INSURANCE COUNCIL OF AUSTRALIA

NORTHERN TERRITORY GOVERNMENT DEPARTMENT OF TREASURY & FINANCE

Northern Territory Revenue Discussion Paper

Submission from the

Insurance Council of Australia

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INSURANCE COUNCIL OF AUSTRALIA

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1. Introduction

The Insurance Council of Australia (Insurance Council) welcomes the opportunity to comment on the Northern Territory (NT) Revenue Discussion Paper being overseen by the Department of Treasury and Finance of the Northern Territory Government (the DTF).

The Insurance Council is the representative body of the general insurance industry in Australia. Our members are responsible for more than 95 percent of total premium income written by private sector general insurers. Insurance Council members, both insurers and reinsurers, are a significant part of the financial services system. They provide insurance products ranging from those usually purchased by individuals (such as home and contents, travel and motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability, professional indemnity, commercial property, and directors and officers insurance).

The industry employs approximately 60,000 people and on average pays out about $132.8 million in claims each working day. September 2017 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of $45.1 billion per annum and has total assets of $118.1 billion.

Through the efficient management of risk, the general insurance industry plays an essential role in supporting the everyday activities of individual Australians, communities and the broader operation of the Australian economy. In particular, the industry plays a critical role in protecting the financial well-being of individuals, households and communities by restoring their standard of living and helping them recover following natural catastrophes. The role of the general insurance industry in community recovery is significant not only in terms of the billions of dollars of claims paid, but also because of the evolving risk mitigation and emergency management initiatives that make for more resilient Australian communities.

The Insurance Council has been a major participant in the State/Territory tax reform debate in the past and is pleased to contribute to the NT's consideration of tax reform through the DTF's consultation.[1] This submission will focus on Chapter 10 of the Discussion Paper, *Insurance duty*.

The Discussion Paper has been released at a time when research and analysis on State/Territory taxation matters are well developed and advanced. The economic case for the abolition of insurance-based taxes is widely accepted, having been canvassed in numerous Federal and State/Territory Government reviews and inquiries including the Australian Government's Review of Australia's Future Tax System (the Henry Tax Review), the NSW Independent Pricing & Regulatory Tribunal (IPART) Review into State Taxation, the Victorian Royal Commission into the 2009 Bushfires Royal Commission, the NSW Government 2012 review: *Funding our Emergency Services*, ACT Review of Taxation, the GST Distribution Review[2] and Productivity Commission reports.

The Henry Tax Review provides a basis on which to judge the efficiency of State and Territory taxes regardless of the where they are levied. Taxes utilised at the State/Territory level in

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[1] See Insurance Council submissions to the Australian Future Tax System Review, the NSW IPART Review, and the Tasmanian State Tax Review, available online.

[2] See GST Distribution Review, Final Report. October 2012.

Australia fall into two basic categories:

- taxes on transactions (such as stamp duties and levies on the purchase of insurance and on property sales) which have large dead weight costs, are a drag to prosperity and suffer from revenue volatility; and
- those such as payroll and land taxes that, although they suffer from weaknesses in their bases through exemptions, offer the States and Territories a tax base that is potentially efficient and revenues that are stable and predictable.

The consensus from recent reviews is that the States and Territories would be materially better off if they reformed their tax bases on payroll and land to reduce exemptions at the same time as they reduced their reliance on transaction type taxes such as insurance duties. The Insurance Council therefore strongly submits that the interests of NT would be best served by abolishing its insurance duties. The successful shift in States such as Victoria, South Australia and Western Australia from funding emergency services through an insurance levy to a broad-based property levy shows that reform is feasible and brings with it significant social and fiscal benefits.

A broad-based property levy, subject to safeguards as to its impact, is a more economically effective and equitable method to fund the NT Government when compared to transactional insurance duties. A broad-based property-based levy would encourage the adequate take-up of insurance; and be a more efficient and certain way of collecting revenue compared to insurance duties, which in essence, penalises policy holders for effectively managing their risks.

The NT Government has the opportunity, through the reform of its insurance tax regime, to strengthen the long term integrity of its own revenue base.[3]

[3] For example, the Productivity Commission's October 2017 Draft Report on its Inquiry into Australia's system of horizontal fiscal equalisation (HFE) underpinning the distribution of GST revenue to the States and Territories.

2. Benefits of insurance duty reform

The Insurance Council endorses the DTF's use of insurance examples in the Discussion Paper to explain the poor consequences stemming from the present regime:

> *"… To the extent that insurance duty increases the cost of insurance, it may deter people from taking up the appropriate level of insurance. Non-insurance is likely to be more prevalent among for persons on lower incomes, who may also be more vulnerable in the event of loss ... Reducing the rate of insurance duty may be desirable from an economic efficiency perspective, as it could lower insurance premiums and encourage individuals and businesses to take up an appropriate amount of insurance."*

Non and under-insurance is a serious problem. According to data from the Australian Bureau of Statistics (ABS) Household Expenditure Survey, it is estimated that of Australia's 8.4 million households which could potentially purchase contents insurance, 29 per cent (or 2.5 million) did not have a contents policy and of the 5.25 million potential buyers of home insurance, 3.8 per cent do not have a building insurance policy.[4]

A recent national survey undertaken by Understand Insurance, the Insurance Council's financial literacy initiative, found that more than 80 per cent of Australian homeowners and renters are under insured for their home and contents and 63 per cent of renters do not have contents insurance. While demand for insurance is influenced by various factors, such as demographics, dwelling type and tenure, the research indicates that insurance affordability is a key determinant of insurance take up.[4]

The current insurance duty regime imposes a tax on people who protect their property, businesses, motor vehicles and personal possessions by insuring them. The non-insured do not pay the insurance duty, while the owners of under insured assets and businesses pay less than the owners of the fully insured when duties on the insurance industry are one of the Government's main own-source revenue mechanisms. This raises significant equity concerns and operates as a disincentive for owners of assets to purchase adequate insurance coverage.

This disincentive is exacerbated by the combined effect of GST charged on insurance premiums, which distorts insurance price signals and reduces insurance affordability, increasing the risk that a household or business will under insure or not take out insurance. The layering of GST on top of an insurance duty can lead to effective taxes of 20 per cent on a home insurance policy premium in NT.[5] The effect of these charges often hit hardest on NT small to medium businesses as commercial premiums are typically significantly higher than for consumer policies.

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[4] Tooth, R, *Sapere Research Group,* (research commissioned by the Insurance Council of Australia), Analysis of demand for home and contents insurance, pages ix-xi. August 2015.
[5] Insurance Council, Submission in Response to the Australian Government's Tax Paper. June 2015.

Research from the Insurance Council in 2015[6] examined the impact of removing State and Territory insurance duties (and the Emergency Services Levy in NSW) on the take-up of house or contents insurance:

- The removal of all insurance taxes and charges in NT and ACT[7] would result in a $6 million (or 5 per cent) increase in household expenditure on pre-tax insurance premium on house or contents insurance across Australia.
- The removal of all insurance taxes and charges would result in a $643 million (or 13 per cent) increase in household expenditure on pre-tax insurance premium on house or contents insurance across Australia.

In 2015, the Insurance Council also commissioned research[8] using computable general equilibrium modelling of the Australian economy[9] to determine the economic impact of removing the removing all insurance-based taxes in all States and Territories Australia, and replacing them with commensurate increases in municipal land rates/property taxes. The research found that this would lead to:

- a net increase in real private consumption across Australia of $5.52 billion; and
- a net increase in tax revenue collected by 0.75% or approximately $5 million for the Northern Territory Government
- a net increase in tax revenue collected by States, Territories and Local Governments of $575 million after five years if this reform was implemented Australia-wide.

The exacerbation of non and under-insurance by the duty on insurance ultimately increases the NT Government's own financial exposure to catastrophic events through strong political pressure to meet community expectations of recovery assistance. It has been recently calculated that the total economic cost of natural disasters in the NT over the past decade averaged $50 million per year and that the total economic cost of natural disasters in NT will reach $3.3 billion a year by 2050, a growth rate of 2.8% per year.[10]

[6] Tooth, R, op. cit., pages 24-30.
[7] NT specific data is not provided as the ABS at the timey aggregated Household Expenditure Survey data for the NT and ACT (the study's source data). To more accurately reflect Territory differences, the study used a blended stamp duty rate to reflect the relative population of households (1/3 weighting to the NT rate and 2/3 to the ACT rate).
[8] Insurance Council and Deloitte Access Economics. Impact of removing stamp duties on insurance. October 2015.
[9] Comparative static computable general equilibrium model of the Australian economy with a representative household to model the impact of these changes on private consumption (as a proxy for welfare) and government budgets is recent best practice of modelling the impact of taxes in Australia, according to Cao, L. et al. Understanding the economy-wide efficiency and incidence of major Australian taxes. The Treasury, Australian Government. 2015; KPMG, CGE analysis of the Current Australian Tax System. Canberra. 2010; and Deloitte Access Economics, Analysis of state tax reform: Report for Insurance Council of Australia. 2011.
[10] Australian Business Roundtable for Disaster Resilience and Safer Communities, Media Release. 21 November 2017.

3. Designing an efficient tax system

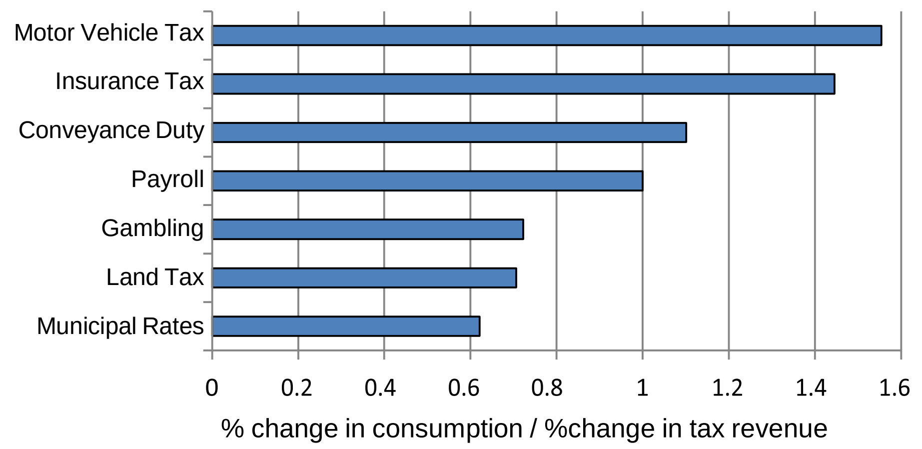
The effectiveness of a tax in achieving its purpose can be assessed against certain criteria, firstly by being equitable in terms of both horizontal and vertical equity (meaning that taxpayers with greater ability to pay, pay more tax). Furthermore, the effective tax should be:

- transparent and simple to understand;
- structured to minimise non-compliance; and
- able to provide the government with sufficient funding to adequately provide the services expected by the community.

Insurance duties imposed on general insurance policies do not satisfy these characteristics. Nor do they uphold the effective tax criteria of efficiency, in that the imposition of insurance duties raises premiums and as a consequence can affect consumers' choice to purchase insurance, increasing the likelihood of non and under-insurance (as discussed in earlier sections).

The Insurance Council conducted an analysis[11] of the economic efficiency of State and Territory government taxes, the rankings are summarised in Chart A below.

Chart A
Australia-wide efficiency rankings of State and Territory taxes



The more efficient a tax is the lower will be the change in consumption. The efficiency rankings are based on the ratio of the percentage change in real consumption to the percentage change in tax revenue and then indexed to payroll tax, which is assigned a value of 1. Accordingly, the higher the ranking the less efficient is the tax.

[11] Analysis conducted in 2009 by Deloitte Access Economics in conjunction with the Insurance Council using the Access Economics General Equilibrium model to assess the efficiency of State government taxes as part of project examining stamp duty reform. The efficiency of an individual tax in the model is measured by the change in household consumption that comes from raising an extra dollar of revenue via the tax while at the same time decreasing lump sum taxes by a dollar (equivalent to raising Government transfers by a dollar). The consumption response is dependent on the size of the demand and supply elasticities incorporated into the model.

The analysis shows that of the main taxes levied by State and Territory governments, motor vehicle taxes, insurance taxes and conveyance duty are the least efficient while municipal rates, land taxes, gambling and payroll taxes are more efficient taxes.

3.1 Stamp duty is a regressive tax

In 2015, the Insurance Council sourced data on average premiums, average sums insured and the number of policies at the post code level from members and combined this data with Australian Taxation Office post code level income data to determine the average stamp duty burden[12] at the post code level[13].

Analysis of the data demonstrated that as incomes increase, the stamp duty burden tends to decrease. This reflects the fact that households on higher incomes have a greater propensity to reduce premiums (for a given sum insured) by adopting self-insurance strategies such as increased deductibles or implementing household mitigation strategies.

The regressive nature of insurance stamp duties is an important equity issue for policy makers. A means tested mechanism should provide targeted assistance to disadvantaged insured households in a similar manner to the GST, where income tax cuts or transfer payments can be designed to compensate for the GST burden on selected households.

3.2 Recent stamp duty reforms in other jurisdictions

As the NT Government may be aware, the NSW and Victorian governments announced last year stamp duty exemptions for a number of insurance covers.

In NSW, stamp duty exemptions for lenders' mortgage insurance took effect from 1 July 2017, while exemptions for certain small business and crop and livestock insurance covers took effect from 1 January 2018.[14]. In Victoria, stamp duty exemptions for certain crop, livestock and agricultural machinery insurance covers took effect from 1 July 2017.[15]

The Insurance Council strongly supports the policy goals underpinning these important exemptions, chiefly as they collectively contribute to helping address the issue of under-insurance and non-insurance in Australia, which can have a devastating financial impact on people's lives.

The Insurance Council's members have invested significant resources in complying with the exemptions – the commercial changes required have been extensive and needed considerable time to develop, test and implement, and largely reflects the complexity of the insurance covers that fall within scope of the exemptions. For example, many crop and livestock risks can be insured under generic commercial product lines (e.g. grouped or blanket commercial property covers), rather than specific, stand-alone agricultural lines. Because of this, insurers have

[12] Stamp duty burden is defined as stamp duty paid divided by income by post code.
[13] Aggregated member data from Insurance Statistics Australia database for the Insurance Council's submission in response to the Australian Government's Tax Discussion Paper. June 2015.
[14] See Revenue NSW's website.
[15] See Victorian State Revenue Office's website.

typically needed to build new systems to apply the exemptions in accordance with the new laws.

Implementing the exemptions has been a challenging experience for industry, particularly in light of the relatively short timeframes provided by governments and the complex nature of many of the insurance covers. With the benefit of hindsight, we believe that more thorough industry consultation would have helped facilitate a smoother transition process for all parties involved. For example, earlier consultation would have helped provide our members with a better opportunity to identify potential technical challenges and work with governments on possible solutions.

Given these recent experiences, we would encourage the NT government, in developing any insurance stamp duty exemptions, to consult early on any proposed changes and provide a sufficient time frame for industry implementation.

4. Alternative model for revenue collection

The Insurance Council strongly submits that the interests of NT would be best served by proceeding with the abolition of inefficient duties on general insurance policies. However in providing this recommendation, we also acknowledge the Discussion Paper raised the question of potential alternative sources of revenue if insurance duty were reformed.

The NT Government's decision to reform an inefficient tax which is diminishing the NT community's welfare would be justifiable on its economic merits alone. However, given the practical considerations in forgoing this revenue, an alternative is to replace insurance duties with a commensurate increase in a broad-based property levy subject to safeguards as to its impact.

The Insurance Council's research presented earlier found that this would result in an increase in real private consumption and a net increase in revenue collected by NT overall. As presented earlier in Chart A, a broad-based municipal or land tax is highly efficient when compared to other possible sources of taxation revenue, including taxes on insurance. The efficiency rankings highlight the scope for economic "upside" if NT Government were to shift their sources of taxation revenue away from transaction insurance taxes to taxes of a more immobile nature such as municipal rates and land taxes).[16]

The Insurance Council respectfully submits that the NT Government should implement a tax reform strategy designed to shift the Territory's reliance from inefficient, narrow-based transaction taxes to broad-based, more efficient taxes. Provided there is adequate consideration of the NT's specific characteristics, the Insurance Council is confident that the NT Government will be able to model and implement an effective broad based property levy in the same manner other Australian jurisdictions have transitioned away from insurance-based levies.

In light of historical issues experienced by other jurisdictions, it would be important for the NT Government to consider the differences between property levy models in each State and Territory. While private land is often the principal base for the property taxes and emergency service levies, there remain significant differences in approach. For example, in Queensland, the levy incorporates stipulated risk factors depending on the activity carried out on the property; in Western Australia, the levy is a function of service levels with minimum payments and maximum caps in place; and South Australia employs a land use factor for its emergency service calculation.

[16] This is consistent with the understanding in the Henry Tax Review and the IPART State Tax Review. The policy objective of shifting State taxes away from transaction style taxes to taxes on immobile bases was also discussed at the Commonwealth