

**ECONOMIC DEVELOPMENT AND INFRASTRUCTURE COMMITTEE**

**Inquiry into state government taxation and debt**

Sydney — 29 October 2009

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Mr J. Hanks, Consultant, National Insurance Brokers Association.

**Mr DAVIS** — I welcome John Hanks, Consultant, with the National Insurance Brokers Association. John, state your position, whether you are appearing in a public or private capacity and your contact address; and I thank you for coming to give evidence during this hearing of our inquiry into state taxation and debt.

**Mr HANKS** — I am a consultant with the National Insurance Brokers Association. Its address is level 18, 111 Pacific Highway, North Sydney 2060.

**Mr DAVIS** — Could you make your presentation, and then we will ask some questions after that.

**Mr HANKS** — The National Insurance Brokers Association welcomes the opportunity to provide the committee with information on the impact and effectiveness of Victorian taxes and charges. Insurance brokers represent the interests of the purchasers of insurance, the policy-holders, and not those of insurance companies. Consequently comments made by NIBA and its members are made not on behalf of insurance companies, but on behalf of the public that purchases insurance.

NIBA is concerned about the inequity of funding the fire services in Victoria through a levy on insurance. It is also concerned about the adverse effect that taxes and charges have on the cost of property insurance in Victoria and the consequential adverse effect on Victoria's individuals and businesses taking out insurance.

Insurance is a basic necessity for all modern businesses. Without adequate insurance, banks and others are reticent to lend for funding building construction and business investment. If the Victorian economy is to grow and prosper, it needs an effective insurance market that is not saddled with high rates of taxes and charges.

There are three taxes and charges that apply to insurance policies taken out by Victorian residents and businesses, namely the fire services levy, GST — as you know, levied by the Commonwealth government which distributes the funds to the states — and stamp duty, which is levied by the Victorian government. These three taxes and charges are cascading — that is, one tax is applied to another. There are, in fact, taxes on taxes on taxes.

The rate of fire services levy for Victorian country commercial insurance is 84 per cent of the basic premium. When GST and stamp duty are applied, the total taxes and charges are a staggering 123 per cent of the basic premium. These extreme rates of taxes drive normally prudent people away from insurance. Around 30 per cent of the homes that were destroyed by the recent Victorian bushfires were uninsured.

**Mr DAVIS** — What percentage?

**Mr HANKS** — Around 30 per cent. Not only do the uninsured risk financial ruin and are a potential burden on the government, but they do not make an appropriate contribution towards funding the fire services. It is NIBA's view that a completely new approach to funding fire services in Victoria is required — a far larger base of contributors than simply insurance policy-holders is required. Consideration should be given to taking an approach similar to that operating in Queensland, South Australia, Western Australia or the ACT where all property owners are levied irrespective of whether or not they have adequate insurance.

According to standard taxation principles, a well-designed tax system is characterised by efficiency, equity, simplicity and transparency. A number of public inquiries have been critical of insurance taxes because they perform poorly against these basic principles of taxation. The 2008 New South Wales IPART *Review of State Taxation* report considered how insurance taxes fared against good taxation principles and concluded:

Insurance duty and fire services funding contributions are the least efficient state taxes.

The 2001 Victorian *Review of State Business Taxes* report stated:

The conclusion of studies (by groups including the Productivity Commission, the heads of treasuries state taxes working group, comprising representatives from all state and territory treasuries; and Access Economics) is that stamp duties and transaction taxes are among the most distortionary of all taxes available to the states. The committee believes ... that abolishing them now would nurture business activity and growth.

It even notes that the taxation on insurance is a matter that has been considered by the Commonwealth Review of Australia's Future Tax System and that a number of submissions, including one from NIBA, have commented adversely on the current situation in Victoria. Dr Ken Henry, the Chair of the Committee and head of the Commonwealth Treasury, in a speech on 15 October referred to insurance taxes as 'bad taxes' and indicated that a tax on a broader base would be more efficient, equitable and transparent.

The AFTS review panel is expected to report to the commonwealth government before the end of the year. Its recommendations will have a significant impact on your study. NIBA believes that it is appropriate for the committee to recommend, as many public inquiries have before it, that Victoria introduce a more equitable method of funding fire services and that state taxes on insurance be abolished. Thank you.

**The CHAIR** — Thank you very much. That is really clear. I heard the conclusion; I was not here for the entire evidence. Mr Hanks, you may have covered this earlier in the part that I missed. NIBA has suggested that the way the fire services levy operates is a disincentive for people to take out insurance and the suggestion is that high numbers of people would take out insurance if it were more equitable. Is there any evidence for that, or is it just what people might say is common sense?

**Mr HANKS** — I think that there is a bit of common sense. When you see the Insurance Council of Australia this afternoon, it may have some figures, but I think the one that strikes me as the most important is this figure on uninsured as coming out of the Victorian fire services. The 30 per cent which I have quoted comes from an Insurance Council figure which was done in early days. I think when the royal commission get some figures from government departments and so on, that figure might even rise to be higher than 30 per cent.

**The CHAIR** — Has your organisation gone so far as to say that if there were a more equitable approach to the fire services levy and it was removed from insurance, that there should be some compulsion to acquire insurance?

**Mr HANKS** — We would not necessarily go along with compulsory insurance but you should not have disincentives for insurance, and I think that is what we have at the present time.

**The CHAIR** — Thank you. That is clear.

**Mr DAVIS** — If I can just get to the heart of your contention there, the alternative models would be what? You are talking about broader, different bases for levying the levy. Our task is to ask these questions, so please tell us what you think.

**Mr HANKS** — I think the issue is who uses the fire services. Largely it is property owners, so our view is that it should be on property owners rather than a subset of property owners, which are the insured. You should try and cover the whole spectrum. We have a number of states which have introduced property-based systems. Those systems are not all exactly the same. They do vary and they vary for a number of reasons. Some of them have strong points. Some of them are not quite so strong in relation to the principles of taxation. Sometimes these can be competing. Equity is not always matched by transparency — sometimes to get equity you have to have less transparency. There are a whole host of different factors you need to consider when you are talking about taxes.

**Mr DAVIS** — So your favoured model?

**Mr HANKS** — We do not have a favourite model. What we are saying though is that you should look at a property-based system. There are good examples in the states. There are a number of reasons that I do not feel competent to give you an answer, because I do not understand all the assumptions and all the factors that are influencing Victoria as somebody who is designing a tax system for you would be able to look at and be able to test. Even by way of example, what things would you want to cover by a property tax? Clearly we want to cover the fire services but some of the other states go past that and they include car accidents or servicing accidents on the roads. Others take in emergency services. There are a number of fundamental questions that you must look at before you can determine which of those models would best suit you, and then of course you would need to look at rates, what are the effects, the modelling, who is going to be affected and who is not. There is quite an amount of work involved in determining what would be suitable for Victoria, having come to the conclusion that a property-based tax is the most suitable way to go.

**Mr DAVIS** — Can I ask you another question? Do you think the current system disadvantages country Victoria over the city?

**Mr HANKS** — Quite clearly. I gave you that figure of 123 per cent — that is, if a country business wants insurance, it pays a premium and then on top of that it pays 123 per cent. This is a staggering figure. More than half your insurance if you are a country business in Victoria is going in taxes. That is a horrific amount. It does discourage insurance. To that extent I would think country Victoria could be said to be disadvantaged because the rates in country Victoria are significantly higher than those applying in the city. I guess you then have to look at other issues like the cost of providing those fire services in country Victoria compared to in the city, and equity is a broader question than looking at just that insurance aspect. Certainly I would say that country Victorians are very heavily taxed.

**The CHAIR** — Can I just ask a follow-up on that? Are country interstate insurance premiums similarly high?

**Mr HANKS** — Victoria is particularly high compared to throughout Australia, and one of the reasons is that you do have a higher rate of fire services levy, higher than most of the others. Of course if you take it off the insurance, as some of the others have done, those revenues show up in a different way. Victoria, through its fire services levy then the insurance on top of that plus the GST then the stamp duty, is fairly high, and I think that the proportion of total Victorian taxes that are paid in relation to insurance is a lot higher than it is in other states.

**The CHAIR** — But what I was trying to ask is: if you are looking at country New South Wales, country Queensland, country Western Australia, is there a comparable increase interstate?

**Mr CRISP** — I think the key border region share is the Victorian-South Australian border. I would appreciate it if Mr Hanks would like to comment on that situation where South Australia has a different system to Victoria. Our small-medium businesses and others along a state border like that South Australia-Victoria are quite key. It is something that I would like — —

**Mr HANKS** — Yes, quite so.

**The CHAIR** — Is there a spreadsheet somewhere that would encapsulate what you are talking about to assist our research team?

**Mr HANKS** — Yes. I think there have been a number of those sorts of spreadsheets that show what the taxes are in different states, and I think you have probably already got that before you in evidence from the Insurance Council, but I am quite happy to talk to Vaughn and to provide him with anything there. Clearly when you move to a property-based system, as they have done in South Australia, you have broadened the base of the tax, so what any individual pays ought to be less, all other things being equal. You do not then apply a GST to that, nor do you apply a stamp

duty to the GST to the fire services levy. So not only does Victoria have high fire services concentrated on a small group of people, but you also have the cascading effect of other taxes.

**Mr CRISP** — If I may, I do not want us to get into pre-empting the royal commission but I am interested in some of your thoughts about the people who are insured and not insured — the decisions they make under threat as to whether to stay or go and how that is influenced. Now I do not know whether the Royal Commission is going to go there or not, or whether we should go there, so I am referring to you and my colleagues on this, but you do raise it and it does concern us whether people are making judgements that can affect their lives — whether to stay or go — when a disaster is occurring.

**Mr HANKS** — I have no basic research, but we have seen comments that have been made along those lines, and I do think some of those sorts of theories will be something that the royal commission will have to look at and test. I think it would be an unfortunate situation if people looked at their insurance, or whether they had it or they did not, before deciding whether they were going to stay or go. That would not be a good thing in my opinion, but I am not able to give you any research that points to the basis of that decision.

**Mr DAVIS** — Some of your members may have anecdotal information, which we would certainly appreciate if it touches Mr Crisp's point.

**Mr HANKS** — Okay, I can make some inquiries and see if we can elaborate further. I do think this will be one of the areas that the royal commission will look at. I understand that they have set aside a couple of days for hearings early in the new year and that these will be the sorts of questions that they will be looking at in a bit more detail.

**Mr CRISP** — Part of the reason I looked at that is Victoria is changing some of its categories about people staying and going, and I am just wondering whether the new system where you are given less choice will impact on people's decisions whether to insure or not. I know that is a question you cannot answer — we will have to wait for consumers — but I was wondering whether this system will have any impact on whether people will insure or not in terms of making it a more equitable system, I doubt it because I have a position of favouring the South Australian model, so that was the reason for starting this line of questioning.

**Mr ATKINSON** — I would rather go somewhere else. I do not know if this is the only thing that you have actually got a brief on or whether or not there are some other areas that we might explore, but I have had quite a lot of complaint raised with me about the practice of motor vehicle insurers setting up exclusive arrangements with motor repair centres, directing their policy-holders to those companies and trying to dissuade them from going to other independent panelbeaters or repairers. I wonder if you have got any comment on that as an issue and if there are any tax implications for state government in respect of that sort of practice.

**Mr HANKS** — I do not have a great deal of expertise in the area. I do know that it was an issue that was raised in New South Wales, and there was quite a lot of parliamentary work done in relation to it and I refer you to that. My understanding is that a code of practice was developed whereby insurance companies agreed to certain behaviour and what they would do and what they would not do. My understanding, again, is that that was working reasonably well and some of the issues that had been there previously were no longer of the same magnitude, but I think it is probably a question better directed to the Insurance Council and the representatives of the insurance companies. Our membership — NIBA membership — while it does have some dealings in what we might call the retail or domestic end of the market, is largely concerned with the commercial insurance and its effects, so that is part of the reason that I am not up to it and across it to the same extent.

**Mr ATKINSON** — The other one I was interested in is — and again there may be taxation implications about this but perhaps a more broad issue as well in terms of the operation of a whole

range of organisations — whether you have a perspective on professional indemnity insurance and how that is operating now compared with two or three years back when there was a real crisis in this area and governments actually had to intervene and introduce new regimes to basically prop up that area of insurance. Where are we at today?

**Mr HANKS** — Well, quite clearly after the collapse of HIH it was difficult to get quite a deal of different types of insurance and one of those was professional indemnity insurance. It became very difficult. The market has eased quite considerably since then, but there are particular areas of the market that still may have difficulty getting it, and quite clearly financial planners are one area that has been of concern. I also note that it was last week, I think, that ASIC issued an advice in relation to the professional indemnity held by financial services advisers, the licensees that they administer, and they decided that it was not possible to get run-off cover — that is, after a business folded professional indemnity insurance would continue. It simply was not possible in the current market to have that, and so they decided not to insist on run-off cover. I think apart from a number of smaller areas the position has improved greatly since the HIH collapse days.

**Mr DAVIS** — I have got another question relating to stamp duty on general insurance and your recommendation that that be removed. I note the earlier recommendation of the Harvey review in Victoria. What would you replace it with? I mean with stamp duty you talk about homes and properties, but in the case of general insurance — —

**Mr HANKS** — Clearly state governments cannot give up taxes without replacing them somewhere. Again, I would like to duck and weave a little bit, if you like, in not having a particular recommendation to say, 'Let us tax this or that in its place'. But quite clearly we are seeing in the Henry committee — their review — that they are going to look at not only the commonwealth taxes but also state taxes. I would expect that they will look at this area of insurance taxes, including the stamp duties, and I would see that they could well come up with a package of ideas, which may involve a payroll tax, for instance, transferring that to the commonwealth, increasing the base and then allowing that money to flow back to the states. That is just purely an example of some of the things that may happen once you get something like the Henry committee looking at these things in a broader scope than the narrow scope in which they are often looked at.

I can understand that in the Victorian situation with revenue the question is: if you need hospitals and all the other services that go with it, can you afford to reduce a tax here or there? But I think there are ways in which that can be done, and with leadership through the Henry committee I would see that there is a possibility of this coming about.

**Mr DAVIS** — Beyond the Fire Services Levy, levies on properties and so forth and taxes there, do you have examples of underinsurance in the general insurance area that you can point to, under or non-insurance?

**Mr HANKS** — The Insurance Council did some of this. A lot of it is not as well documented as we would like, but we do know that after each disaster of one sort or another — whether it be the Victorian fires or the ones that happened in Canberra in 2001, or a cyclone or whatever — there are people who cannot simply take their insurance and go back into where they were. One of the figures I heard yesterday in relation to the Victorian situation is that somewhere around 80 per cent of Victorians are taking a cash payment for their insurance. This is a lot higher than normal. The question is: why? If you cannot use the money to re-establish yourself, then you take the money and go somewhere else. Again, if insurance was sufficient, they would replace the house; if it is not, they take it.

**Mr DAVIS** — But beyond property; I am talking about general insurance.

**The CHAIR** — Can I just make a comment on that? It also goes to the kind of insurance policy they have. Because there are some insurance companies that have house insurance based

upon replacement on the number of bedrooms and the size of the house, whereas there are others that are numerated.

**Mr HANKS** — Yes. I think, though, that in the Victorian situation there are a lot more people taking cash than there are with other disasters. From my understanding, from talking within the industry, it is a very, very high figure — much more than what would normally be the expectation. And if companies can fix the houses or whatever through bringing in builders or repairers, those sorts of things, they often do that and people are often satisfied with that as an approach to have their house fixed rather than taking a sum of money. But the emphasis is moving to the sum of money.

**Mr DAVIS** — So do you think the difference in this Victorian case is due to the actual scale and nature of the disaster — the horror?

**Mr HANKS** — It could be due to a lot of things. But I am suggesting to you that one of them, at least — the extent of it you may argue about — one significant factor is underinsurance.

**Mr DAVIS** — Can I just return to general insurance, as opposed to property and related insurance that we are talking about there, and ask — and you may not be able to give this to me now: are there examples of under and non-insurance in those general areas? Broader insurance, this is.

**Mr HANKS** — Yes, there is no doubt: it is a problem right throughout Australia — business interruption insurance, or whatever. Yes, the answer is that there are a lot of people underinsured. But when you move away from property it becomes a bit more difficult to assess exactly what you should have — for instance, if you look into liabilities. You know what your property is valued at, and you know how much it should be insured for. But how much is enough liability insurance? How much professional indemnity insurance? How much is a matter of judgement by an individual of what their exposures are. And in many cases brokers recommend, ‘As much as you can afford’. It is harder to make assessments outside a property area of the extent of underinsurance. But certainly business interruption insurance, when it goes hand in hand with property, is taken a lot less. People have less business insurance than they do with a property, so that if their business burns down or is destroyed by a fire, they suffer an income stream loss for the business. That can be covered by insurance; it probably is not to the extent it ought to be.

**Mr DAVIS** — Do you have some figures on that sort of business insurance in the case of the fires?

**Mr HANKS** — No, unfortunately a lot of this sort of stuff, I am afraid, is — —

**Mr DAVIS** — Is anecdotal.

**Mr HANKS** — Is on that basis.

**The CHAIR** — Thank you very much. We appreciate your coming today and giving evidence. Hansard will provide you with a copy of the transcript within about a fortnight. You are free to make corrections to typographical errors but not to substance. Good morning, and thank you again.

**Mr HANKS** — Thank you.

**Witness withdrew.**