Tax on Insurance

Background

Taxes on insurance play a large role in determining how much insurance is purchased by the Australian community. Despite the important role that insurance plays to the economic well being of the nation, the insurance sector is heavily taxed. In the year 2005/06, taxes purely on insurance amounted to $3.7 billion.

Insurance is heavily taxed

Taxes on insurance have escalated considerably - from $2.1 billion in 2000 to $3.7b in 2006.[1] This 72% increase in the insurance tax take between 2001 and 2006 is greater than the 22% increase in the CPI over the equivalent period. [2]

As a result of this heavy tax burden, taxes on insurance inevitably play a major part in supporting State government budgets.

As the table below demonstrates, taxes on insurance comprise as much as 10% of all State taxes in Victoria and South Australia.

Insurance Taxes as a share of Total State Taxes

(2006/07)

Victoria	10.1%
SA	9.7%
Tas	7.6%
NSW	6.9%
WA	6.7%
Qld	4.4%
ACT	4.4%
NT	2.9%

Source: State Budgets, 2006/07

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[1] Source: ABS Cat No 5506 *Taxation Revenue* and ABS Cat No 5206 *National Accounts*

[2] Source ABS Cat No 6401 *Consumer Price Index*

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High levels of taxation on insurance inevitably results in State government's being reliant on insurance taxes to fund State services. This means that efforts to relieve the burden of taxation on insurance become inevitably tangled with discussions on the capacity of the States to fund core services (such as health, education and law and order) or the trade-off between taxes on insurance and cuts to government spending.

The Insurance Tax System

The insurance sector is subjected to a wide range of taxes and levies. They are:

Taxes on Income

- Company Tax, where insurance companies pay a direct tax of 30%.
- Income Tax

Taxes on Employers

- State Payroll taxes

Taxes on Good & Services

- Fire Service Levies (FSL) – which are applied to a range of insurance products and are levied for the purposes of funding fire brigade services in the jurisdictions of NSW, Victoria and Tasmania.
- Goods & Services Tax (GST) - the economy wide indirect tax levied at a rate of 10% to final customers.
- Stamp Duties – which are applied to the insurance contract with varying rates across the States and territories.

The State of NSW also subjects insurers to the Insurance Protection Tax (IPT). The Insurance Protection Tax was introduced post the HIH Royal Commission to protect policy holders from insurer collapse and to fund State government debt arising from the collapse of HIH insurance. Unlike other State taxes, however, the IPT is not able to be passed onto policy holders and accordingly, is a direct tax on insurer shareholder capital. This tax serves to penalise small retail "mum and dad" investors and acts as a disincentive to investors in the insurance industry. In 2006/07, the NSW government is forecast to collect $69 million from the IPT.

The interaction and overlap of the indirect taxes on general insurance gives rise to punitive tax on tax effects. For example, in NSW and Victoria, a purchaser of insurance cover is subject to three layers of tax that accumulate on one another in this fashion.

- The Basic Insurance Premia which forms the base for the Fire Services Levy (FSL)

- The Basic Insurance Premia, together with the FSL forms the tax base for the GST.
- The Basic Insurance Premia, the FSL, and the GST forms the base for the levy of stamp duty.

This tax on tax effect adds a significant impost to consumers as outlined overleaf.

Impact of Government Taxes on Home Insurance Premiums

(as at Sept 2006)

	Vic	**NSW**	**SA**	**WA**	**Qld**	**Tas**	**ACT**	**NT**
Metropolitan Areas								
Basic Premium	100	100	100	100	100	100	100	100
Add Fire Levy	22	20	Nil	Nil	Nil	Nil	Nil	Nil
Add GST	12.20	12.00	10	10	10	10	10	10
Add Stamp Duty	13.42	13.20	12.10	11	8.25	8.80	11	11
Final Price	***147.62***	***145.20***	***122.10***	***121.00***	***118.25***	***118.80***	***121.00***	***121.00***
Country Areas								
Basic Premium	100	100	100	100	100	100	100	100
Add Fire Levy	22	20	Nil	Nil	Nil	Nil	Nil	Nil
Add GST	12.20	12.00	10	10	10	10	10	10
Add Stamp Duty	13.42	13.20	12.10	11	8.25	8.80	11	11
Final Price	***147.62***	***145.20***	***122.10***	***121.00***	***118.25***	***118.80***	***121.00***	***121.00***

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Impact of Government Taxes on Business Insurance Premiums

(as at Sept 2006)

	Vic	NSW	SA	WA	Qld	Tas	ACT	NT
Metropolitan Areas								
Basic Premium	100	100	100	100	100	100	100	100
Add Fire Levy	50	36	Nil	Nil	Nil	28	Nil	Nil
Add GST	15	13.60	10	10	10	12.80	10	10
Add Stamp Duty	16.50	13.46	12.10	11	8.25	11.26	11	11
Final Price	***181.50***	***163.06***	***122.10***	***121.00***	***118.25***	***152.06***	***121.00***	***121.00***
Country Areas								
Basic Premium	100	100	100	100	100	100	100	100
Add Fire Levy	44	36	Nil	Nil	Nil	28	Nil	Nil
Add GST	14.40	13.60	10	10	10	12.80	10	10
Add Stamp Duty	15.84	13.46	12.10	11	8.25	11.26	11	11
Final Price	***174.24***	***163.06***	***122.10***	***121.00***	***118.25***	***152.06***	***121.00***	***121.00***

Source: Insurance Council, September 2006[3]

Is Taxing Insurance good tax design?

The basic principle of good tax design as historically supported by public finance policy makers are:

- That the tax (and/or system) promotes economic efficiency and growth. In other words, the imposition of the tax does not distort decisions from economic agents. In turn, this leads to the efficient allocation of resources across the economy and fosters economic growth.

- That the tax is equitable and fair. By fairness, this means not only that those with additional capacity paying higher rates of tax (ie vertical equity) but also that individuals in similar circumstances pay the equivalent in tax (ie horizontal equity). Making State taxes more efficient will tend to improve horizontal equity.

[3] The Insurance Council publishes advisory Fire Services Rates to assist members in the determination of their levy obligations. Members undertake their own evaluations of levies having regard to their own business conditions.

- That the system is simple, both administratively and with respect to compliance. A parallel of this objective is that the system is transparent to decision makers and economic agents.

On the basis of these principles, insurance taxes and levies are not optimal taxes. In particular, taxing insurance distorts the take up of insurance and therefore the ability of economic agents to share and spread risk. Inequities arise as householders that do not take out insurance at all (or self insure) are still provided the public benefit of State provided emergency and fire services. According to the latest Household Expenditure Survey 2003-2004, over 650,000 Australian households have no home/home contents insurance, with 100,000 of these households owning outright or paying off their own home.

There are also particular attributes of insurance markets that make insurance a poor tax base. In particular, the more price sensitive demand and supply of a product is to tax effects, the more likely that the tax will result in behavioural distortions. Introducing and/or increasing taxes on general insurance will result in efficiency losses and over time, do little to secure the robust tax base desired by governments and policy makers.

What are the options for reform?

A number of State and Territories have taken steps to remove Fire Services Levies and replace these levies on insurance with a broader tax base – in most cases, property. For example, Western Australia replaced Fire Service Levies with a Property based approach in 2003/04. A review of the policy change conducted in mid 2004 found that the abolition of Fire Service Levies resulted in consumers significantly increasing their total level of insurance cover at a lower overall cost.

NSW, Victoria and to a lesser extent, Tasmania (commercial policies only) remain the only States that continue to apply fire service levies. Despite both NSW & Victoria having undertaken recent reviews of fire service levies, these States remain steadfast in their endorsement of the current system. This reflects the increasing dependence of these governments on taxes on insurance.

Enquiries

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