

# **COMMONWEALTH GRANTS COMMISSION**

**DISCUSSION PAPER CGC 2002/18**

## **THE INSURANCE TAXATION ASSESSMENT**

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## **INTRODUCTION**

1. This paper provides an overview of proposals by the Commission staff for the Insurance Taxation assessment for the 2004 Review. It presents:

- issues covered in the States' 2004 Review submissions;
- discussion of the methodological and technical aspects (including data consistency) of the assessment; and
- staff responses to the issues.

## **DESCRIPTION OF THE CATEGORY**

2. For the 1999 Review, this category comprised the net collections from stamp duty on general insurance and life insurance. Stamp duty on Compulsory Third Party (CTP) motor vehicle insurance was included in the Motor Vehicle Registration Fees and Taxes categories.

## **CURRENT ASSESSMENT**

3. The revenue base measure used in the 1999 Review was premium revenue of the general insurance industry with adjustments to remove:

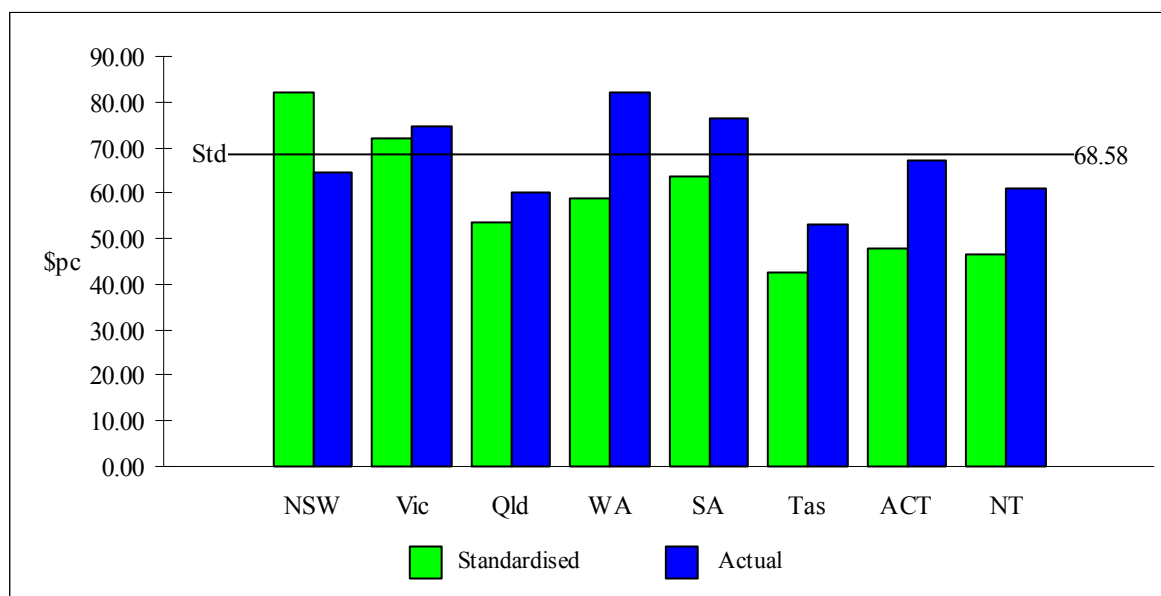
- premium revenue from CTP motor vehicle insurance;
- premium revenue from employers' liability insurance;
- premium revenue from reinsurance; and
- revenue from fire insurance levies.

4. Data on revenue from fire insurance levies was obtained from the Australian Bureau of Statistics (ABS) publication Taxation Revenue (Catalogue number 5506.0). The rest of the data used in the revenue base calculation came from the Australian Prudential Regulation Authority (APRA).

5. In recent updates, APRA data for the latest year of the assessment period have been unavailable. The Commission has estimated the revenue base for the latest year by increasing the revenue base of the second last year by the rate of change in actual revenues, excluding the effect of any tax rate changes. In subsequent updates, the estimated revenue base has been replaced with one measured using actual premium data.

6. In 2000-01, insurance taxation collections totalled \$1322 million (or \$68.58 per capita). This was 2.8 per cent of State own-source revenue. In the 2002 Update, the insurance taxation assessment redistributed \$94.3 million compared with an equal per capita distribution. Figure 1 summarises the assessment for 2000-01 from the 2002 Update.

**Figure 1** STANDARDISED, ACTUAL AND STANDARD REVENUES PER CAPITA, 2000-01, 2002 UPDATE FAG RELATIVITIES



## MAJOR DEVELOPMENTS SINCE THE 1999 REVIEW

### *Tax Rate Changes*

7. Some States have changed their tax rates since the 1999 Review. Western Australia increased stamp duty on general insurance from 5 per cent to 8 per cent of premiums. South Australia and the Northern Territory increased their tax rate from 8 per cent to 11 per cent and 10 per cent respectively. New South Wales has reduced stamp duty on some types of general insurance from 11.5 per cent to 10 per cent. Western Australia changed its tax on CTP insurance from 25 cents per policy to 8 per cent of premiums.

### *Collapse of the HIH Group of Companies*

8. The collapse of the HIH insurance group of companies had financial impacts on State budgets. As a result, some States have introduced additional revenue raising measures.

- (i) New South Wales introduced an Insurance Protection Tax on general insurance premiums, from 1 July 2001 (estimated to raise \$69 million

a year) and between 15 March and 15 June 2001 policies taken out to replace policies with HIH were exempted from stamp duty (at an estimated cost of \$15 million).

- (ii) Victoria introduced a special levy on domestic (residential) building permits to partly fund a rescue package for homeowners who were victims of the HIH collapse.
- (iii) Queensland increased the Nominal Defendant levy by \$5 per vehicle from 1 October 2001 which was estimated to raise \$12 million a year.
- (iv) Western Australia increased its levy on workers' compensation premiums by 3 per cent.
- (v) South Australia has provided an assistance package for builders' indemnity insurance from September 2001 which is to be partly funded by a surcharge on building contractor and tradesperson licence fees which were expected to raise \$255 000 in 2001-02.
- (vi) Tasmania imposed a levy on workers' compensation insurance and exempted replacement policies from stamp duty.
- (vii) The Northern Territory introduced a 4 per cent levy on workers compensation insurance premiums from 1 July 2002 ( estimated to raise \$1.8 million a year).

9. States have introduced a wide range of revenue measures following the collapse of the HIH group of companies. It appears that those revenue measures reflect decisions on the extent to which they consider the expenditure side of their budget will be affected by the collapse. That effect, in turn, appears to reflect a range of different policies that States had prior to the collapse of HIH, on matters such as whether the compulsory insurances should be undertaken by government or private insurers, and on their reaction to the collapse — partly affected by the level of involvement of HIH in their markets.

10. Overall, it is difficult to establish a common or standard policy. Subject to any further discussion, staff intend to recommend that all revenues from levies or surcharges introduced to fund responses to the collapse of HIH be classified to the Other Taxes category and assessed on an equal per capita basis.

### ***Public Liability and Professional Indemnity Insurance***

11. Further problems have occurred in the insurance industry since the collapse of the HIH insurance group of companies. However, State responses to these difficulties are still evolving. Information on State responses currently available to the Commission indicates the following actions have been taken (or are planned).

- (i) New South Wales reduced stamp duty on general insurance (including public liability insurance) from 10 per cent of premiums to 5 per cent from 1 August 2002.

- (ii) Tasmania abolished stamp duty on public liability insurance during 2002-03 at an estimated cost of \$1.7 million.
- (iii) The ACT has introduced stamp duty relief for community, non-profit and sporting groups during 2002-03, at an estimated cost of \$200 000.

12. Insufficient information is currently available on the full range of reactions to developments in the markets for public liability and professional indemnity insurance. However, if the above reactions are typical of those finally introduced by all States, the most appropriate response might be to simply treat them as variations in the revenue raising effort for general insurance taxation.

### ***Implications for the Commission's Assessment***

13. Because data on the insurance premiums for the latest assessment year are not available at the time of the assessment, the revenue base for that year has to be estimated. The estimation is based on the rate of change in actual revenues over the last two assessment years, adjusted for the effect of any tax rate changes.

14. The revenue base measure for the Insurance Taxation category is general insurance premiums. Based on advice from APRA, Commission staff understand that the data on premiums excludes State taxes. Thus, the Commission's measure of each State's revenue base for insurance taxation will not be affected by any changes in tax rates arising from these new developments. However, to the extent that the difficulties in the insurance industry lead individual insurance companies to vary the premiums they charge, those effects will be reflected in the measure of the revenue base.

## **MAJOR ISSUES RAISED IN STATE SUBMISSIONS**

15. In *Discussion Paper CGC 2001/12, Scope and Structure of the Standard Budget*, it was proposed that revenue from stamp duty on compulsory third party (CTP) motor vehicle insurance be reclassified to the Insurance Taxation category from the Vehicle Registration Fees and Taxes categories in the 2004 Review. This change would:

- (i) better align the Commission's classification of State tax revenues with the ABS classification; and
- (ii) carry the implication that the measure of the revenue base for taxes on CTP insurance would be changed from the number of vehicles (the measure of the revenue base used for motor vehicle taxes) to the value of CTP insurance premiums (premiums are used to measure the revenue base for insurance taxation).

16. Victoria did not comment on the proposed reclassification, but asked the Commission to introduce an adjustment to take account of policy differences in the way States fund the provision of fire services.

17. South Australia said that if the Commission was satisfied with the accuracy and consistency of APRA data, it had no objection to the Commission's proposal to include premium revenue from CTP motor vehicle insurance in the revenue base.

18. Tasmania supported the Commission's proposal to simplify the insurance taxation assessment by including premium revenue from CTP motor vehicle insurance in the revenue base. It also supported the current method of treating contributions by insurance companies to fire brigades as a user charge for the Emergency Services category.

19. The ACT supported the current method of assessment and requested that it be retained as it is based on independent data provided by APRA and accurately reflects the ACT's revenue raising capacity.

## **ISSUES TO BE ADDRESSED**

### ***Funding the Provision of Fire Services***

20. The Victorian submission outlined the differences in the way States fund the provision of fire services. In Victoria, the government charges insurance companies a fire insurance levy to meet 75 per cent of the cost of providing fire services. (The insurance companies recover some of that burden from their policyholders through an additional charge.) The remaining 25 per cent of funding comes from either local government or State government general revenue sources.

21. Victoria said that other States, such as Queensland and South Australia, fund fire services from a tax on property, which is collected by local governing bodies. It proposed that the Commission introduce an adjustment to take account of these policy differences.

22. In the 1999 Review, the Commission was aware that New South Wales, Victoria, Western Australia, South Australia and Tasmania charged insurance companies a fire insurance levy to help meet the cost of providing fire services. An adjustment was made to exclude those amounts from the premium revenue data provided by APRA in measuring the revenue base for Insurance Taxation. Premium data for Queensland, the ACT and the Northern Territory were not affected because they did not impose a levy on insurance companies.

23. On 1 July 1999, South Australia replaced its fire insurance levy on insurance premiums with an emergency services levy on property. Accordingly, the deduction of a fire insurance levy from South Australia's revenue base became unnecessary and ceased from 1999–2000.

24. The current adjustment to the data on premiums to remove revenue from fire insurance levies seems to take account of the different ways States fund the provision of fire services. The continuation of this adjustment should address the issue raised by Victoria.

### ***Data Quality and Consistency***

25. In its submission, South Australia raised doubts about the quality and consistency of the APRA data on CTP insurance premiums. Commission staff have been told by the APRA that, in terms of scope and coverage, the data are consistent across the States. However, APRA can not control the data provided by the public sector in the way it can for private insurers.

26. The Commission staff's view is that APRA is the best independent data source available for this assessment. As APRA provides a measure of the revenue base that is consistent across States, the staff intend to recommend that the Commission continue to use the APRA data.

## **CHANGES TO THE INSURANCE TAXATION ASSESSMENT**

27. The major change to the assessment follows from the proposal in *Discussion Paper CGC 2001/12, Scope and Structure of the Standard Budget*, to include revenue from CTP motor vehicle insurance in the Insurance Taxation category. In the 1999 Review, this revenue was included in the Vehicle Registration Fees and Taxes categories. State submissions show that there is general support for the Commission's proposed change.

### ***The Proposed Assessment Framework***

28. Attachment A shows the legislated rates that are applied to different types of insurance by each State. The standard policy seems to be to levy stamp duty on the:

- sum assured for life insurance; and
- premium paid for general insurance.

29. The 1999 Review method assessed life insurance and general insurance together using the same proxy for the tax base (premium revenue) because life insurance was a relatively small component of the revenue.

30. The major change in the assessment arises from the proposal in CGC 2001/12 to include CTP motor vehicle insurance revenue in the Insurance Taxation category. That proposal reflects the treatment of tax revenue from CTP insurance in the GFS statistics, where CTP revenue is a sub-category of Insurance tax revenue. Thus, the proposal improves the transparency of the assessment processes because the revenue figures used by the Commission would be consistent with those produced by the ABS.

31. It will also result in a measure of the revenue base for taxes on CTP insurance that better measures States' revenue raising capacities because it better reflects how most States currently impose the tax. Attachment A shows that prior to 1 July 2002 four States levied stamp duty on CTP motor vehicle insurance based on the value of premiums paid. Since 1 July 2002, Western Australia has applied an *ad valorem* levy to CTP insurance premiums. Queensland and Tasmania still charge a flat fee per policy. New

South Wales does not tax CTP insurances. Thus the most common policy now is to levy stamp duty on CTP policies on the basis of premiums — similar to that for other general insurance. (Under the 1999 Review methods, the assessment of the revenue from CTP premiums was in the Vehicle Registration Fees and Taxes categories, where the weighted number of vehicles was used as the revenue base.)

**Revenue Base Measure**

32. As the majority of States levy stamp duty on CTP motor vehicle insurance based on the value of premiums paid, it is appropriate to apply the same proxy tax base as is applied to general and life insurance.

33. Table 1 shows that CTP motor vehicle insurance premium revenue is approximately one third of the existing general and life insurances premium revenue.

**Table 1** GENERAL, LIFE AND CTP MOTOR VEHICLE INSURANCE SHARES OF PREMIUM REVENUE, 2002 UPDATE

	General and Life Insurance	CTP Motor Vehicle Insurance	Ratio of CTP to General and Life Insurance
	\$m	\$m	%
1996-97	9532.4	3287.8	34.5
1997-98	9887.5	3341.4	33.8
1998-99	10689.4	3530.0	33.0
1999-2000	11122.9	3699.3	33.3

34. However, the average effective tax rate applied to the CTP appears to be quite different from that applied to other insurances. Table 2 compares the effective tax rates for CTP insurance and for general and life insurance using data from the 2002 Update.

**Table 2** COMPARISON OF EFFECTIVE TAX RATES FOR CTP MOTOR VEHICLE INSURANCE AND GENERAL AND LIFE INSURANCE, 2002 UPDATE

	CTP Motor Vehicle Insurance	General and Life Insurance
	%	%
1996-97	4.58	9.31
1997-98	4.70	9.95
1998-99	4.66	9.61
1999-2000	4.91	10.59

35. The effective tax rates for CTP motor vehicle insurance are approximately half the rates for general and life insurance — States tax CTP insurance more lightly than

they tax other insurance. Including all CTP premiums in the revenue base would overstate the revenue States would raise if they applied the standard tax policy.

36. If the assessments are to reflect ‘what States do’ these different tax approaches should be reflected in the assessment. This could be done either by:

- (i) dividing the Insurance Taxation category into two components — a CTP component and a general and life insurance component; or
- (ii) including a tax weighted proportion of CTP premiums in the measure of the revenue base — since the effective tax rate on CTP premiums is about half that on other premiums, this approach would include half the CTP premiums in the revenue base.

37. Both approaches would produce a similar result. The approach based on two components is more transparent and Commission staff are inclined to recommend that it be adopted.

38. Table 3 shows the effect on State shares and capacities of this approach to assessing taxes on CTP motor vehicle insurance. That is, treating taxes on CTP as a component of insurance taxes rather than as motor vehicle taxes.

**Table 3** IMPACT OF PROPOSED CHANGE TO INSURANCE TAXATION ASSESSMENT ON STATE GRANTS

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT	Aust
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
2002 Update	7334.3	5257.1	4938.1	2314.8	2523.0	1067.7	491.2	1358.3	25284.6
Proposed Approach	7301.7	5270.5	4942.7	2323.9	2528.2	1069.3	490.0	1358.4	25284.6
Grant change (\$m)	-32.6	13.4	4.6	9.1	5.1	1.6	-1.2	0.0	33.8
Grant change (%)	-0.44	0.25	0.09	0.39	0.20	0.15	-0.25	0.00	

39. The table indicates that using the proposed approach in the U2002 Update would have had the greatest effect on New South Wales. This outcome arises primarily because the per capita value of CTP premiums in New South Wales (the proposed measure of the revenue base) is above the national average whereas the weighted number of vehicles per head (the measure of the revenue base for CTP insurance under the 1999 Review method) was below the national average. Notwithstanding the change in redistribution, Commission staff are of the view that the proposed approach represents a better assessment.

### **Summary**

40. The proposed changes to the Insurance Taxation assessment improve the assessment (and the offsetting changes to the Vehicles Registration Fees and Taxes assessments) overall because:

- (i) the classification of revenues is better aligned with the GFS statistics; and

- (ii) the stamp duty on CTP motor vehicle insurance would be assessed with other general insurance taxes which better reflects the way most States now tax the transactions.

41. Implementing the proposed changes involves:

- transferring revenue from stamp duty levied on CTP motor vehicle insurance from the Vehicles Registration Fees and Taxes categories to the Insurance Taxation category; and
- using premiums on CTP insurance to measure the revenue base for a CTP component of the Insurance Taxation category.

**Table A-1 STAMP DUTY RATES ON INSURANCE**

	NSW	Vic	Qld	WA	SA	Tas	ACT	NT
<b>Life:</b> Based on sum assured, except in SA	<p><b>\$0-\$2 000:</b> \$1;</p> <p><b>Over \$2 000:</b> \$1 + 20c per \$200, or part thereof in excess of the first \$2000.</p> <p>Annuities exempt.</p>	<p><b>\$200-\$2 000:</b> 12c per \$200 or part;</p> <p><b>Over \$2 000:</b> \$1.20 + 24c per \$200 or part above \$2 000.</p>	<p><b>\$100-\$200:</b> 10c;</p> <p><b>\$201-\$2 000:</b> 5c per \$100 or part thereof;</p> <p><b>Over \$2 000:</b> \$1 + 10c per \$100 or part thereof in excess of \$2 000.</p>	<p><b>\$100 to \$2 000:</b> 5c per \$100;</p> <p><b>Over \$2 000:</b> \$1 + 10c per \$100.</p>	<p>\$1.50 per \$100 or part thereof of net premiums of previous year paid as annual licence.</p>	<p><b>Up to \$2 000:</b> 10c per \$200;</p> <p><b>Over \$2 000:</b> \$1 + 20c per \$200.</p>	<p><b>\$100-\$2 000:</b> \$1.00;</p> <p><b>Over \$2 000:</b> \$1 + 20c per \$200 or part thereof in excess of \$2 000.</p>	<p>10c per \$100.</p>
<b>Term/temporary:</b>	<p>Term insurance or riders: 5% of first year premium.</p>	<p>Term insurance: 5% of first year premium.</p>	<p>Temporary or term insurance: 5% of first year premium.</p>	<p>Term or temporary insurance: 5% of first year premium.</p>		<p>Term policy: 5% of first year premium. Temporary policy: 2% of premium on the policy.</p>	<p>Term insurance: 5% of the first year's premium.</p>	<p>Term or temporary: 5% of first year premium.</p>
<b>General:</b>	<p>From 1.10.00: 10% of premium paid.</p> <p>Since 1.1.97, 5% of premium paid on motor vehicle, aviation, disability income, occupational indemnity, hospital &amp; ancillary health benefits.</p> <p>2.5% of premium paid on crop and livestock.</p> <p>No duty on workers compensation, compulsory third party motor vehicle insurance.</p>	<p>10% of previous month's premiums.</p> <p>No duty on workers compensation or commercial marine insurance.</p>	<p>8.5% of the net premium.</p> <p>5% of net premium for workers compensation, motor vehicle comprehensive, professional indemnity insurance and plate glass insurance for dwellings (10c on plate glass insurance for other than dwellings).</p> <p>10c flat on 3rd party motor vehicle insurance.</p> <p>3c flat of the net premium for tourist and travel special policy where the period of tour does not exceed seven days.</p>	<p>8% of gross premiums.</p> <p>3% of net premium for workers compensation for employers with an annual wages bill under \$675 000, 5% for other employers.</p> <p>Before 1 July 2002, 25c per policy on 3rd party motor vehicle insurance. Since then 8% of premium.</p>	<p>\$11 per \$100 or part thereof of premiums (including compulsory 3rd party premiums).</p> <p>No duty on workers compensation or commercial marine insurance.</p>	<p>8% of premiums.</p> <p>\$6 flat on 3rd party motor vehicle insurance.</p> <p>No duty on workers compensation.</p> <p>Reference period: payments relate to the previous month's transactions.</p>	<p>10% of gross premium.</p> <p>Premiums on goods carried in international trade are exempt.</p> <p>No duty on workers compensation.</p>	<p>10% of gross premiums.</p> <p>No duty on policies covering workers compensation, transport of goods &amp; commercial marine hulls.</p>