

Ms Ana Markulev
Horizontal Fiscal Equalisation Inquiry
Productivity Commission
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9 November 2017

Dear Ms Markulev

HORIZONTAL FISCAL EQUALISATION INQUIRY

The Insurance Council of Australia¹ (the Insurance Council) appreciates the opportunity to comment on the Productivity Commission's (the Commission) 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 (the Inquiry).

This submission focuses on the Commission's finding in the Draft Report that States and Territories considering implementing efficient tax policies may be deterred by the effects of tax reform on GST redistribution under the present system of HFE.

The Insurance Council is very concerned with the Commission's finding, as it indicates that the current system of HFE may operate as a material disincentive for States and Territories to phase out inefficient general insurance taxes.

As the Commission would appreciate, general insurance taxes, a form of transaction tax, can have a higher distortionary effect than other taxes; they significantly increase the cost of general insurance premiums for Australian households and businesses and contribute to the incidence of non-insurance and under-insurance in Australian communities.

The removal of insurance taxes has long been advocated by major national inquiries, such as the Australian Government's Review of Australia's Future Tax System (the Henry Tax Review) and the Commission's 2014 Inquiry into Natural Disaster Funding Arrangements. In this context, it is very concerning that the present system of HFE may be deterring Australian governments to adopt the recommendations of those important inquiries.

¹ The Insurance Council of Australia is the representative body of the general insurance industry in Australia. Our members represent more than 90 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. June 2017 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross written premium of \$45 billion per annum and has total assets of \$124.9 billion. The industry employs approximately 60,000 people and on average pays out about \$135 million in claims each working day.

Insurance Council members provide insurance products ranging from those usually purchased by individuals (such as home and contents insurance, travel insurance, motor vehicle insurance) to those purchased by small businesses and larger organisations (such as product and public liability insurance, professional indemnity insurance, commercial property, and directors and officers insurance).

As the Inquiry is considering whether the present system of HFE is in the best interests of national productivity, or whether there may be preferable alternatives, the Insurance Council strongly encourages the Commission to recommend alternative GST distribution options (such as via an alternative GST formula) that would not operate to disincentivise States and Territories to undertake unilateral or multilateral tax reform to phase out insurance taxes.

Australia's System of HFE may Discourage State Tax Reform

The Insurance Council notes the Commission's finding that, in principle, the GST formula underpinning the present system of HFE can give States and Territories a financial incentive to rely on inefficient taxes (namely those with a mobile tax base, such as insurance taxes), as reducing the rate of these taxes would see a relatively large increase in their tax base and, all else equal, a consequential reduction in their GST payments².

The Insurance Council appreciates the Commission's use of potential insurance tax reform examples in its Draft Report to help explain the potential financial disincentive created by the present system of HFE:

"...if a State with high insurance taxes legislated a lower tax rate, the reduced cost of insurance would lead to greater take up by households and businesses. But this larger tax base would mean the State is assessed as having a higher revenue raising capacity, and so receives less in GST payments. If the State's capacity was initially below average, the effect on GST payments would be exacerbated by the downward impact on the average tax rate..."³

The Insurance Council also notes the Commission's finding that where policy reforms involve substantial modification to existing taxes, a State or Territory acting unilaterally could materially deviate from the 'average policy', which would have a commensurate impact on its GST payments that could serve as a 'first mover disadvantage' to tax reform⁴.

In our view, QLD's application of general insurance stamp duty may help provide some context to this finding. It would appear from the Commonwealth Grants Commission's previous assessments of GST Revenue Sharing Relativities⁵ that, leading up to QLD's increase in general insurance stamp duty to 9 per cent in August 2013⁶, Queensland had for a number of years been assessed as having a relatively higher capacity to raise insurance taxes, which had negatively impacted its GST distribution in the insurance tax category.

We submit that the present system of HFE must not operate to potentially discourage States and Territories from pursuing taxation reforms that seek to correct material inefficiencies in their tax systems, given, for example, the clear long term social and economic benefits of phasing out insurance taxes, as explained in the following section.

² Productivity Commission [Draft Report](#), Inquiry into Australia's system of horizontal fiscal equalisation, October 2017. Page 92.

³ Ibid.

⁴ Productivity Commission [Draft Report](#), Inquiry into Australia's system of horizontal fiscal equalisation, October 2017. Page 91.

⁵ Commonwealth Grants Commission, [GST reviews and updates](#), changes in the GST distribution by revenue assessments.

⁶ Queensland State Budget 2013-14, [Budget Measures](#), Budget Paper No. 4. Page 57 refers.

Significant Benefits of Insurance Tax Reform

Phasing out State and Territory insurance taxes would provide significant social and economic benefits to Australian communities – it would reduce the incidence of non-insurance and under-insurance in Australian communities and lead to net increases in private household consumption and tax revenue collected by state and local governments.

Reducing non-insurance and under insurance

Research from the Insurance Council in 2015⁷ examined the impact of removing State and Territory insurance premium taxes on the take-up of house or contents insurance.

- The research estimated the change in take-up if stamp duties (and the Emergency Services Levy in NSW) were removed from States and Territories.
- The research estimated that 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.

The consequences of Australian households or businesses underinsuring or not insuring is unfortunately too commonly demonstrated following natural catastrophes – where they are either not insured or underinsured, they leave themselves financially vulnerable by risking their properties and other valuable assets. Inefficient insurance taxes, which can increase base premiums by up to 45 per cent⁸, have a substantial impact on insurance affordability and continue to operate as a significant barrier to purchasing adequate insurance coverage.

Increasing net household consumption and taxation revenue

Separate Research from the Insurance Council in 2015⁹ found that significant economic benefits could arise from removing insurance-based stamp duties and raising the revenue forgone through alternative, more efficient means – namely, a commensurate increase in municipal rates (i.e. a broad-based tax on land) – that would have a neutral impact on State and Territory government budgets.

The Insurance Council's research found that removing all insurance-based stamp duties across Australia, including the ESL in NSW, and replacing them with commensurate increases in municipal land rates, 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 state and local governments of \$575 million after five years if this reform was implemented Australia-wide.

As the Commission may be aware, in July last year the ACT Government became the first State or Territory jurisdiction to abolish insurance stamp duties after completing a five-year transition. Without the removal of stamp duties, we estimate¹⁰ that the average combined ACT home building, contents and motor insurance premium would be around \$185 higher.

⁷ [Research](#) by Dr Richard Tooth, *Sapere Research Group*, commissioned by the Insurance Council of Australia in 2015.

⁸ In NSW, the ESL, GST and stamp duty can lead to effective taxes of around 45 per cent on a home insurance policy premium.

⁹ [Research](#) by *Deloitte Access Economics*, commissioned by the Insurance Council of Australia in 2015.

¹⁰ Insurance Council of Australia [Media Release](#), 1 July 2016. The average combined cost of ACT home building, contents and motor insurance in 2016 was \$1851. With a 10 per cent stamp duty applied, that cost would rise to \$2036.

The ACT Government's decision to phase out insurance stamp duties is a clear acknowledgement that reform of state insurance taxes is achievable. Importantly, the ACT Government's reform also recognises that encouraging insurance take-up is a major part of building a community's long term resilience to natural disasters and other catastrophes.

Given the clear long term benefits of phasing out insurance taxes, it is concerning that the system of HFE may be deterring other jurisdictions from following the ACT Government's lead on insurance tax reform – we submit that broader economy-wide benefits of insurance tax reform should always take priority over any potential impact on GST revenue distribution.

If you have any questions or comments in relation to our submission, please contact John Anning, the Insurance Council's General Manager Policy, Regulation Directorate,

Yours sincerely

Robert Whelan
Executive Director & CEO