SUBMISSION TO THE TASMANIAN STATE TAXATION REVIEW

FEBRUARY 2011
INTRODUCTION

The Insurance Council is pleased to be able to provide this submission to the Tasmanian State Tax Review. By way of introduction, the Insurance Council of Australia Limited (Insurance Council) is the representative body of the general insurance industry in Australia with members of the Insurance Council representing more than 90 percent of total premium income written by private sector general insurers. 1 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).

General insurance provides a vital service to protect the health and well being of individuals, households and communities. Although often unrecognized, it is general insurance that assists in the speedy and expeditious recovery of communities after a significant catastrophic event, such as those witnessed in the February 2009 Victorian bushfires and more recently, the Queensland floods. General insurance is also the mechanism under which individuals are largely assisted following injury or trauma. In simple terms, general insurance, through its primary offer of “peace of mind” facilitates transactions, enabling households and businesses to undertake activities safe in the understanding that insurance will be available in the event of loss or misadventure. And for governments, general insurance provides financial security and stability, comfortable in the knowledge that in the event of a major catastrophic event, the cost of assistance and recovery will not be met by governments alone, with the resultant straining of government capacities and resources. 2

Yet, despite the widespread benefit that accrues to society from having efficient private insurance markets, the Australian general insurance industry remains unreasonably burdened by inefficient taxation imposts. The inefficiency of general insurance taxation is not unknown to Australian policy makers and has been extensively researched and documented elsewhere. 3 Nevertheless, although policy maker consensus exists on the inefficiency of general insurance taxation, there has been little willingness to take action (at either a State or Commonwealth level) to fundamentally tackle the general insurance taxation reform challenge. 4 The Insurance Council submits that the Tasmanian State Taxation Review re-affords policy makers the opportunity to fundamentally take on the task of reforming general insurance taxation.

In recent times, the Insurance Council has been a critic of existing State tax structures arguing that there exists substantial scope to improve economic efficiency through State taxation reform. 5 These submissions have provided strong evidence that substantial gains to economic welfare can be achieved through State taxation mix switches away from transaction style taxes (such as stamp duties and other taxes on insurances) to State taxes of a more durable and efficient base (such as land, payroll and to a lesser extent, gaming). In its submissions to policy makers, the Insurance Council accepts the service demands of State governments and with it, the requirement that reform of State taxation arrangements must not only result in gains to efficiency but, also that it ensures the revenue capacity of State government’s is not eroded. For this reason, the Insurance

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1 June 2009 Australian Prudential Regulation Authority statistics show that the private sector insurance industry generates gross premium revenue of $32.0 billion per annum and has total assets of $95.2 billion. The industry employs approx 60,000 people and on average pays out about $97.5 million in claims each working day.

2 For example, total general insurance claims for the Victorian bushfires amounted to $1.07 billion compared to assistance provided by the Victorian and Commonwealth governments of $146 million and $390 in community appeals/donations. (Source: Insurance Council of Australia and Victorian Bushfire Reconstruction & Recovery Authority)


4 It should be noted however, that on the 27 August 2010, the Victorian government announced the abolition of the Victorian Fire Services Levy and its replacement with a broad based property tax.

Council has recommended reforms that are not only revenue neutral but that also add considerably to economic efficiency. This guiding approach is repeated in this submission. Accordingly, the Insurance Council finds itself in considerable agreement with the findings of the Review of Australia’s Future Tax System (i.e. the Henry Tax Review) that State governments reform their tax bases away from transaction taxes to State tax bases of a more durable and efficient nature (including examining improvements to existing “efficient” State taxes).

A HISTORY OF STATE TAXATION REVIEWS

As emphasised in its own Discussion Paper, the Tasmanian State Taxation Review is taking place in the context of a State tax reform pathway recommended in the Commonwealth’s own comprehensive AFTS (or Henry) Tax Review. The Insurance Council concurs with the findings of the Henry Tax Review that State taxes are open to reform particularly in the direction where a greater reliance is placed on more efficient State taxes and dependency on inefficient State taxes is phased out. The Insurance Council contends that this broad direction should be no surprise to policy/decision makers given the widespread consensus that exists not only on what State taxes are “better” State taxes but also the broad pathways available to improve State fiscal arrangements. In this submission, it is not the intention of the Insurance Council to traverse the material in the Henry Tax Review given its widespread coverage elsewhere (including the detailed synopsis of the State taxation recommendations outlined in the Tasmanian State Tax Review Discussion Paper) but to add to that body of research/analysis on the gains that are available from transaction tax reform.

The Tasmanian State Tax Review should be cognisant that the broad directions for State tax reform (that is, away from transaction taxes towards more durable tax bases) have been enunciated for well over a decade. For example, the Tasmanian State Tax Review has available to it a considerable body of research and analysis on State Taxes. The Insurance Council submits that, given the relative similarities in tax bases and tax mixes across the States, the Tasmanian Tax Review is able to be informed by findings of the NSW Independent Pricing & Regulatory Tribunal (IPART) Review of State Taxation; the Victorian Government’s Review of State Business Taxes (i.e. the Harvey Review) and the WA State Tax Review well as being able to review the recommendations made in several Royal Commissions such as those of into the collapse of HIH and more recently, the Royal Commission into the Victorian Bushfires. ⁶

In the main, what the above reviews of State taxes reveal are reform directions akin to that mentioned in the Henry Tax Review. These can be broadly summarised as:

- The inefficiency and inequity of transaction taxes and the need to remove the dependency of State revenues from such taxes.
- The relative efficiency and durability of specific State taxes, and in particular payroll tax and land tax (and to a lesser extent gaming taxes) although these taxes can be improved markedly through removing existing exemptions.
- The opportunities available to State governments through the introduction of better user pay arrangements in transport and when managing the environment or natural resource scarcity.

The Insurance Council concurs with these directions and in particular, the need to reform transaction taxes. In this regard, the Insurance Council submits that although the 2000 Intergovernmental Agreement (IGA) between the Commonwealth and the States commenced the path to reform of transaction taxes, despite numerous reviews since, the pace of reform has slowed considerably. The Insurance Council is mindful that the original

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2000 IGA did not include the reform of insurance taxes, notwithstanding the long established evidence that insurance taxes carry the greatest deadweight losses. Accordingly, the Insurance Council believes therefore that the reform of general insurance taxation must be a priority for policy makers today.

AN OUTLINE OF TASMANIAN STATE TAXATION

In 2007/08, the Tasmanian State government collected some $800 million in State taxes. Since the introduction of the GST and New Tax System in 2000/01, Tasmania’s national share of all taxes by the States and Territories has remained relatively constant at around 1.6%.

Over 50% of all Tasmanian tax revenue is drawn from payroll taxes and stamp duties on the transfer of property alone. Other significant sources of taxation revenue include taxes on insurance (including stamp duties and insurance company contributions to the fire services), land taxes and gaming taxes. Over the period since the introduction of the GST, total Tasmanian State tax receipts increased by 47%, with the greatest contribution to the growth in Tasmanian tax receipts coming from payroll taxes, land taxes and taxes on property conveyances.

Tasmania does not depart too widely from the structure of State taxes evident in other jurisdictions - as the table below demonstrates. Comparing Tasmania to the largest non resource States of NSW and Victoria, suggests that Tasmania rests between these two States in terms of tax shares for the predominant tax groupings. In fact, Tasmania’s tax structure can be said to be broadly typical of all States, even taking into account the exclusion from such calculations of the resource predominant States of Queensland and Western Australia.

<table>
<thead>
<tr>
<th>Tax Type</th>
<th>Tas</th>
<th>NSW</th>
<th>Vic</th>
<th>Total ex QLD &amp; WA</th>
</tr>
</thead>
<tbody>
<tr>
<td>Payroll</td>
<td>32.2%</td>
<td>35.6%</td>
<td>31.5%</td>
<td>33.0%</td>
</tr>
<tr>
<td>Gaming</td>
<td>7.3%</td>
<td>5.9%</td>
<td>8.0%</td>
<td>6.9%</td>
</tr>
<tr>
<td>Stamp duties</td>
<td>28.4%</td>
<td>26.2%</td>
<td>31.6%</td>
<td>28.9%</td>
</tr>
<tr>
<td>Land taxes</td>
<td>10.0%</td>
<td>12.6%</td>
<td>9.8%</td>
<td>11.7%</td>
</tr>
<tr>
<td>Other taxes</td>
<td>22.1%</td>
<td>19.8%</td>
<td>19.1%</td>
<td>19.4%</td>
</tr>
</tbody>
</table>

Source: ABS catalogue No 5506.0

The Insurance Council acknowledges that one of the challenges facing State governments is the ability to reconcile revenue stability (in order to fund services in certainty) and a State taxation structure that has a disproportionate weight to volatile tax streams. As the chart overleaf demonstrates, it is those State taxes more closely aligned with underlying economic conditions (such as payroll) that are the most stable and hence more predictable to forecast. By contrast, those taxes with bases that are detached from underlying economic activity – such as conveyancing duties which are dependent on sales and asset prices – remain the most volatile and consequently, more difficult to forecast. Accordingly, the Insurance Council submits given the need for State governments to limit revenue volatility in order to maintain outlay certainty, it is in the interests of the States to migrate their taxation structures away from transaction style taxes towards those State taxes of a more durable and stable base.

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7 Research by KPMG Econtech, produced for the Review of Australia’s Future Tax System (2009) estimated that the welfare losses from taxes on insurance amounted to 67 cents in every dollar.
8 Source: Australian Bureau of Statistics, Taxation Revenue:, Catalogue Number 5506
9 The introduction of the GST/New Tax System also saw the introduction of the Intergovernmental Agreement between the Commonwealth and the States which committed GST proceeds to the States as General Revenue Assistance.
10 Source: Australian Bureau of Statistics, Taxation Revenue: 2007/08, Catalogue Number 5506
Regrettably however, there is little suggestion that the States are moving away from transaction style taxes. The chart below suggests that since the introduction of the GST, the proportion of Tasmanian tax revenue drawn from transaction taxes has increased from 23% in 2001 to 31% in 2009.  

11 Note, “Transaction” taxes include financial transaction taxes that have been subsequently phased out as part of the 2000 Intergovernmental Agreement between the Commonwealth and the States. Transaction taxes excluding financial institution taxes include stamp duties on conveyances, all taxes on insurance including contributions to fire brigades and stamp duties on motor vehicle registrations.
A greater dependence on relatively volatile tax bases, such as transaction taxes, is not optimal for budget management as the ability to undertake long term revenue (and expenditure) planning is compromised. The NSW Independent Pricing & Regulatory Tribunal (IPART) and the Business Coalition on Tax Reform (BCTR) have expressed the difficulties posed by the States in their reliance on relatively volatile taxation sources. 12 As the BCTR state in their report:

"The States are becoming increasingly reliant on volatile and unpredictable taxes for a large share of their own source revenues. Volatility in the revenue base can be problematic for fiscal management and is a key risk to achieving budget targets" 13

OVERVIEW OF INSURANCE MARKETS IN TASMANIA

The State of the General Insurance Market in Tasmania

In the twelve months to June 2010, insurers licensed by the Australian Prudential Regulation Authority (APRA) wrote $489 million in revenue for risks written in Tasmania. 14 The trend for Tasmanian general insurance penetration and density is expressed in the Chart below. 15

13 Centre for International Economics (March 2009) op cit, page 51
15 General Insurance (GI) penetration is the ratio of gross written premium to Gross State Product. GI Density is Gross Written Premium per capita.
Comparing Tasmania with the other States on GI penetration and density, suggests that Tasmania sits in the middle range. For example, as the Charts below highlight, although NSW has the deepest general insurance market in Australia, the Tasmanian market is comparable to that of Victoria and on the measure of GI penetration, Tasmania remains comparable to that of Queensland.

Source: Australian Prudential Regulation Authority & Australian Bureau of Statistics
Non Insurance in Tasmania

In May 2007, the Insurance Council released a report on non insurance in the Australian community. The study “The Non Insured: Who, Why and Trends” detailed the take up of domestic home and contents insurance as well as examining the factors and influencers that impact on the take up of insurance.  

(A copy of the Non Insured: Who, Why and Trends report accompanies this submission). The Non Insurance report also set out the terms under which non insurance could be defined. That is, in the case of building non insurance, the relevant population to consider for non insurance in this segment were those owner occupied households residing in a dwelling that did not require the payment of body corporate fees. Conversely, the market for contents insurance is potentially available to all households, resulting in the relevant population sample being all households.

The Non Insurance report utilised the Australian Bureau of Statistics (ABS) Household Expenditure Survey (HES) to determine the extent of non insurance across Australia. This detailed data set allows the Insurance Council to estimate the level of non insurance according by a number of attributes, including income quintile. The HES data also allows the Insurance Council to calculate the estimated value of assets at risk from non insurance.

The ABS HES data confirms that, in Tasmania, there are approximately 7,200 owner occupied households not paying body corporate fees that do not purchase any form of building insurance. This represents a non insurance “rate” for buildings only of approximately 5%. Conversely, approximately 47,000 households in Tasmania do not have contents insurance representing a non insurance “rate” for contents only of approximately 24%. The table overleaf sets out the pattern of non insurance in Tasmania on a household weekly income basis.

Source: Australian Prudential Regulation Authority & Australian Bureau of Statistics

17 In other words, excluded from the need for buying building insurance were those households that resided in apartments, flats etc where insurance cover for the building is part of the body corporate management fee.
18 The Insurance Council utilised Confidential Unit Record Files (CURF’s) to determine this detailed level of non insurance information.
19 That is, 5% of the relevant population that being owner occupied Victorian households not paying body corporate fees.
20 That is, 24% of the relevant population that being all households in Victoria.
### Building Non Insurance By Income Quintile (Owner Occupiers Not Paying Body Corporate Fees, Tasmania)

<table>
<thead>
<tr>
<th>Household Weekly Income</th>
<th>Number of Households</th>
<th>% of Total Non Insured Households</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Quintile 1 – Less than $382.50</td>
<td>2,938</td>
<td>41%</td>
</tr>
<tr>
<td>Income Quintile 2 – Greater than $382.50 &amp; less than $584.50</td>
<td>2,349</td>
<td>33%</td>
</tr>
<tr>
<td>Income Quintile 3 – Greater than $584.50 &amp; less than $928.50</td>
<td>1,661</td>
<td>23%</td>
</tr>
<tr>
<td>Income Quintile 4 – Greater than $928.50 and less than $1,442.25</td>
<td>263</td>
<td>4%</td>
</tr>
<tr>
<td>Income Quintile 5 – Greater than $1,442.25</td>
<td>Nil</td>
<td>Nil</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>7,212</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

*Note: Numbers may not add to totals due to rounding*


The above table demonstrates the substantial financial risks carried by the uninsured on low income in the event of a significant loss affecting their homes. Over three quarters of Tasmanian households non insured for buildings are from the bottom two income quintiles with a total household income of less that $31,000 per annum. Put simply, in the event of a significant catastrophe affecting these households, the greatest burden of recovery will fall upon those with the least financial capacity to respond. It is precisely in circumstances of diminished household means that governments are often required to “step in” and provide assistance. Moreover, it is estimated the value of uninsured housing assets in Tasmania is $0.9 billion, with 64% of this value being held by households in the bottom two income quintiles.

The equity of these circumstances has drawn the attention of the Commonwealth’s AFTS Review. For example, the AFTS Review noted:

> "As well as being inefficient by leading to under-insurance or non insurance, insurance taxes can also be inequitable … Because of their financial positions, people in these groups may be more vulnerable in the case of loss”. The AFTS Review also noted the risk to government expenditure in the event of a disaster if communities remained non insured". 21

#### Average Household Weekly Expenditure on Key General Insurance Products

On average, according to the 2003/04 ABS Household Expenditure Survey, Tasmanian households spent $4.31 on building house insurance and $15.86 on non third party motor vehicle insurance per week. However, as a proportion of income, expenditure on general insurance decreases the further up the income scale the household is. This is demonstrated in the table overleaf.

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As the table above confirms, lower income households spend a greater share of their income on insurance than their higher income counterparts. Accordingly, the table above confirms that taxation on general insurance is regressive to the extent that given it is based on general insurance premium. As a proportion of income, lower income households are likely endure a greater tax burden than high income households.

### A Detailed Review of General Insurance Taxation in Tasmania

At present, general insurance premium in Tasmania is subjected to two levels of taxation at the State level. They are:

- Stamp duties on general insurance premium although exemptions to duty are provided to certain institutions and for specific classes of insurance most particularly workers compensation and public liability insurances.  

- Fire levies for prescribed classes of insurance under the Tasmanian Fire Service Act 1979 and set out under Part 4 of the Tasmanian Fire Service (Finance) Regulations 2006.

In addition, at the Commonwealth level general insurance premiums are also subject to the Goods and Services Tax (GST).

### Fire Services Levies for Prescribed Classes of Insurance

Other than Tasmania, only NSW will continue to retain insurance premium based arrangements for the funding of the fire services. Following the release of the final report of the Royal Commission into the 2009 Bushfires, the then Victorian government adopted the Royal Commissions recommendation to abolish fire services levies on insurance and replace them with a property tax. The decision of the then Victorian government follows the path of other State administrations in recent times to transition to systems where fire and

<table>
<thead>
<tr>
<th>House Insurance</th>
<th>Contents Insurance</th>
<th>House &amp; Contents Combined</th>
<th>Sickness/Personal Accident</th>
<th>Motor Vehicle</th>
</tr>
</thead>
<tbody>
<tr>
<td>$</td>
<td>% of Income</td>
<td>$</td>
<td>% of Income</td>
<td>$</td>
</tr>
<tr>
<td>1st Quintile</td>
<td>5.21</td>
<td>1.3</td>
<td>3.14</td>
<td>1.3</td>
</tr>
<tr>
<td>2nd Quintile</td>
<td>3.04</td>
<td>0.7</td>
<td>3.68</td>
<td>0.8</td>
</tr>
<tr>
<td>3rd Quintile</td>
<td>4.75</td>
<td>0.6</td>
<td>5.88</td>
<td>0.8</td>
</tr>
<tr>
<td>4th Quintile</td>
<td>4.54</td>
<td>0.4</td>
<td>4.33</td>
<td>0.4</td>
</tr>
<tr>
<td>5th Quintile</td>
<td>3.66</td>
<td>0.2</td>
<td>4.74</td>
<td>0.3</td>
</tr>
<tr>
<td>Total</td>
<td>4.31</td>
<td>0.5</td>
<td>4.51</td>
<td>0.6</td>
</tr>
</tbody>
</table>


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23 Note. The Tasmanian fire service levy distinguishes itself from that in place in NSW and Victoria. In Tasmania, the precise levy is set by statute and outlined in the regulation. This contrasts with the approach in NSW and Victoria wherein licensed insurers are required to “contribute” to the cost of the fire and emergency services and then recover such contributions from insured policy holders. For an explanation of the contribution system see Insurance Council (2010) “Submission to the Victorian Government Green Paper: Fire Services & the Non Insured” available at www.insurancecouncil.com.au

24 On August 27, 2010 the then Premier of Victoria, then Hon John Brumby announced the abolition of fire services levies in Victoria.
emergency services levies are collected through charges on property value rather than on insurance premiums.

An outline of the fire and emergency services systems across Australia is outlined in the Box below.

<table>
<thead>
<tr>
<th>OUTLINE OF FIRE FUNDING MODELS ACROSS AUSTRALIA</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Western Australia</strong></td>
</tr>
<tr>
<td>Property based system with emergency service levy applied on the gross rental value of all immobile properties. No levy imposed on motor vehicles. State is divided into fire levy categories according to level of service (i.e. extent of emergency service provision and access) with Category 1 (i.e. Perth) through to Category 5 (remote WA). Minimum charge of $43 with maximum levy payable by households of $225 and commercial property owners $130,000. Levy collected by local government.</td>
</tr>
</tbody>
</table>

| **South Australia**                              |
| System introduced in 1999. Emergency Service Levy levied on capital values for fixed property and also on motor vehicles and other mobile capital. Levy on fixed property is a fixed fee ($50) plus a variable component. Variable component derived from capital value, an “area factor”, land use “factor” and the levy rate. For motor vehicles a fixed fee applies (e.g. $24 for cars and large capacity motor cycles). The SA Transport Authority collects the levy from motor vehicles while the SA State Revenue Office collects the levies from properties. Concessions for seniors apply. |

| **Queensland**                                  |
| Queensland Fire & Rescue Service funded through an Urban Fire Levy on properties. Urban Fire Levy contributes 73% of funding with State government and user charges making up the remaining proportion. Amount of levy is dependent on the “class” of the urban district (i.e. where the property is situated); the activity carried out on the property or the use to 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). The latter two factors determine the fire levy “group”. Once the appropriate fire levy group and urban class is determined, the amount payable is set out under Schedule 2 “Annual Contributions of Owners of Prescribed Properties”, Qld Fire & Rescue Service Regulation 2001. |

| **Victoria**                                    |
| Statutory contributions system. Metropolitan Fire Brigades Act 1958 requires insurers to contribute 75% of Metropolitan Fire Services costs, with local government paying 12.5% and State government 12.5%. Country Fire Authority Act 1958 requires insurance industry to pay 77.5% of CFA budget with State Government paying 22.5%. MFB & CFA Contributions Regulations applies a weighting of 40% to domestic insurance and 80% for any other insurance against fire (i.e. that for domestic policies 40% of premium is subject to contributions and for any other insurance against fire, 80% of premium is subject to contribution.) In August 2010, the then Victorian government announced the abolition of the statutory contributions system with funding for the fire and emergency service to be collected from a broad based property charge. Details of the reform system remain to be developed. |

| **NSW**                                         |
| Statutory contributions system. NSW Fire Brigades Act 1989, Rural Fire Services Act 1997 and State Emergency Services Act 1989 requires insurers to contribute 73.7% of funding, with local government paying 11.7% and State government 14.6%. Schedules to the Acts provide a weighting of 50% to domestic premiums and 80% for other property insurances, insuring against fire. (i.e. that for domestic policies 50% of premium is subject to contributions and for any other insurance against fire, 80% of premium is subject to contribution) |

| **Tasmania**                                    |
| Statutory levy model. Levy on insurance of 28% of gross premium for all commercial insurances against fire, including contractors all risk. For marine and cargo insurance levy is 2% of gross premium and for aviation 14% of gross premium. Local government levies assessed on annual value of properties with minimum charges applicable. Charge on motor vehicles of $14. Concessions available to pensioners. |

| **ACT**                                         |
| Property based system. Residential and rural properties $91.20 with commercial properties levied on the basis of the average unimproved land value over three years. |

25 For example, in June 2002 the Western Australia government announced reforms to emergency services funding stating “for too long there has been an unfair and inequitable situation with as many as one in three homes either not insured or under-insured, but still receiving emergency protection” See Western Australia Government Media Office, Ministerial Statements (12 June 2002) statement by WA Emergency Services Minister “New funding system to assist the State’s volunteer emergency services.”
Internationally, there are a number of models/approaches used to fund the fire services although by far, property based systems and direct grants to the fire and emergency services are the most common form of funding. For example, the London Fire Brigade (an arm of the London Fire & Emergency Planning Authority (LFEPA)) secures the bulk of its funding from central government funding and the remainder from London boroughs primarily though taxes on property. 26 Similarly, in the United States although local governments use a variety of methods to enhance the funding of the professional fire services, the most common taxes supporting fire and emergency services remain property taxes usually levied at a set rate per dollar of assessed value.27

In contrast, the New Zealand Fire Service is funded through the imposition of a fire service levy on insurance policies to the value of 7.6 cents per $100 of insured value for residential, commercial and personal property (with a cap of $100,000 for residential property insurance, $20,000 for personal property and no cap for commercial). Motor vehicles less than 3.5 tonnes are levied a flat rate of $6.08 per vehicle. 28

An outline of a range of international approaches to funding fire and emergency services is set out in the Box below.

<table>
<thead>
<tr>
<th>OUTLINE OF INTERNATIONAL FIRE &amp; EMERGENCY SERVICE FUNDING MODELS</th>
</tr>
</thead>
<tbody>
<tr>
<td>United States</td>
</tr>
<tr>
<td>United Kingdom</td>
</tr>
</tbody>
</table>

28 See New Zealand Fire Service at www.fire.org.nz
Canada

There are approximately 3,500 Fire Departments in Canada of which around 3% are full time and 91% volunteers. Of the 108,000 estimated fire services personnel 22% are full time and the remainder volunteers. Primary responsibility for fire and emergency services is the responsibility of cities and municipalities. For example, fire services and emergency services in the City of Toronto is coordinated by the Office of Emergency Management. The Toronto Fire Services provides “all hazard” assistance and is funded and mandated by the City of Toronto. 40% of the City of Toronto is funded by property taxes, with federal and provincial subsidies making up an additional 25% of funding. The Vancouver Fire & Rescue Service is a department of the City of Vancouver and was funded to the amount of $88 million by the City. The City of Vancouver recovers the bulk of its revenue from taxes on property.

New Zealand

The New Zealand Fire Service is funded through the imposition of a fire service levy on insurance policies to the value of 7.6 cents per $100 of insured value for residential, commercial and personal property (with a cap of $100,000 for residential property insurance, $20,000 for personal property and no cap for commercial). Motor vehicles under 3.5 tonnes are levied a flat rate of $6.08 per vehicle.

Regrettably, the Tasmanian State Tax Review does not consider in detail the efficiency of the current fire funding arrangements in Tasmania. The Insurance Fire Levy collected $17 million in 2009/10 the equivalent of 24% of the total Tasmanian Fire Commission budget. The Insurance Council submits that the Tasmanian government should follow the approach of other States (most recently Victoria) in transferring their fire funding arrangements away from taxes on insurance to other more stable bases such as property. Indeed, as will be further argued below, the ability of the Tasmanian government to migrate away from the insurance fire levy is more readily available given the presence of the existing Fire Service Contribution which is collected by local councils. Given the existing presence of a property based system, the Insurance Council contends that the Tasmanian government would improve the efficiency of the fire levy system by abolishing the Insurance Fire Levy and transferring the revenue requirement to the municipal based Fire Service Contribution system.

Stamp duties on General insurance

In Tasmania, general insurers are subject to insurance stamp duties at a rate of 8% with exemptions applying for given institutions and for certain classes of insurance. Stamp duties on general insurance apply to the full consideration of the general insurance transaction and not the insurance “margin” or underwriting result. In other words, a general insurance stamp duty applies to the full insurance premium, including that component of the premium which is attributable or applied towards meeting future claims. This contrasts sharply with the approach to taxation of say gaming, which taxes only the operators “commission” after taking into account winnings.

The inefficiencies of taxation on general insurance have been well documented, most notably in the Review of Australia’s Future Tax System (AFTS). It is not the intent of the Insurance Council to traverse the material outlined in the AFTS Report. Suffice to say however, that the Insurance Council contends that given the clear and unambiguous inefficiencies of State stamp duties on general insurance that all State governments must insist on general insurance tax reform as a priority. In this regard, the proposed Federal Tax Summit expected for mid

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29 The Tasmanian State Tax Review Discussion Paper references the Fire Service Levy on page 79.
31 The Fire Service Contribution collected by local councils amounted to $30 million in 2009/10.
33 The Insurance Underwriting Result is defined as net premium revenue less net incurred claims and underwriting expenses.
2011 offers the opportunity to advance reform of State transaction taxes and in particular, to reengineer State
government revenue arrangements away from a dependency on transaction taxes.  

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35 See Transcript of Commonwealth Treasurer’s Press Conference, 8th September, Parliament House, Canberra and available at
MODELLING THE EFFICIENCY OF TASMANIAN STATE TAXES

It is recognised that all taxes reduce economic efficiency in some way. Decisions to work, invest or consume are affected by the impositions of taxes with the resultant reduction in consumer welfare. Taxes that are relatively efficient result in small welfare losses relative to the revenue they raised. With general equilibrium models, welfare losses from a given array of taxes can be estimated allowing a variety of taxes to be ranked in terms of one another. In turn, these same models allow estimates to be made of the improvement to economic welfare if one set of taxes is removed for another in a revenue neutral way. This allows policy makers to determine the most efficient taxation mix and evaluate reform options that are welfare enhancing in their jurisdictions.

The Insurance Council commissioned Access Economics to provide a contemporary ranking of Tasmanian State taxes for inclusion in this submission. The Access Economics rankings of Tasmania’s State taxes – both in aggregate and in detail - are reproduced below.

![Aggregate Tasmanian Tax Rankings](image_url)

Source: Access Economics (2011)
The Access Economics rankings provide confirmation to the Review of Australia’s Future Tax system of the inefficiencies of transaction taxes and in particular, taxes on insurance. Access Economics estimate that the marginal welfare loss of insurance taxes to be 56 cents for every extra dollar of revenue raised. The Access Economics ranking also help in understanding the potential for efficiency gains from reform to existing taxes. For example, the efficiency of payroll tax would be substantially improved with the removal of exemptions and the broadening of the taxation base.

Along with the above Tasmanian Tax Rankings, the Insurance Council also commissioned Access Economics to deploy their general equilibrium model to undertake a number of simulations estimating the gains to economic welfare from a series of tax reform proposals. These proposals are revenue neutral (that is, the losses of revenue from reform of one State tax are replaced with revenue from reform of another) and are designed to provide the Tasmanian Tax Review with insights into the economic gains achievable from altering the mix of Tasmanian State taxes. Simply put, the simulations are designed to provide empirical evidence of the advantages to the Tasmanian economy of migrating away from transaction style taxes (such as those on insurance) and replacing lost revenue with taxation from more efficient tax bases. The Insurance Council contends that the challenge set down by the Tax Review to provide alternatives to insurance taxation is met through the empirical evidence provided in these simulations.

36 See Access Economics (2010). In considering this modelling, it is also important to acknowledge their limitations including efficiency losses not captured by the model. For example, in the case of conveyancing duties, such modelling does not capture the “price discovery” benefits of removing such taxes.

37 For example, Question 9.5.2.B of the State Tax Review Discussion Paper asks the question “What alternative to insurance duty would you suggest to improve performance against the principles outlined in section 8, while maintaining revenue neutrality? Why would this be better?” See Tasmanian State Tax Review: Discussion Paper at page 55.
<table>
<thead>
<tr>
<th>Tax Reform Description</th>
<th>Change in Real Consumption (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Replace the Fire Levy on insurance only and fund its replacement with the municipal charge</td>
<td>0.05%</td>
</tr>
<tr>
<td>Replace both the Fire Levy on insurance and the levy applicable to motor vehicles and fund its replacement with the municipal charge</td>
<td>0.10%</td>
</tr>
<tr>
<td>Replace insurance duties with payroll taxes while retaining the existing exemptions to payroll taxes</td>
<td>0.40%</td>
</tr>
<tr>
<td>Replace insurance duties with payroll taxes while removing exemptions to payroll taxes</td>
<td>0.47%</td>
</tr>
<tr>
<td>Replace insurance duties with gaming taxes</td>
<td>0.21%</td>
</tr>
<tr>
<td>Replace property conveyances with a land tax with no exemptions (the AFTS recommendation)</td>
<td>0.29%</td>
</tr>
</tbody>
</table>

*Source: Access Economics (2010)*

As the above table demonstrates, the gains to the Tasmanian economy from tax reform are potentially quite large. The Access Economics modelling confirms the directions of the AFTS that reform of transaction taxes are welfare enhancing.

The key observations that can be made from this modelling are:

- The fire levy on insurance is a drag to the Tasmanian economy and if Tasmanian policy makers were of a mind to replace the levy with a charge on property (such as the reform direction recently announced by the Victorian government), then this reform would enhance economic welfare.
- That notwithstanding the large exemptions, payroll tax remains a much more efficient State tax than insurance duties, leading to substantial gains to welfare if insurance duty was replaced by payroll taxes. Moreover, if at the same time as replacing insurance duties, payroll taxes were reformed by removing exemptions, then the gains to economic welfare would be larger still.
- The AFTS Review recommendation to abolish property conveyances with a land tax without exemptions would generate substantial gains to the Tasmanian economy.

In other words, the Access Economics modelling provides further confirmation to a State tax reform agenda that would see transaction taxes replaced with taxes of a more efficient and durable base. Further, the Access Economics model directly contests popular mythology that payroll taxes are poor taxes and that State governments should seek to reduce their reliance on them. Quite the contrary, the modelling suggests that cuts to payroll taxes that force replacement revenue to be drawn from transaction taxes, destroys economic welfare. For this reason the Insurance Council submits that policy makers need to be cautious of calls to cut payroll taxes if such revenue is then replaced with increased revenue dependency on transaction taxes.
REFORMING TASMANIAN STATE TAXES

The Insurance Council concurs with the broad State taxation directions set out by the Review into Australia’s Future Tax system and in particular, the aspiration to abolish State transaction taxes (including taxes on insurance) and to replace them with more efficient (and broadly based) State taxes. The Insurance Council submits that the States have available to them taxes which are already relatively efficient, (such as payroll and land tax) and with further reform to their base (such as through the removal of exemptions) these efficient taxes can be improved further. Simply put, the Insurance Council is of the view that the States have at their ready disposal relatively efficient State taxes, such as payroll and land, in which to meet their expenditure obligations and accordingly, a State tax mix switch that sees inefficient transaction taxes replaced by broader and better existing State taxes will necessarily result in an enhancement to Tasmania’s overall economic welfare. Further, although there remains some preference to pursue reform of this type through a centrally coordinated Commonwealth State forum, reform of inefficient State taxes should not be abandoned in the absence of such a Commonwealth State process. As the Victorian government has demonstrated with its decision to abolish fire services levies with a broad based property tax, State taxation reforms in the direction of the AFTS Review need not await a centrally coordinated Commonwealth State process. The Insurance Council contends that opportunities for taxation reform are available to the States themselves (such as reform of insurance fire services levies) and that these need to be pursued independently by the States.

A Reformed Payroll Tax – Opportunity for the States

Both the AFTS review and the Tasmanian Tax Review Discussion Paper draw attention to the common misunderstandings that afflict payroll tax and in particular, the erroneous claim that a payroll tax is a “tax on jobs”. As the Tax Review Discussion Paper succinctly states:

“Payroll tax is a widespread but little understood tax mechanism. It is widely criticised as a “tax on jobs” but it is far from clear there is a substantial merit to this claim”.39

The Insurance Council argued in its Supplementary Submission to the AFTS Review along similar lines. Moreover, the Insurance Council suggested in the same submission that reform to payroll tax, through the removal of exemptions, would significantly improve the efficiency of payroll tax. As the Chart overleaf demonstrates, exemptions to payroll tax result in a significant erosion of the tax base, and in the case of Tasmania, over 60% of the payroll tax base is theoretically eroded with exemptions, thereby significantly diluting the efficiency of payroll tax. The Insurance Council also suggested in the same submission that given that prior to 1971 payroll tax was a Commonwealth tax (payroll tax was handed to the States as a “growth tax” in that year), there remains the scope to reconsider a hand back of an improved payroll tax to the Commonwealth and for the tax to be administered though the Business Activity Statement/Australian Business Number system. The Insurance Council submission suggested that a reformed payroll tax would provide a revenue source to remove inefficient State insurance taxes and would have the advantage of sharing revenue on the basis of source as opposed to distribution through the Commonwealth Grants Commission.41

38 The policy directions in the AFTS are also enunciated in Attachment B of the Incoming Government Treasury Brief (aka the “Red Book”) which was released under Freedom of Information on the 23rd September, 2010 and available at http://www.treasury.gov.au/contentitem.asp?NavId=007&ContentID=1876
Although the AFTS Review has recommended the abolition of payroll tax and its replacement with a broadly based Cashflow Tax, the Insurance Council respectively suggests that the positions of the Insurance Council and the AFTS are not irreconcilable. Rather, the Insurance Council suggests that the AFTS finding that currently structured State payroll taxes are inefficient and there is a case to be made for payroll tax broadening is consistent with Insurance Council submissions. Given the time and steps needed to transition to a Cashflow Tax, the Insurance Council believes it may be desirable to reform payroll tax along the lines suggested by the Insurance Council (that is, broaden the base and administered by the Commonwealth) as a pathway to an eventual Cashflow Tax. Moreover, given the oft repeated statements by the Treasurer ruling out consideration of reform of the GST, then reformed payroll tax arrangements offer the States and Commonwealth an immediate solution to the need to find an efficient growth tax to replace their inefficient State taxes in the short term. 42

The efficacy of returning payroll to the Commonwealth and remitting it back to the States is arguably best demonstrated by comparing payroll tax revenues in 1971 to those applying today. As mentioned previously, prior to 1971 payroll tax was a Commonwealth tax, levied at 2.5% across the board and all payrolls were subjected to the tax (i.e. no exemptions). In contrast, State payroll tax today is subjected to a range of exemptions and States apply differential payroll tax rates.

The chart overleaf maps out the difference across the States between payroll tax revenues today with a theoretical revenue 1971 payroll tax of 2.5% universally applied (i.e. no exemptions). As the graph demonstrates, Tasmania would have been “better off” in revenue terms had it retained a payroll tax rate and base set at pre 1971 handover levels. Overall, across all the States, a hypothetical 1971 payroll tax rate of 2.5% across the board would yield revenue of $15b today compared to current payroll tax revenues of $17b. This suggests that notwithstanding the States engaging in what Commonwealth Treasury has described as “destructive competition” 43 of the payroll tax base over four decades, the overall revenue outcomes for the States from payroll taxes has not materially altered.

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42 The Terms of Reference for the Review of Australia’s Future Tax System also ruled out consideration of reform to the GST.
43 See page 21 of Attachment B of the Incoming Government Treasury Brief (aka the “Red Book”) which was released under Freedom of Information on the 23rd September, 2010
Moreover on an international level, Australian payroll taxes are modest in scope and the “tax wedge” – the difference between total labour cost to an employer and the corresponding disposable income of an employee – is low by OECD standards. For single income individuals without children at the income of the average worker, Australia’s wage “tax wedge” is the fourth lowest in the OECD at 26.7% and well below the OECD average of 36.4%. The international comparative data confirms the suggestion in the AFTS that Australia has a capacity to increase the burden of taxation on labour value added.

As mentioned previously, the Insurance Council notes the common misunderstandings that apply to payroll taxes in the business community and in particular, the suggestion that a payroll tax is a “tax on jobs”. The Insurance Council suggests that common “myths” surrounding payroll tax have regrettably circumscribed the ability of governments to improve payroll tax arrangements. However, the Insurance Council contends that these views remain misguided and although businesses may remain the collection agency for payroll tax (irrespective of who is the collection agency), in the long run, businesses (irrespective of their size) will not bear the economic incidence of the tax as lower returns to capital. To the contrary, given that labour is less mobile than capital, in the longer run the burden of a payroll tax will fall on labour. This should make payroll tax an attractive tax to the States and as the AFTS has found, for the future, “Australia’s future tax system will need to raise significant revenues from the value added by labour”. The Insurance Council contends that efforts by the States to apply themselves to reform of payroll taxes as a “switch away” from transaction taxes is a desirable immediate term project in Commonwealth/State Financial relations.

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44 The tax wedge is usually expressed as a percentage of total labour costs.
46 For a comprehensive review of the economic effects of a payroll tax, see Australia’s Future Tax System (2010) “Part Two: Detailed Analysis” at pages 293 – 301.
47 See AFTS (2010): “Part Two: Detailed Analysis” at page 293
CONCLUSION

There is now a clear body of evidence supporting the need for State tax reform. This evidence, synthesising with the Review of Australia’s Future Tax System, enjoys a consensus that there are “poor” State taxes and “better” State taxes. The less efficient (or “poor”) State taxes are transaction style taxes and in particular, stamp duties on insurance and fire services levies. The more efficient State taxes remain payroll, land, and gaming taxes. Accordingly, overall economic welfare would be improved significantly if there was a policy pathway that sought less reliance on transaction taxes and a greater reliance on the aforementioned “better” State taxes.

The Insurance Council welcomes the opportunity that the Tasmanian State Tax Review presents to further raise the gains to be made from State tax reform. The Insurance Council contends that the Tasmanian State Tax Review should adhere to the pathway suggested in the AFTS that all taxes on insurance (including fire services levies) should be abolished and replaced by alternate (and efficient) tax sources. The Insurance Council submits that the economic gains from State tax reform are large and equivalent in scope to those generated from past State actions such as competition policy. In short, the Insurance Council, believes that State taxation reform should be a policy aspiration equivalent to that which drove national competition policy and that the Tasmanian Tax Review affords policy makers the opportunity to do so.