

20 September 2010

Mr Barry O'Farrell
Leader of the Opposition
Parliament House
Macquarie St
SYDNEY 2000

Dear Mr O'Farrell

Insurance taxes

The National Insurance Brokers Association (NIBA) is an independent industry association representing 500 firms and more than 2600 intermediaries, who handle almost 90% of the commercial insurance transacted in Australia.

Brokers play a major role in insurance distribution, handling \$10 billion in premiums annually and placing around half of Australia's total insurance business. They represent the interests of the purchasers of insurance, the policy-holders, and not those of insurance companies. Consequently the comments below are made not on behalf of the insurance buying public.

NSW is now the only mainland State to remain committed to a Fire Services Levy (FSL) on buildings and contents insurance policies to fund the fire and emergency services. This follows the commitment by both the Victorian Government and Opposition to replace the FSL in that State with a progressive, property based tax, following the recommendations of the Victorian Bushfires Royal Commission.

The Royal Commission found that this method of funding the fire services is inequitable, inefficient, lacks transparency and is unsustainable. Previous inquiries and reviews which drew similar conclusions include the HIH Royal Commission (2003), the NSW Independent Pricing and Regulatory Tribunal Review of State Taxation (2008) and The Henry Report: Australia's Future Tax System (2010).

Insurance is a basic necessity for all modern businesses. Without adequate insurance, banks and others are reticent to lend for funding of building construction and business investment. If the NSW economy is to grow and prosper it needs an effective insurance market that is not saddled with high rates of taxes and charges which discourage the take-up of insurance.

NIBA urges the NSW Coalition to commit to a fairer method of funding the fire services which does not place an unfair burden on those prudent enough to take out insurance to protect their property.

Each year funding pressures on the fire services increase as they require more revenue to provide services to a growing population. There needs to be a funding model which provides greater transparency and spreads the funding burden across the entire community.

In addition, there is a “tax on tax” effect which adds to the cost burden, because GST and State Stamp Duty are applied on top of the FSL.

NIBA recognises that governments need revenue to maintain vital infrastructure and services. However, governments must weigh against the need for revenue the long-term need to minimise the financial pressures that fall on them when a large-scale natural disaster occurs.

The best way to ensure the incidence of Governments being called upon to provide ex-gratia assistance to individuals and businesses affected by disasters is minimised is by encouraging them to protect their property through insurance.

According to the Australian Bureau of Statistics, approximately 1.8 million Australian households have no house and contents insurance – that is 23% of all Australian homes. In Victoria, the Bushfire Reconstruction and Recovery Authority has estimated that 25% of those affected were not insured and of those who were, as high as 80% were under-insured, adding to the demands on the Victorian Government for financial assistance.

In 2007, the Insurance Council of Australia commissioned a study into non-insurance by the Centre for Law and Economics at the Australian National University.

Rates of non-insurance were found to be closely correlated with State-based 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 declined while rates climbed elsewhere, supporting the view that States with higher tax rates on insurance premiums have higher rates of non-insurance for both building and contents insurance.

Other States have demonstrated that more equitable methods of funding do exist and that they have been readily accepted by the community.

A more detailed submission is attached and I would very much like the opportunity to discuss this issue with the Coalition.

Yours sincerely

Noel Pettersen
Chief Executive

Insurance Taxes - FSL

(September 2010)

The National Insurance Brokers Association (NIBA)

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 insurance buying public.

The Issue

In recent NSW Budget papers it was noted that taxes on insurance will deliver \$1.912 billion into State coffers in 2010-11.

The \$1.912 billion, which is imposed as a tax on insurers, forms a significant part of the funding for NSW fire services and the State Emergency Service, and is passed on to policyholders through a fire and emergency services levy, to which is added GST as well as Stamp Duty to provide a “tax on tax” effect.

NSW is now the only mainland State to remain committed to a tax on insurance policies to fund fire services after the Victorian Government announced on 27 August 2010 that the Fire Services Levy (FSL) was inequitable and would be replaced.

In response to the recommendations of the Victorian Bushfires Royal Commission, the Victorian Government committed to replacing the FSL with a “progressive, property-based levy.” Queensland, South Australia, Western Australia and the ACT have all introduced equitable, property based methods of funding the fire services.

NIBA supports the work of the fire services authorities and agrees that it is important that these services are well funded. NIBA is, however, strongly opposed to the weight of taxation that NSW insurance policyholders have to bear.

NIBA urges the NSW Coalition to commit to abandoning the tax and to adopting reforms that have been recommended by a string of high level reviews.

This submission concentrates on the inequity of funding the fire services through a levy on insurance. It also comments on the adverse effect that taxes and charges have on the cost of property insurance and the consequential adverse effects on individuals and businesses taking out insurance.

For instance, if a NSW business insures its assets under typical policies such as a Commercial Business Pack or Industrial Special Risk it pays a base premium calculated on the risk and the FSL is applied. Furthermore, if it chooses to add flood cover as an optional extra it will be charged an additional premium and charged a FSL on the total premium including the flood component.

An additional FSL is therefore paid on a peril that has nothing to do with fire. The same applies under a Home Policy where the more benefits such as accidental damage, burglary, flood etc. attract a higher premium, upon which a FSL is paid.

Clearly, insurance is a basic necessity for all modern businesses. Without adequate insurance banks and others are reticent to lend for funding building construction and business investment. If the NSW economy is to grow and prosper it needs an effective insurance market that is not saddled with high rates of taxes and charges.

The extreme level of taxation by any measure has a significant effect on the take up of insurance. A low level of insurance protection is evident in both NSW businesses and households.

According to the Australian Bureau of Statistics, approximately 1.8 million Australian households have no house and contents insurance – that is 23% of all Australian homes. In Victoria, the Bushfire Reconstruction and Recovery Authority has estimated that 25% of those affected were not insured and of those who were, as high as 80% were under-insured, adding to the demands on the Victorian Government for financial assistance.

In 2007, the Insurance Council of Australia commissioned a study, “The Non-insured: Who, Why and Trends” into non insurance by Dr Richard Tooth and Dr George Barker of the Centre for Law and Economics at the Australian National University.

Rates of non-insurance were found to be closely correlated with State-based 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 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.

Those people that do not insure their property make no contribution towards the fire services authorities of NSW while still enjoying the services they provide. Those that under-insure do not make an adequate contribution for the services that they receive.

It is NIBA’s view that a completely new approach to funding fire services in NSW is required. A far larger base of contributors than simply insurance policyholders is required to fund the fire services.

Taxation Principles

In order for a taxation system to be regarded as a quality one it needs to do more than simply raise sufficient revenue to fund essential services such as the fire and emergency services. According to standard taxation principles, a well-designed tax system is characterised by efficiency, equity, simplicity and transparency.

A number of public inquiries have been critical of insurance taxes because they perform poorly against these basic principles of taxation.

Particular criticism has been directed at a lack of equity and the effect insurance taxes have on underinsurance and non-insurance. The system is also criticised for involving a “tax on a tax”, whereby the fire services levy, GST and stamp duty are calculated at each level ensuring a maximum tax return for government.

Having a single broad-based tax such as the GST apply to insurance is reasonable. Having three taxes (two of which are specific insurance taxes levied by the NSW Government), on top of one another, is not.

The Taxes and Charges that Apply to NSW Policy-Holders

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

- Fire Services Levy (levied by the NSW Government in order to fund the fire services)
- GST (levied by the Commonwealth Government which distributes the funds to the states)
- Stamp duty (levied by the NSW Government).

These three taxes and charges are cascading – effectively, one tax is applied to another tax.

The FSL is imposed on insurance companies commensurate with their premiums for certain classes of insurance. The levy is passed on to consumers and businesses through buildings and contents policies. Businesses pay 36% and householders 20% and GST and Stamp Duty at 9% are added on top. In effect, a contribution is required from all insurance premiums on policies of insurance covering the risk of fire on NSW property.

The insurers’ recovery system is imperfect as it requires insurers to collect money from insureds in advance of the insurers knowing the exact amount that they will be required to pay in FSL for the financial year. Consequently an estimate has to be made.

The Insurance Council of Australia, in consultation with actuaries and the fire services authorities, estimates the appropriate rates that can be used by insurance companies to levy their policyholders. Any surplus or shortfall is a matter for each individual insurer.

The calculation for NSW is as follows:

Business Insurance		Home Insurance	
\$1000.00	Basic premium	\$1000.00	Base Premium
<u>360.00</u>	36% Fire Services Levy	<u>200.00</u>	20% Fire Service Levy
\$1360.00		\$1200.00	
+ 136.00	10% GST	+ 120.00	10% GST
\$1496.00		\$1320.00	
+ 134.64	9% NSW Stamp Duty	+ 118.80	9% NSW Stamp Duty
<u>\$1630.64</u>		<u>\$1438.80</u>	

Recent Taxation Reviews

On 31 July, 2010 the Victorian Bushfires Royal Commission handed down its report which included the finding in relation to FSL that “lack of equity and transparency in the current arrangements constitutes a good reason for moving to another system.” It recommended a property based levy similar to those in place in other States.

In recent years, there have been many public inquiries that have been highly critical of the excessive burden placed on insurance policy-holders by the high level of government taxes and charges.

Some quotes and recommendations from a few relevant reports follow:

2001: Victorian State Business Tax Review

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.

Recommendation 1: All business stamp duty be abolished at the earliest opportunity, including stamp duty on (i) general insurance

Recommendation 5: The existing fire services levy raised on insurance premiums be replaced by a separately identifiable charge on all rateable property.

2003 Departmental Review of Victorian Fire Services Funding Arrangements

Alignment between contributions and benefits is poor for:

- Those who do not insure, or significantly underinsure.....

Transparency is limited because there is no observable link between insurance statutory contributions and the amounts collected by insurance companies as an FSL.

2003 HIH Royal Commission

Recommendation 55: I recommend that state and territory governments abolish stamp duty on general insurance products.....

Recommendation 57: I recommend that those states that have not already done so abolish fire services levies on insurers.

2008 NSW Independent Pricing and Regulatory Tribunal Review of State Taxation

The fire services levy adds to multiple layers of taxation on insurance, discouraging householders and businesses from acquiring an appropriate level of insurance cover. This has implications for the efficient allocation of resources within the economy.

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.

Recommendation 8: In the short term, the standard rate of stamp duty for general insurance be reduced from 9% to 5%.

Recommendation 10: In the short term, the statutory contributions by insurance companies to fund fire services should be replaced by an equivalent, transparent property-based levy collected by local councils.....

The Henry Review of Australia's Tax System

Recommendation 79 said:

"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."

NIBA notes that a number of submissions, including one from NIBA, commented adversely on the situation. The Commonwealth Treasury in the August 2008 Discussion Paper for the purposes of AFTS 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 these taxes increases the cost of premiums relative to other products, which may encourage people to take up less insurance than otherwise.

2010: Victorian Report of the Economic Development and Infrastructure Committee on the Inquiry into State Government Taxation and Debt

The 14 month cross-bench inquiry supported the end of the FSL and called for insurance taxes to “minimized or abolished over the long term”

Examples of a property based levy

A number of State governments have recognised the difficulties of funding their fire services by a levy on insurance and now have a more equitable, property based levy which has been readily accepted by their communities.

Western Australia

Property based system with emergency service levy applied on the gross rental value of all immobile properties. No levy is imposed on motor vehicles. The State is divided into fire levy categories according to the level of service provided.

South Australia

Emergency Services Levy is levied on capital values for fixed property and also on motor vehicles and other mobile capital. The levy on property is a fixed fee plus a variable component derived from capital value, an “area factor”, “land use factor” and the levy rate.

Queensland

Queensland Fire & Rescue Service funded through an Urban Fire Levy on properties. Amount of levy is dependent on the location of the property, the activity carried out on the property or the use for which the land is used and the size and nature of any improvements on the land, using the local government guide to classification of properties.

Conclusion

- NIBA considers that it is incumbent upon a NSW Government to uphold any recommendation or policy that will ensure that the NSW fire services are well supported by the Government and the public and that they are funded on a long term equitable basis.
- As in Victoria, there is little doubt that the system of funding fire services in NSW is inequitable and not sustainable into the future.
- A major change is required and it is required as a matter of urgency. Other states fund their fire services by a property based levy and NSW should do the same.
- The only areas for concern with a property based model are that the administrative costs would be borne by property owners rather than insurance policyholders and new administrative arrangements, including a property data base and collection procedures, would need to be developed. These are hardly insurmountable hurdles

and minor when compared to improvements in equity, efficiency, simplicity and transparency.

- NSW should also look towards reducing the stamp duty that it applies to insurance and it should abolish this tax in a relatively short period of time.
- The current situation in NSW whereby a tax is applied to a tax which is applied to a tax undoubtedly discourages individuals and businesses from protecting their property by way of insurance.

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.

I would be happy to discuss this important issue with you or your colleagues at any time.

Yours sincerely

Noel Pettersen
Chief Executive