WHAT YOU NEED TO KNOW ABOUT TAXES ON INSURANCE

National Insurance Brokers Association
Insurance Taxes Discussion Paper

May 2009

Introduction

The National Insurance Brokers Association (NIBA) is an independent industry association representing 500 insurance broking firms and more than 2600 individual brokers, who handle nearly 90% of the commercial insurance transacted in Australia. Insurance brokers play a major role in insurance distribution, handling $10 billion in premiums annually and placing around half of Australia's total insurance business.

The association has long been an outspoken opponent of insurance taxes in Australia. It has campaigned for the abolition of state-based fire services levies (FSL), stamp duties and other taxes that serve to discourage the uptake of insurance in the community.

Such taxes are a disincentive to people and businesses to insure their property at prudent levels, or indeed to insure them at all.

This paper explains why there is a need for reform to the way in which tax is imposed on many insurance premiums.

State governments – particularly New South Wales and Victoria – continue to exploit insurance as a convenient and low-profile way to extract millions of dollars from people and individuals who simply want to protect their property.

Over the past decade a royal commission, two state governments reviews and a number of commissioned studies have acknowledged the link between insurance taxes and the alarmingly high incidence of underinsurance and – even worse – non-insurance in the Australian community.

The disastrous February 2009 bushfires in Victoria have revealed as many as 30% of those who lost their homes had no insurance at all. We expect the royal commission investigating the fires will find – as has been established after similar disasters elsewhere – that affordability was a major factor in people's decision not to insure.

For individual Australians, the loss of their property through natural or man-made causes can be devastating. Without adequate levels of insurance to fall back on, a business is unlikely to ever reopen its doors and a family risks losing everything – their financial security, their home and sometimes their livelihood.

Yet without the three or four taxes heaped on the premium, home and contents insurance would be easily affordable for every Australian. It has reached the stage where insurance is taxed at the same or even higher levels as the so-called "sin taxes" – alcohol, tobacco and gambling.

Reform is desperately needed, but reform won't come until the community understands the problem and demands change. NIBA presents this paper to assist in the drive to raise community awareness of the impacts and alternatives to insurance taxes.

Noel Pettersen
Chief Executive
National Insurance Brokers Association

Tax Reviews

In the past eight years there have been three major official examinations of insurance taxation and its impact on the community. The two states most involved in taxing insurance premiums – Victoria and New South Wales – have both conducted inquiries that were sharply critical of government imposts tied to insurance premiums.

Similarly, the HIH Royal Commission, set up to examine the causes behind the collapse of one of Australia's largest insurers, concluded in 2003 that underinsurance and non-insurance were greatly exacerbated by insurance taxes.

2001: State Business Tax Review (Victoria)

Recommendation 1: All business stamp duties be abolished at the earliest opportunity, including stamp duties on (i) general insurance; (ii) compulsory third party insurance, et al.

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

2003: HIH Royal Commission

Recommendation 55: I recommend that state and territory governments abolish stamp duty on general insurance products. It would be appropriate for this process to be co-ordinated through the proposed ministerial council with responsibility for general insurance.

Recommendation 56: I recommend that those states that have not already done so abolish fire services levies on insurers.

Recommendation 57: I recommend 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.

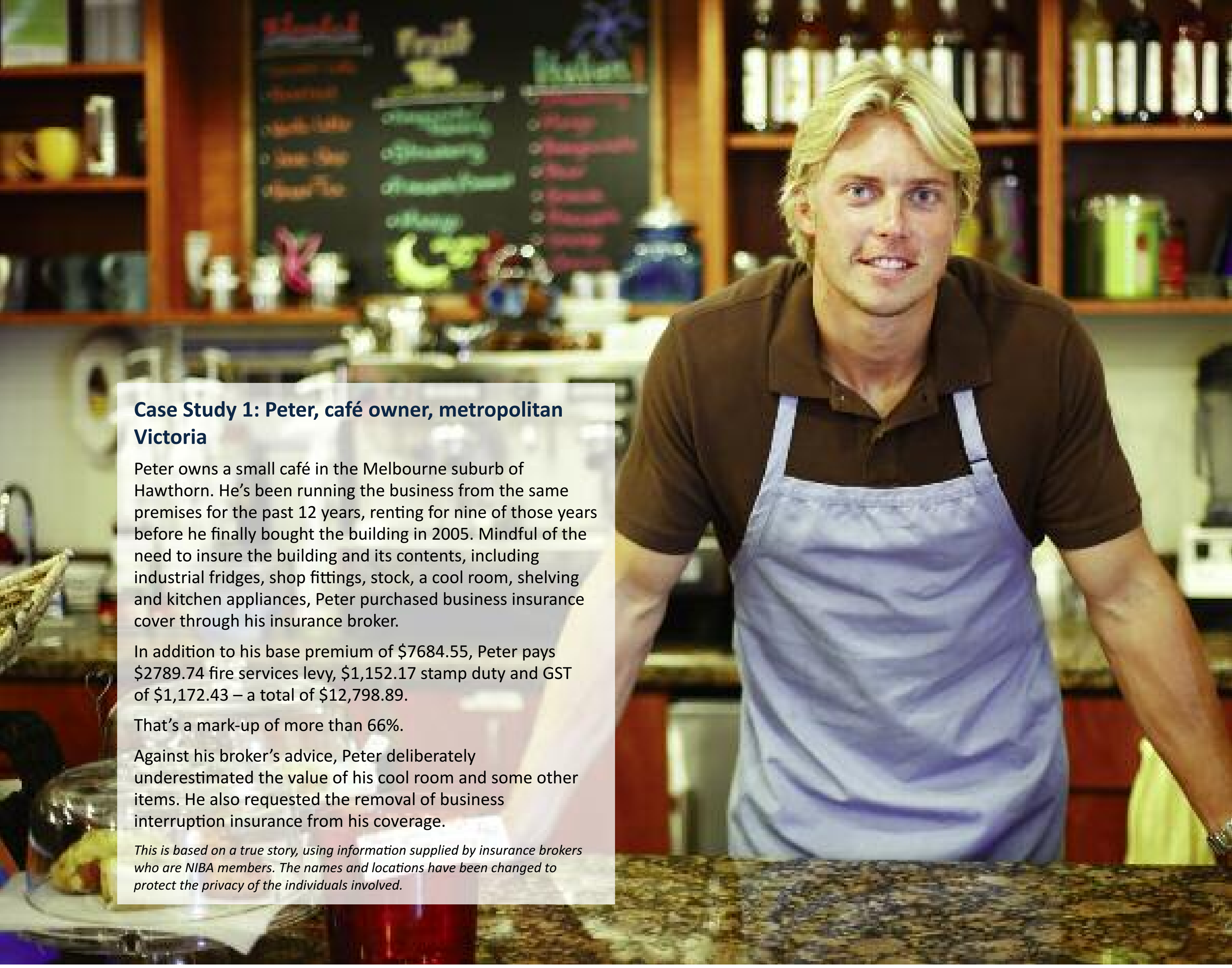
Recommendation 58: I recommend that governments avoid imposing on insurers levies and other taxes that cannot be passed on to policyholders.

2008: New South Wales Independent Pricing and Regulatory Tribunal Review of State Taxation (IPART)

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

Recommendation 9: In the short term, the stamp duty exemption for third party motor vehicle personal injury insurance should be abolished.

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 levy should be separately identified on rates notices, be phased in over time and be excluded from the municipal rates cap. The State Government's contribution to fire services should increase by the amount that the State Government currently contributes to the Fire Services Levy through insurance premiums.



Case Study 1: Peter, café owner, metropolitan Victoria

Peter owns a small café in the Melbourne suburb of Hawthorn. He's been running the business from the same premises for the past 12 years, renting for nine of those years before he finally bought the building in 2005. Mindful of the need to insure the building and its contents, including industrial fridges, shop fittings, stock, a cool room, shelving and kitchen appliances, Peter purchased business insurance cover through his insurance broker.

In addition to his base premium of $7684.55, Peter pays $2789.74 fire services levy, $1,152.17 stamp duty and GST of $1,172.43 – a total of $12,798.89.

That's a mark-up of more than 66%.

Against his broker's advice, Peter deliberately underestimated the value of his cool room and some other items. He also requested the removal of business interruption insurance from his coverage.

This is based on a true story, using information supplied by insurance brokers who are NIBA members. The names and locations have been changed to protect the privacy of the individuals involved.

Fire Services Levies (FSL)

In Victoria, New South Wales and to a lesser extent Tasmania, a fire services levy is charged on the insurance industry. Set by each state's Minister for Emergency Services in consultation with the State Treasurer, revenue from the levy is used to fund about 73-75% of the cost of running the metropolitan and rural fire services, with the balance being provided by local government and consolidated revenue. In 2006/07 the three state governments involved raised $854 million in fire services levies.

To recover the cost of their contributions to the fire services, insurance companies impose the levy on domestic and commercial insurance policies – so it only applies to insurance buyers. If a property-owner chooses not to insure, they do not pay for the fire service.

In Victoria, the levy is substantially higher for country-based businesses than for urban companies. This situation is particularly ironic, when it is considered that mainly volunteer-based rural fire services are less likely to reach country properties in time to extinguish the fires.

A small business in country Victoria with a base premium of $100 is charged an additional $97.23 in taxes. This comes through a massive 63% fire services levy, with 10% GST and 10% stamp duty on top of the full amount.

This compares with FSL rates of 48% in metropolitan Victoria, 36% in New South Wales and 28% in Tasmania.

Governments need revenue to maintain vital infrastructure like roads and schools. So why would they be interested in letting go what has become over time a convenient and simple way of raising revenue through taxes and charges on insurance premiums?

Put simply, governments must weigh against the need for revenue the long-term need to minimise the financial pressures that fall on it when a large-scale disaster strikes. And the best way to secure a more financially stable and far less "needy" community is by encouraging individuals and businesses to protect their property through insurance.

Take the example of the February Victorian bushfires. The State Government has for years discouraged the purchase of insurance by imposing world-record levels of taxes and charges on premiums. As a result the Government has had to fund the financial recovery of the estimated 30% of people who had no insurance or didn't have adequate cover.

The more governments penalise the insured, the more underinsured people there will be who need financial assistance to survive. As governments help those who didn't insure, those who did ask why.

Homeowners pay less FSL than businesses, but the amount is still sizeable. The levy for householders in rural Victoria is 24% and 20% in metropolitan areas. The New South Wales householder levy has now reached a uniform 19% across the state.

NIBA has campaigned strongly against what it regards as an unfair and inequitable impost on policyholders. It says the fire services levy effectively forces those prudent enough to insure their assets to foot the bill for their region's fire services. People and businesses that choose not to take out cover are not required to pay a cent for the security that fire services provide.

The New South Wales Independent Pricing and Regulatory Tribunal Review of State Taxation (IPART) that was released in October 2008 highlighted the problem thus:

"… fire services funding contributions are the least efficient State taxes. [These] revenue sources penalise those who are prudent enough to take out insurance, and so encourage underinsurance and non-insurance. In addition, significant free-rider problems are associated with the fire services funding arrangements, where non-contributors benefit from the provision of fire services without contributing to the cost through insurance policies."

The New South Wales and Victorian Governments have conducted their own studies into the effectiveness of the system, and while aspects of the studies have admitted the unfairness of fire services levies – the Victorian Government refuses to recognise the levy as simply another form of tax – both governments have chosen to retain the system.

In November last year the New South Wales Government went one step further, announcing the introduction of a fourth tax on their state's policyholders due to come into effect on July 1 this year. Used to fund the State Emergency Service, the new levy goes directly against the recommendations of the IPART Report, which called for the scrapping of the fire services levy system and a sharp reduction in all other taxes on insurance policies.

Branded "cynical" and "discriminatory" by NIBA and "ill-conceived" by the Insurance Council of Australia, the $39 million levy essentially mirrors the antiquated fire services levy. It is estimated it will cost the average domestic policyholder $10 when it comes into force in July. The impact on commercial policies will be much worse.

South Australia, Western Australia and Queensland have dropped the FSL system in recent years, replacing it with a collection system based around normal local government property-based taxes. The Australian Capital Territory and Northern Territory fund their fire brigade services from consolidated revenue.

Case Study 2: John and Karen, farmers, rural Victoria

Victorian farmers John and Karen renewed their policy through their insurance broker in September 2007. Their "Farm Pack" insurance cover costs $4389.85 for a year. Their base premium was $2709.94, but government taxes – in the form of a fire services levy, stamp duty and GST – added another $1479.91 to the cost. The broker charged a mere $200 for his services.

Suffering under the strain of the drought, they decided to contact their broker and find out about the "extra" government charges.

"Despite their farm being in an area prone to bushfires and a voluntary fire service would not likely save their property in the event of a fire, I had to explain to them that the fire services levy is a compulsory fee on policyholders used to pay for the cost of the state's fire services," their broker said. "If you don't have insurance, you don't pay the fee."

Discussing this with their neighbours, John and Karen soon learned of several cases in their region where fires were attended by the Country Fire Authority despite the landowner being uninsured.

This is based on a true story, using information supplied by insurance brokers who are NIBA members. The names and locations have been changed to protect the privacy of the individuals involved.

Taxation Principles

While a taxation system should logically meet the revenue needs of essential public services such as the fire and emergency services, it should also be efficient, equitable, simple and transparent.

An ideal system would minimise the scope for avoidance, have little effect on purchasing behaviour and avoid worsening existing inequalities. More importantly, the community should clearly understand what they are paying for and how it is calculated.

NIBA has consistently argued that taxes on insurance premiums fly in the face of fundamental principles of good taxation. Particular criticism has been directed at the inefficient “tax on a tax on a tax” method of taxation, whereby the fire services levy, GST and stamp duty are calculated at each level to ensure the state reaps the maximum amount. Importantly, it also adds to the cost of doing business.

A 2001 Victorian Government review of state business taxes agreed stamp duties and transaction taxes are among the most distortionary of all taxes available to the states. It also concluded that abolishing them immediately would nurture business activity and growth. It said:

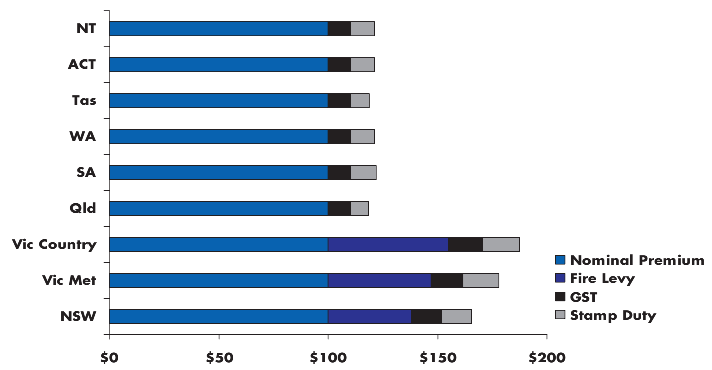
“The abolition of stamp duties on insurance will eliminate the invidious situation of taxes being charged on other taxes, a problem that is brought into sharp relief when the fire services levy, stamp duty on insurance and GST all appear on the one bill.” (2001, Victorian Government Review)

Placing multiple taxes on insurance is blatant and unfair to those prudent enough to insure their property through insurance. By adding to the price of insurance, such taxes deter people from taking out appropriate levels of insurance and add to the cost of insurance, thereby contributing to underinsurance and non-insurance.

In 2007, the Insurance Council of Australia’s review into non-insurance in the Australian community revealed that high levels of taxation were correlated with high levels of non-insurance.

Its findings – compiled by an independent researcher – showed that if state taxes on insurance were removed some 300,000 extra households would take out contents insurance and approximately 70,000 extra households would take up building insurance.

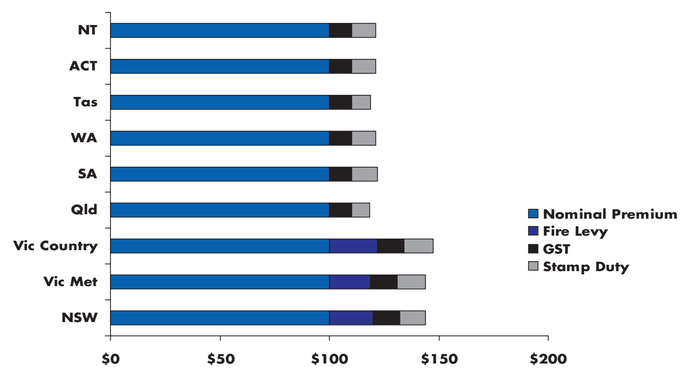
Impact of Government Taxes on Business Insurance



Note: Nominal Premium set at $100 for purposes of illustration

Source: Insurance Council

Impact of Government Taxes on Home Insurance



Note: Nominal Premium set at $100 for purposes of illustration

Source: Insurance Council

The study branded the fire services levy system as inefficient and a disincentive to insure, saying it encourages a situation where the uninsured still receive the benefit of the fire services in the event of an emergency even though they do not contribute (via insurance) to the cost of providing those services.

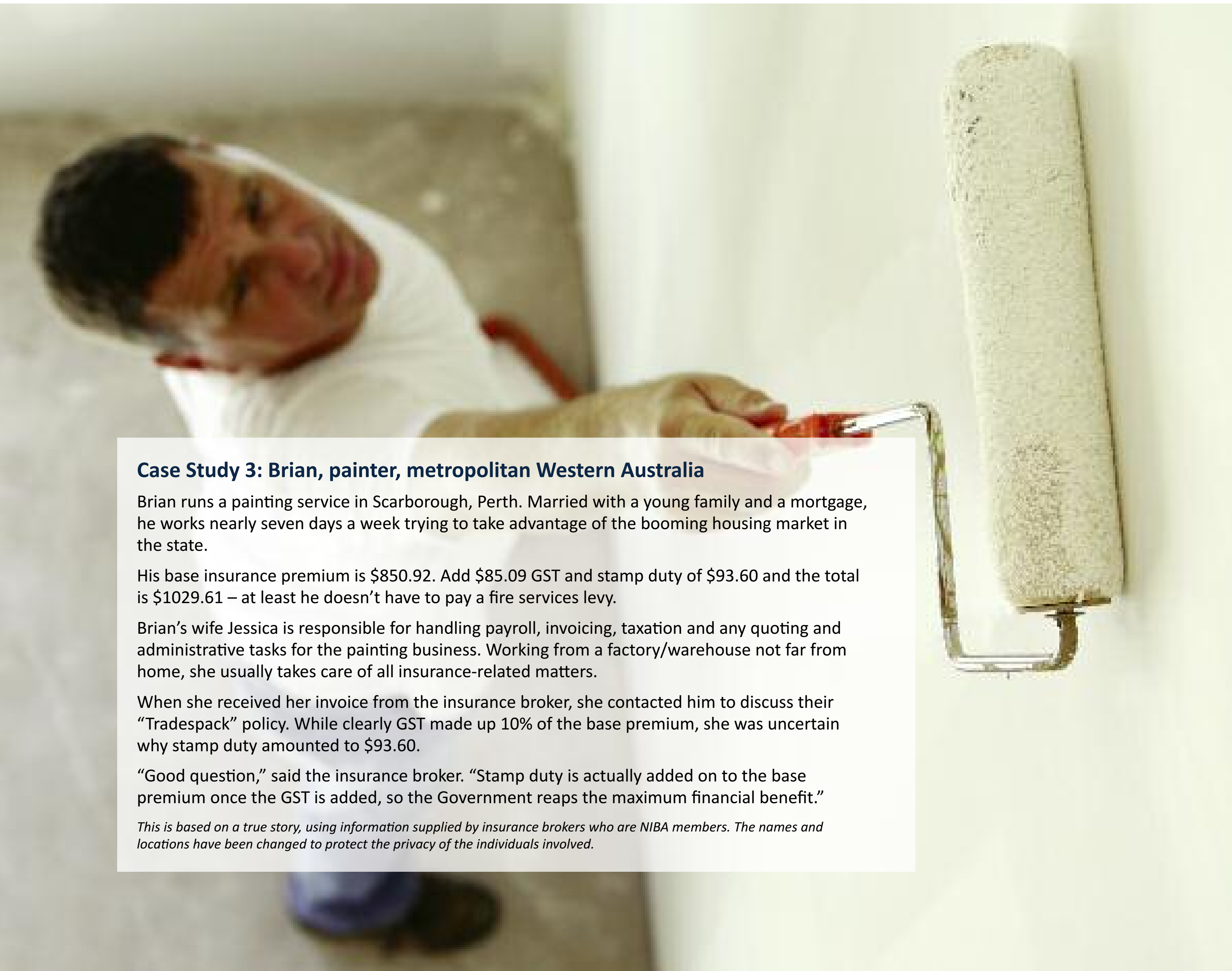
The method of collection is neither simple nor transparent to the general public. While insurers' contributions are relatively straightforward, the complex method used by insurers to recover their contribution is far from clear and does not necessarily reflect the individual policyholder's real contribution to the fire services.

While the use of carefully targeted levies that are in the public interest have the effect of curbing negative behaviour, taxing insurance as a "sin tax" – at much the same level as taxes on gambling, tobacco and alcohol – is having an adverse effect.

In fact, state governments now accrue more in insurance taxes than they do from gambling machines.

When the GST was introduced in 2000, state insurance taxes were not included in the original Intergovernmental Agreement, allowing commitments to use GST revenues in the overall strategy of reducing the burden of business taxes to go by the wayside.

Nine years on, the states are showing healthy revenue, particularly since GST revenue is returned to them.



Case Study 3: Brian, painter, metropolitan Western Australia

Brian runs a painting service in Scarborough, Perth. Married with a young family and a mortgage, he works nearly seven days a week trying to take advantage of the booming housing market in the state.

His base insurance premium is $850.92. Add $85.09 GST and stamp duty of $93.60 and the total is $1029.61 – at least he doesn't have to pay a fire services levy.

Brian's wife Jessica is responsible for handling payroll, invoicing, taxation and any quoting and administrative tasks for the painting business. Working from a factory/warehouse not far from home, she usually takes care of all insurance-related matters.

When she received her invoice from the insurance broker, she contacted him to discuss their "Tradespack" policy. While clearly GST made up 10% of the base premium, she was uncertain why stamp duty amounted to $93.60.

"Good question," said the insurance broker. "Stamp duty is actually added on to the base premium once the GST is added, so the Government reaps the maximum financial benefit."

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In 2006/07 state governments raised $3.714 billion from taxes on insurance premiums, which includes $854 million in fire services levies.

Under a new levy introduced by the New South Wales Government in November 2008 to finance the operations of the State Emergency Service, that figure will grow by an additional $39 million a year from July.

Higher premiums being imposed by insurance companies in reaction to a much higher incidence of weather-related claims around Australia will also result in higher levels of GST and stamp duty being diverted directly and indirectly to state and territory governments' coffers.

Estimated Effect of Removing Premium Taxes on Home and Contents Insurance (Australia)

NSW Households (000's) without contents insurance					
	From 2003/04 ABS HES Survey	Reduction if FSL Removed	% Decline	Reduction if all GI State Taxes removed	% Decline
	2,170	182	8	300	14
NSW Households (000's) without buildings insurance (owner occupiers not in a body corporate)					
	203	49.2	24	69.2	34

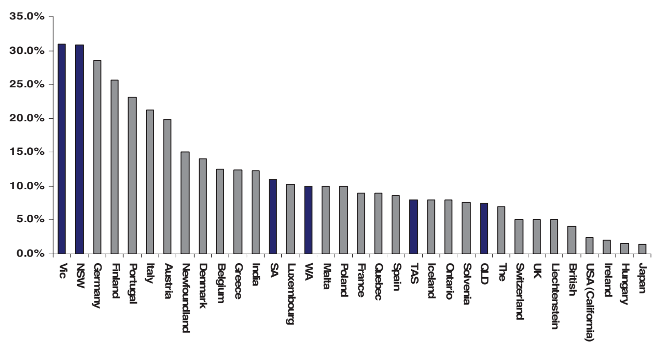
Source: Tooth, Richard (2007) "*An Analysis of the Demand for House and Contents Insurance in Australia: A report for the Insurance Council of Australia*".

International Comparisons

Australian insurance policyholders are paying world-record levels of state and territory taxes. Victoria has the world's highest level of insurance taxes, closely followed by New South Wales. They are well above any other developed countries.

This graph compares Australian taxes on general insurance with the rest of the world.

International General Insurance Premium Taxes (ex consumption taxes)



Source: CEA Indirect taxation on insurance contracts in Europe. PWC international comparisons of insurance taxes (March 2007). Governor's Budget California 2005-06. PW Guides Canada other indirect taxes.

Case Study 4: Richard and Tina, homeowners, regional New South Wales

Richard and Tina purchased their first home in Jervis Bay, New South Wales. Taking advantage of the Federal Government's first homebuyers grant, they picked up a reasonably priced three-bedroom weatherboard home not far from the beach.

Looking for an insurance policy to cover their new home and its contents that wouldn't break the bank, they contacted their local broker, who arranged coverage with a major Australian insurer.

They weren't happy when their invoice showed their $1222.19 base premium came with a 19% fire services levy ($232.21), plus 10% GST ($145.44) and 9% stamp duty ($143.98). Include the broker fee of $51.37 and the cost of the policy had blown out to from a manageable $1222.19 to $1795.19. That's a 47% hike.

Note: this example does not include the State Emergency Service levy, which will come into force in July 2009.

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Eliminate the FSL and more people insure

"Shifting the funding for fire services away from those who currently insure their properties to all property owners, as a separate item on local government rates notices, would achieve greater equity in supporting the fire services."

The Western Australian Government replaced its fire services levy with a broader tax in 2002, following South Australia's lead in 1999.

An independent report by Sigma Plus in 2004 found the change in Western Australia led to lower premiums and an increased number of people taking out insurance. Home and contents insurance fell by 13% while commercial property premiums were 15% cheaper in the year after the levy was lifted.

Conclusion: the insurance-buyer must demand change

The “loser” in the insurance taxes debate isn’t the insurance companies, or the intermediaries who arrange the insurance. It is the policyholder who pays for the insurance, and they are paying considerable amounts in “hidden” taxes.

Governments have found it relatively easy to ignore the insurance industry’s arguments for the elimination of taxes which are both unfair and inefficient.

Where there has been success in convincing governments of the need for change – as happened when South Australia and Western Australia accepted the fire services levy system was outdated and inefficient – the results have been positive. Premiums have fallen and more people have taken out more realistic levels of insurance cover.

However, the need to address the wider subject of insurance taxes – especially the imposition of stamp duty on top of GST – also has to be considered. Australia is at present in the early stages of examining the possibilities for a more efficient system of raising government revenue at all levels. There is broad community acceptance of the need for taxation revenue to build and maintain public services and infrastructure.

However, NIBA believes the collection of taxes should be done equitably. It does not believe the insurance industry or its customers are being treated in accordance with the best principles of taxation practice.

In such a situation, where state governments pay little more than lip service to the principles of fairness and equity over the taxation of insurance premiums, NIBA believes the policyholder must also weigh in. It is the policyholder who is paying far more than they should for their insurance, and it is in the policyholder’s interest to investigate and understand how much of their payments for insurance are in fact being used to supplement government revenue.

If you would like to know more about government taxes on insurance, and what you can do to help raise awareness among politicians that this is not acceptable, contact your insurance broker.

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