January 2013

Executive Officer
Economic and Finance Committee
Parliament House
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ECONOMIC AND FINANCE COMMITTEE - TAXATION REVIEW

Insurance Australia Group (IAG) welcomes the opportunity to make a submission in relation to the Economic and Finance Committee's Taxation Review. IAG believes that it is timely to undertake a Review to inquire into and report on the South Australian taxation system.

IAG would be happy to discuss this submission and to assist in any way we can. 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

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Who is Insurance Australia Group?

IAG is the parent company of an international general insurance group, with operations in Australia, New Zealand, the United Kingdom and Asia. IAG has more than 808,000 shareholders (as at August 2012). IAG's register is the third largest in Australia. Its current businesses underwrite over $9 billion of premium per annum and pay over $6 billion in claims per annum. IAG employs more than 13,600 people of whom around 9,000 are in Australia.

Across our portfolio of brands IAG insures 7.7 million cars, 2.9 million homes, 103,000 farms, 117,000 employers and nearly 400,000 businesses. IAG had more than 16.1 million policies in force in financial year 2012.

Within Australia, IAG's Direct Insurance business provides personal insurance products as well as business insurance packages targeted at sole operators and smaller businesses in NSW, ACT, Queensland and Tasmania primarily under the NRMA Insurance brand. SGIO is the primary brand in Western Australia, and SGIC in South Australia. In Australia, IAG also has a distribution agreement with RACV (underwritten by Insurance Manufacturers of Australia – owned 70% IAG; 30% RACV) in Victoria. Products are distributed through branches, call centres, the internet and representatives.

Within Australia, IAG's intermediated insurance products are sold nationally, primarily under the CGU Insurance and Swann Insurance brands through a network of more than 1,000 intermediaries, such as brokers, agents, motor dealerships and financial institutions. CGU is also a leading provider of workers' compensation services in Australia.

What is IAG's Interest in the Taxation Review?

IAG has been a strong advocate for improved taxation bases and taxation reform that see revenue dependency shift from transaction style taxes (for example insurance) towards those taxes that are more efficient.

A number of Federal and State Government reviews and inquiries have argued for insurance tax reform - the IPART Review of State Taxes (2008), the Henry Tax Review (2009), the Victorian Bushfire Royal Commission (2009), the Johnson Report into Australia as a Financial Centre Forum (2009), Tax Forum (2011), Lambert Report (2011), ACT Taxation Review (2012) and the Productivity Commission Draft Report on Barriers to Effective Climate Change Adaptation (2012).

IAG believes the current regimes for the taxation of insurance are indefensible upon the generally accepted taxation principles of simplicity, efficiency and equity. These tax regimes are inappropriate, regressive and based on historical circumstances rather than 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.

IAG argues that there is a clear social and economic case for eliminating or at least reducing State insurance taxes as a priority for any reform of South Australia's taxation system. This case is based on recognition of the essential benefits of insurance to the South Australian economy and community generally and of the role of the tax system in encouraging insurance coverage.

Taxation Burden on Insurance Sector

Australian Bureau of Statistics (ABS) data indicate that taxes on insurance in South Australia totalled $371 million in 2010-11.

Taxes on Insurance 2010-11

	NSW $m	VIC $m	QLD $m	SA $m	WA $m	TAS $m	NT $m	ACT $m	TOTAL $m
Insurance companies contributions to fire brigades	672	544	-	**-**	-	16	-	-	1 232
Third party insurance taxes	133	147	56	**57**	-	4	-	-	397
Taxes on insurance nec	1 229	765	490	**314**	468	46	33	60	3 405
TOTAL	2 035	1 456	546	**371**	468	65	33	60	5 035

nec not elsewhere classified

Source: ABS (2012), Taxation Revenue Australia 2010-11, Cat.No. 5506.0, April 2012.

Taxation Reform – A Case for Insurance Duty Reform

The Financial Industry Council of Australia (FICA) commissioned Access Economics in 2008 to review State taxes and, especially their impact on economic efficiency. The 2008 FICA report detailed a quantitative analysis of the efficiency of individual taxes and a number of revenue neutral tax reform scenarios. The efficiency rankings reported that state stamp duty on motor vehicles and insurance are amongst the least efficient of taxes, generating significant deadweight losses. The Report is available at: http://www.niba.com.au/tax/resource/Article13.pdf

FICA commissioned Deloitte Access Economics in 2011 to report on the efficiency of existing State and Federal taxation arrangements. The 2011 study found that State Governments remain heavily reliant on inefficient tax bases. Again, the 2011 study found motor vehicle taxes (specifically, stamp duty on motor vehicles) and taxes on insurance are least efficient while municipal rates, land tax and gaming taxes are most efficient. The 2011 Report suggest that the potential gains from the reform of state taxation are large and rival the gains derived from past microeconomic reforms.

Additional research by Dr Richard Tooth (2011), *Flood insurance: economics and issues* commissioned by Insurance Australia Group highlighted the effect of insurance taxes:

> *"…is to increase the price of the insurance service for consumers and reduce consumer demand for taking out insurance. This lower demand could be seen in households either choosing not to insure; or choosing to under-insure i.e. reduce their premiums by partly self-insuring".*
>
> *The effect of taxes on demand has been estimated by analysing how demand has changed in responses to variations in taxes across jurisdictions and time. The estimated impact (summarised in Sullivan, 2010) of removing the non-GST taxes from insurance premiums is an increase in the number of households without contents insurance by around 300 thousand and an increase in the number of owner-occupiers without home insurance by around 69 thousand" (p.9)*

The Henry Tax Review (2009) recommended the following in relation to taxation on insurance:

> *"All specific taxes on insurance products, including the fire services levy, should be abolished. Insurance products should be treated like most other services consumed within Australia and be subject to only one broad-based tax on consumption."*

The NSW IPART's *State Taxation Review (2007)* noted in relation to 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)*

Similarly, the 2012-13 ACT Budget noted:

> *"Inefficient taxes distort behaviour. For example, households and businesses pay a tax on insurance premiums this may – increase insurance costs – result in under insurance – create a disincentive to insure."*

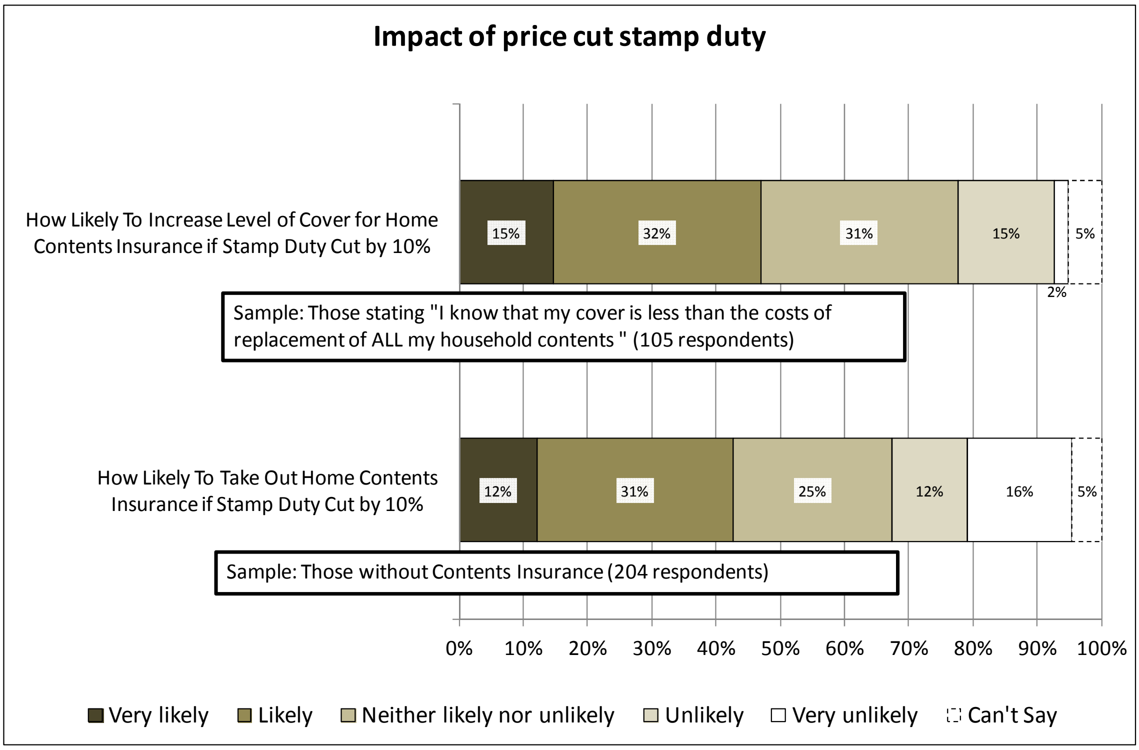
The ACT Government will abolish duty on insurance premiums over the next five years. Every year, over the next five years, duty will reduce by 20% From 1 October 2012, duty on general insurance premiums will fall to 8%. The Independent Competition and Regulatory Commission will be tasked to monitor and report in the future to ensure that consumers receive the full benefits of the savings.

IAG commissioned research (Sapere Research Group and Roy Morgan Research - *Australian Household Insurance: Understanding and Affordability - February 2012)* looking at the level of understanding of insurance and affordability also highlights the case for reform. The survey (1,200 households) seeks to understand household attitudes to insurance, their likely decisions around how they insure in response to affordability pressures and associated outcomes for under and non-insurance. Results indicate:

- 12% of those without contents insurance thought it 'very likely' they would take out Home Contents insurance if stamp duty was cut;
- Another 32% thought it 'likely'; and
- Of those who knew their cover was insufficient, around 15% thought it 'very likely' they would increase their cover.

See details below.

Response to cut in stamp duty



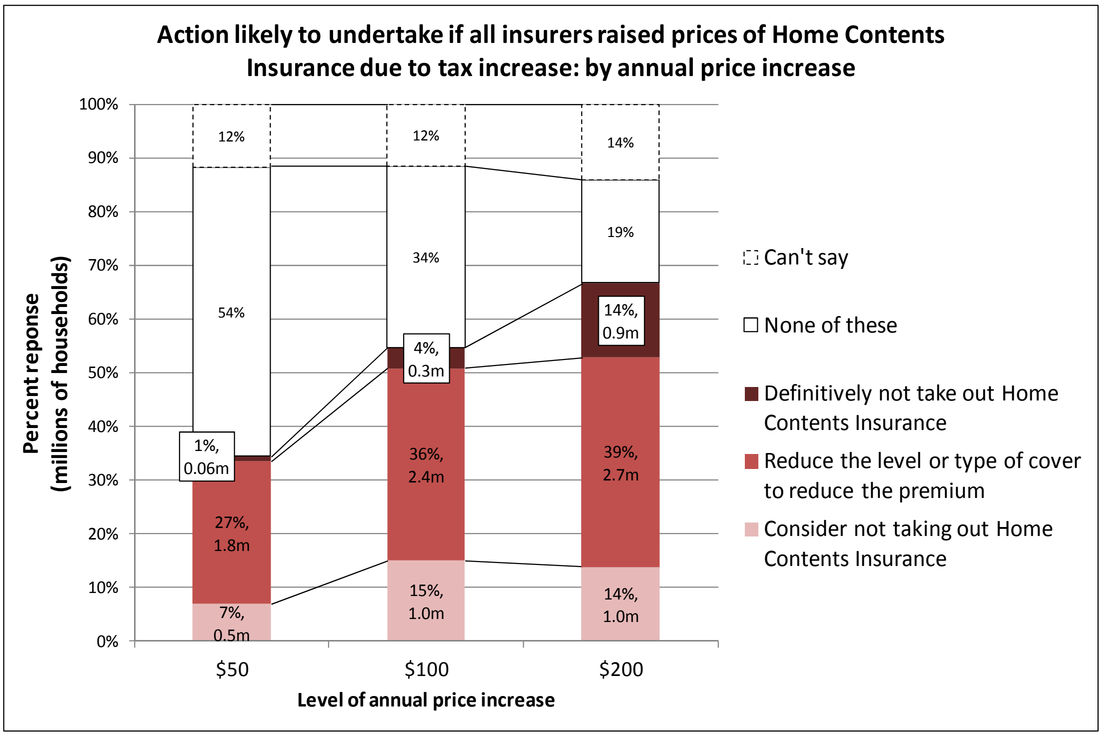
Base: *Those with home contents insurance (975 respondents). Household weights used.*
Source: IAG commissioned research - Sapere Research Group – Australian Household Insurance: Understanding and Affordability (2012).

To assess the impact of increased taxes on premiums, respondents with contents insurance were asked what their likely actions would be to different price rises.

Results indicate a small price increase would lead to a significant response. For an increase of $50 per year — in the order of 10% of the average home contents insurance premium[1] — the results suggest an estimated 27% of insured households would choose to underinsure and between 1 and 8% would choose to not insure. Predictably a larger yearly price increase yielded a more extreme response. See results below.

[1] No exact percentage can be calculated as home contents and home building insurance premiums are typically combined. Information from the ABS SIH 2009/10 indicates the average household premium was around $885 per annum. With some premium inflation and assuming the home contents insurance component is of similar magnitude to home building, the home contents insurance premium component is in the order of $450 to $500.

Response to tax increase



Base*: Respondents with contents insurance from Full Sample. Household weights are used*

1. *Respondents could only choose one action.*
2. *Results are largely insensitive to sample used.*

Source: IAG commissioned research - Sapere Research Group – Australian Household Insurance: Understanding and Affordability (2012).

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.

The Henry Tax Review (2009) highlighted:

> *"…Changes are required to taxes, transfers and other types of expenditures across levels of government. Reforms would also need to be sequenced in a way that allows people to understand the reason for change and how they will be affected. One way to coordinate and implement reforms over time would be through an intergovernmental agreement between the Australian government and the States. A well-managed process would not only allow for poorly performing taxes to be replaced by more sustainable ones, it could also be a mechanism to deliver better policy outcomes across the federation on an enduring* basis." (p.70)

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.