FSC
FINANCIAL SERVICES COUNCIL

Kickstarting the Productivity Conversation

FSC submission to NSW Productivity Commission

December 2019

FINANCIAL SERVICES COUNCIL

Contents

1 About the Financial Services Council

The Financial Services Council (**FSC**) is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in one of the largest industry sectors in Australia, financial services.

Our Full Members represent Australia's retail and wholesale funds management businesses, superannuation funds, life insurers, financial advisory networks and licensed trustee companies. Our Supporting Members represent the professional services firms such as ICT, consulting, accounting, legal, recruitment, actuarial and research houses.

The financial services industry is responsible for investing $3 trillion on behalf of more than 15.6 million Australians. The pool of funds under management is larger than Australia's GDP and the capitalisation of the Australian Securities Exchange, and is the fourth largest pool of managed funds in the world.

2 Introduction

The FSC welcomes the opportunity to make a submission to the New South Wales Productivity Commission (**the Commission**) on proposals to improve productivity in the State.[1]

The focus of this submission is responding to Chapter 7 of the Commission's discussion paper, which is about the State's taxation system, and primarily these questions:

- How can insurance taxation arrangements be improved? (section 7.4)
- How can payroll tax arrangements be further improved and simplified? (section 7.6)

In response to these questions, the FSC is recommending for the following:

FSC recommendation: insurance duties on life insurance products and payroll tax on payments by financial advice licensees should be removed.

The reduced revenue from these changes could be funded from a number of sources:

- The Federal Government devolving some income tax revenue raising capacity to the States.
- Increase in the rate of the GST and/or broadening of the base of the GST.
- At a Federal Government level, improved economic activity, increased tax revenue, and reduced welfare spending, with the Federal Government sharing these benefits with the States as a result of the FSC's recommended tax reforms.
- At a State level, improved economic activity, increased tax revenue, and reduced welfare spending as a result of the FSC's recommended tax reforms.

[1] The FSC has made a similar submission to the New South Wales Government Review of Federal Financial Relations.

2.1 Payroll tax on financial advice

The FSC submits that payroll tax arrangements in the financial planning industry can be improved and simplified. The FSC considers payroll tax is unfairly imposed, under the contractor provisions,[2] on financial planners who provide "financial services"[3] as small independent practices under the Australian Financial Services Licence (**AFSL**) authorisation of a larger financial institution or dealer group. The FSC considers the imposition of payroll tax on financial planners is not appropriate or fair, particularly in the context of broader regulatory changes which are imposing substantial costs on this industry and continue to apply intense pressure on the industry.

In effect, payroll tax is applied only to sole traders, and financial planning businesses with a small number of employees are exempted. This is a quite unhelpful outcome: taxing the smallest business, and providing an exemption for larger.

In broad terms:

- A planner operating as a sole trader can be subject to payroll tax.
- A planner operating with two, three, four (and potentially more) colleagues is exempt from the tax.
- A large planning business with many employees is subject to payroll tax.

All Australian jurisdictions provide payroll tax exemptions for small businesses, but the changing approach by State Revenue Offices relating to financial planners has effectively reimposed this tax on micro businesses while retaining exemptions for slightly larger small businesses.

Historically, the policy of the NSW Government was not to impose payroll tax on financial planning businesses as the tax was considered to be an unintended result of the financial services licensing regime under the *Corporations Act 2001 (Cth)* (**Corporations Act**) and associated regulations.

As a result, there was a specific exemption in New South Wales (**NSW**) from the application of payroll tax for financial planners. This exemption ended in 2007 when six Australian States and Territories (**the States**) harmonised payroll tax legislation. Since the removal of the exemption, there has been considerable dispute as to whether payments to financial planning businesses, and particularly those operating as sole traders, are subject to payroll tax. This is supported by recent case law that shows the rules for the imposition of payroll tax and the application of relevant exemptions are highly complex and legalistic.

The FSC submits that the uncertainty as to whether payments to financial planning businesses are subject to payroll tax is causing these businesses to suffer unnecessary stress and having an adverse effect on their productivity. Further, in our view, it operates unfairly at a policy level as it works to assert a tax on small independent businesses that are

[2] Part 3, Division 7 of the Payroll Tax Act 2007 (NSW).
[3] As this term is defined in Division 4 of Part 7.1 of the Corporations Act 2001 (Cth).

least prepared to navigate the complexities that arise in relation to the operation of the payroll tax regime.

Section 5 of this Submission provides a summary of the reasons why it is now timely for the NSW Government to confirm administratively or (if necessary) through legislation that financial planners fall outside the payroll tax regime.

2.2 Simplifying payroll tax arrangements

The FSC recommends the NSW Productivity Commission recommend transferring the administration and collection of payroll tax to the Australian Government. A coordinated approach to this with other States could be considered by the Council of Australian Governments, the Council on Federal Financial Relations, the Board of Treasurers, and other appropriate bodies.

One approach to this would be for the removal of the requirement to submit monthly payroll tax returns – instead the payroll tax calculations and payments would be based on data from Australian Government's Single Touch Payroll (**STP**). Payroll tax would be collected by the Australian Taxation Office (**ATO**) and then paid to each State. The payments could remain monthly or could align with the payment times for Pay as you Go (**PAYG**). The Australian Government would collect an administration fee from the States which would (most likely) be lower than the costs of administration for each State Revenue Office.

This proposal should reduce Government administration costs; reduce the likelihood of errors; increase data integrity and visibility; reduce administration and compliance costs for business taxpayers; and opens up the potential for this approach to be used for other taxes over time.

Further details on this proposal are in Section 4.

2.3 Expand remit of the Board of Tax to cover State taxes

The FSC also proposes the NSW Productivity Commission recommend to the Australian Government that remit of the Board of Taxation be expanded to include State tax issues, and to be able to conduct reviews, provide reports, and assess regulatory reform relating to State taxes.

This change will mean the States have access to an additional "advisory board" for tax purposes, noting the Board of Taxation is a "non-statutory advisory body charged with contributing a business and broader community perspective to improving the design of taxation laws and their operation."[4]

The FSC also recommends the NSW Productivity Commission commend this change to the Board of Treasurers and other appropriate bodies.

[4] Board of Taxation website.

3 Stamp Duties on Insurance

The main reasons FSC is arguing for removal of stamp duty of insurance are detailed in the remainder of this submission and in summary include the following:

- Stamp duties on life insurance are amongst the most distortionary and inefficient in the economy. This is acknowledged in the NSW Productivity Commission's discussion paper (see for example page 97 and 98).
- There is no market failure reason, or other logical argument to justify an additional level of taxation on insurance.[5]
- Taxes on insurance act as an incentive for individuals and businesses to underinsure or not insure. The burden of these taxes falls on those who prudently take out insurance, while the uninsured who do not contribute often receive public assistance.[6]
    - This means insurance taxes operate inequitably between insured and uninsured individuals.
- Insurance duties are regressive – they have a greater relative impact on less well off individuals, and have a smaller relative impact on the rich.
- Insurance duties are a volatile revenue source so reliance on these revenue sources creates volatility and uncertainty in State Budget positions
- Insurance duties paid by life insurers are very complex. Details of this complexity are provided in separate information provided to the NSW Productivity Commission.
- Insurance duties have high compliance costs for insurance companies – on one estimate, the compliance costs are 90 per cent of revenue. This is, in part, a consequence of the high levels of complexity.
- The duties paid on insurance in high by comparison with other developed countries.

3.1 Background

Life insurers are subject to stamp duties on products they sell in most States and Territories. In some cases, there is a specific stamp duty on life insurance; in addition components of life insurance can be subject to the stamp duty that relates to general insurance.

Based on a previous survey of life insurers by the FSC, the total duty paid by the life insurance industry was $453 million in 2014, a figure that had grown by 84 per cent in the five prior years. The total figure for New South Wales was $294.6 million in the years 2010 to 2014.[7]

Most States and territories have a different rate and basis for levying taxes collected. Some are sum insured based; some are premium based; some have a combination; some have no duty on life insurance but loaded duties on rider benefits; the percentage of rates levied on life rider benefits vary from State to State and product to product.

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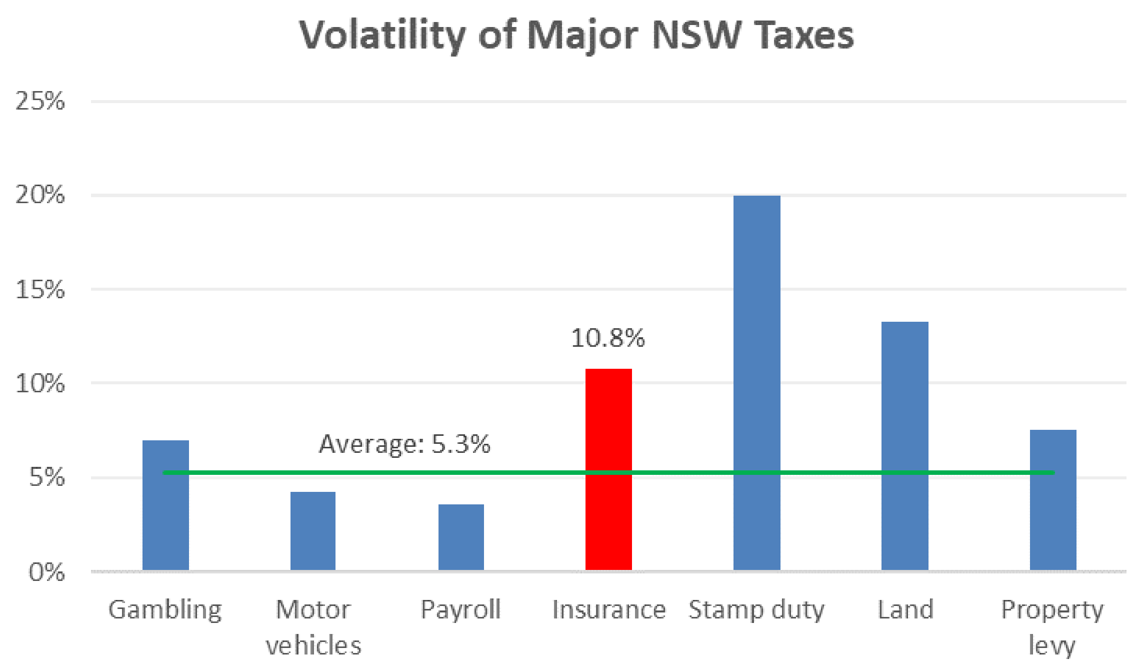
[5] Freebairn, Stewart & Liu (2015) reform of state taxes in Australia - rationale and options.
[6] IPART (2008) Review of State Taxation - final report
[7] FSC submission to 2015 Tax White Paper.

This creates a productivity drag on life insurers because it necessitates complex assessment processes, legal fees and systems reconfiguration, all of which would be simplified under a harmonised system, or not necessary at all if stamp duty was abolished.

The premium taxes on insurance in Australia are generally high by developed country standards. There were no taxes on life insurance in Belgium, Denmark, Finland, France, Germany, Japan, Luxembourg, Netherlands, New Zealand, Norway, Poland, Spain, Sweden, Turkey and the UK in about 2000, while the tax in many other developed countries including Canada, Ireland, Italy, Korea, Portugal and the US is imposed at a lower rate than in Australia.[8] More recent information from 2011 shows this comparison still holds.[9]

In NSW, insurance taxes are significantly more volatile than the average for all major taxes in the State – more than double the average, see the graph below.



Source: Figure 14 of Daley, J. and Coates, B., 2015, *Property taxes*, Grattan Institute. Note: volatility is standard deviation of annual growth from long run compound annual growth rate (1990–91 to 2013–14).

A study by NATSEM for a South Australian review of taxation found that insurance duties have a greater proportionate impact on poorer households – in other words, the taxes are regressive, as shown in the table below taken from that report. The percentage impact on the poorest household (quintile 1) is highest, and then the impact declines as household income increases to the top quintile.

[8] Skipper (2001) *The taxation of life insurance policies in OECD countries: implications for tax policy and planning*, Table 4.
[9] PwC (2011) *International comparison of insurance taxation*

2013-14 results[a]	
Household type	**Insurance duty**
Income	
Quintile 1	0.54%
Quintile 2	0.53%
Quintile 3	0.49%
Quintile 4	0.47%
Quintile 5	0.36%
Total income	**0.44%**

Source: Page 23 of South Australian Government State Tax Review Discussion Paper, 2015

3.2 Insurance duties are widely recognised as being particularly inefficient

Many reviews over recent years have agreed that stamp duties on insurance (life, general and/or health insurance) are among the worst taxes levied in Australia, and abolishing these taxes would provide substantial benefits to the economy. These reviews or studies are outlined below. A paper by the Australian Treasury[10] reviewing major Australian taxes in 2015 is not included in the list below because it did not cover insurance duties.

Note the studies below are largely about all forms of insurance and do not differentiate between life, general and health insurance.

3.2.1 Centre for International Economics report State Business Tax Reform

This report[11] found replacing State insurance duties and conveyancing duties with Federal taxation would increase GDP by 0.6 per cent in the long term. This translates to a gain of 45 cents of economic activity for every dollar of tax change in the long term. Replacing additional inefficient State taxes would produce higher economic gains.

3.2.2 Henry Tax Review in 2010

The Henry Tax Review final report (Australia's Future Tax System) stated the following:

> *Insurance allows people to manage their risk and provides them with the flexibility to exploit economic opportunities. Australia has high taxes on insurance, both in comparison to the taxes imposed on other products and industries, as well as compared to other countries. Imposing specific taxes on insurance adds to the cost of insurance premiums and can lead to under-insurance or non-insurance. Specific insurance taxes should be abolished. (page 469)*
>
> *Compared to other countries, taxes on insurance in Australia are relatively high. (page 472)*

[10] Liangyue Cao, Amanda Hosking, Michael Kouparitsas, Damian Mullaly, Xavier Rimmer, Qun Shi, Wallace Stark, and Sebastian Wende (2015), "Understanding the Economy-wide Efficiency and Incidence of Major Australian Taxes", *Treasury Working Paper*, 2015-01.

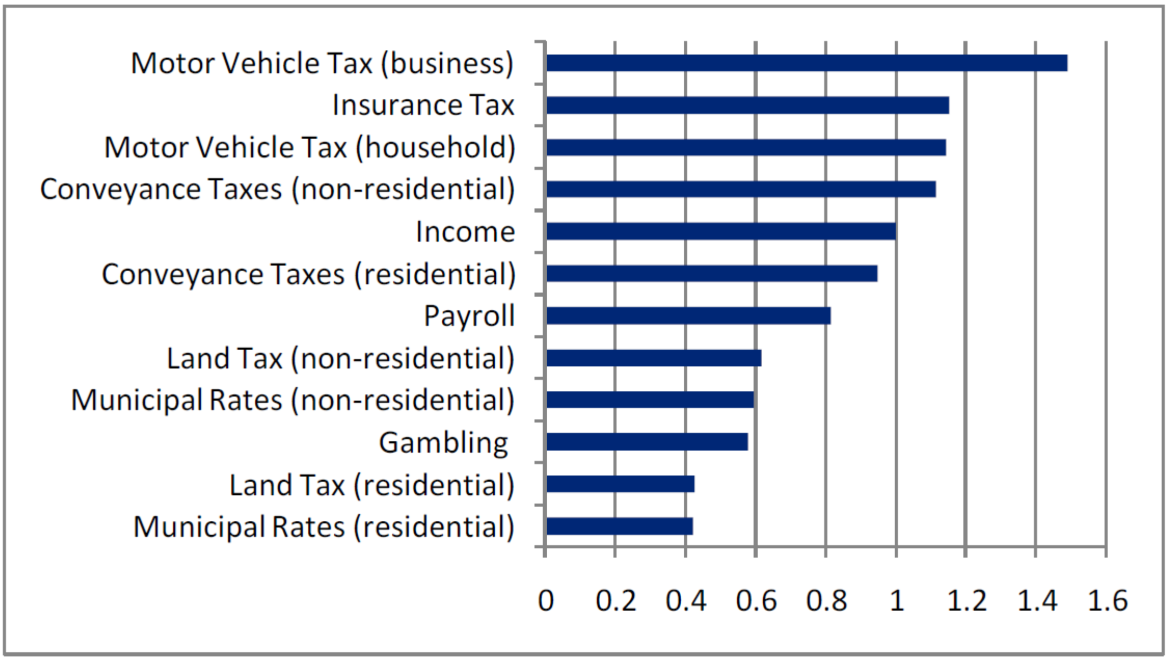
[11] Centre for International Economics (2009) State Business Tax Reform – Seeding the tax reform debate – report for Business Coalition for Tax Reform

There is little justification for levying specific taxes on insurance products. Rather than correcting a market failure, insurance taxes can add to existing problems in the insurance market. The revenue from insurance taxes should be replaced by revenue from a more efficient and equitable tax. (page 474)

3.2.3 Deloitte Access Economics (2011) Analysis of State Tax Report

This report[12] found that insurance taxes are the second worst Australian taxes amongst those reviewed, as shown in the chart taken from that report:

Chart 3.2: Detailed efficiency rankings of State and Federal taxes



Source: Deloitte Access Economics estimates

3.2.4 KPMG Econtech (2010) analysis for Henry Tax Review

This report[13] argued:

The excess burden of insurance taxes is very high. This is for two reasons:

- *First, insurance taxes are applied to a narrow base – insurance services. By applying insurance taxes to this service, this increases the price of these services relative to other goods and services, and leads to inefficiently low consumption of insurance services.*
- *Moreover, insurance taxes have a high effective rate. An important consideration is that while the statutory tax base is typically the value of premiums, the true cost of insurance services to policyholders is the value of premiums net of benefits,*

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[12] Deloitte Access Economics (2011) Analysis of State Tax Report 2011 – Report for Finance Industry Council of Australia

[13] KPMG Econtech (2010) CGE Analysis of the Current Australian Tax System

which is a much smaller tax base. This smaller tax base means that the effective rates of tax are far higher than the statutory rates.

A table from the KPMG report is reproduced below, showing insurance taxes are the third most inefficient Australian tax amongst the taxes considered:

Table A: Marginal and average excess burdens of Australian taxes (cents of consumer welfare per dollar of revenue)

Rating	Tax	MEB	AEB
Low	Tobacco excise [a]	-8	-23
Low	Import duties [b]	-3	-7
Low	Petroleum resource rent tax [c]	0	0
Low	Municipal rates	2	1
Low	GST	8	6
Low	Land taxes [d]	8	6
Low	Alcohol excise and WET [a]	9	7
Medium	Fuel taxes	15	10
Medium	Stamp duties other than real property [e]	18	18
Medium	Luxury car tax [f]	20	9
Medium	Labour income tax	24	16
High	Conveyancing stamp duties [g]	34	31
High	Motor vehicle registration [h]	37	32
High	Motor vehicle stamp duties [h, i]	38	38
High	Corporate income tax	40	23
High	Payroll tax	41	22
Very High	Insurance taxes	67	47
Very High	Royalties and crude oil excise	70	50
Very High	Gambling taxes [j]	92	54

Source: KPMG Econtech's MM900 model estimates

Note the KPMG report assumes the tax rates on insurance are constant across States (in other words, the variation in tax rates between States is ignored) and the report therefore states “the excess burden estimate for insurance taxes may be underestimates” (page 129).

3.2.5 ANU working paper by Chris Murphy in 2016

This paper[14] found insurance taxes are less efficient than personal tax, GST, municipal rates and land taxes. The ranking of taxes from that report is below (adapted from Table A):

The paper also notes:

> *Insurance taxes appear to be applied at moderate rates when expressed as percentages of premiums. However, the true price of an insurance service to a customer is the premium net of the expected benefit. When re-expressed in this way, insurance taxes are seen to be levied at high effective rates on narrow bases… In light of its high MEB, estimated here at 58 cents in the dollar (Table 4.1), arguably insurance taxes should be abolished.*

3.2.6 Centre of Policy Studies (CoPS) modelling in 2019

This report[15] appears to be the only Australian analysis that separately analyses life insurance and other types of insurance. This report purports to find the duty on life insurance was somewhat less inefficient (or less detrimental to the economy) than other insurance duties. However, we have significant concerns about the technical details of this modelling, which mean the results are likely to underestimate the inefficiency of duties on life insurance. The details of these concerns are in Attachment A.

Note some of these concerns may similarly apply to other modelling cited earlier in this submission.

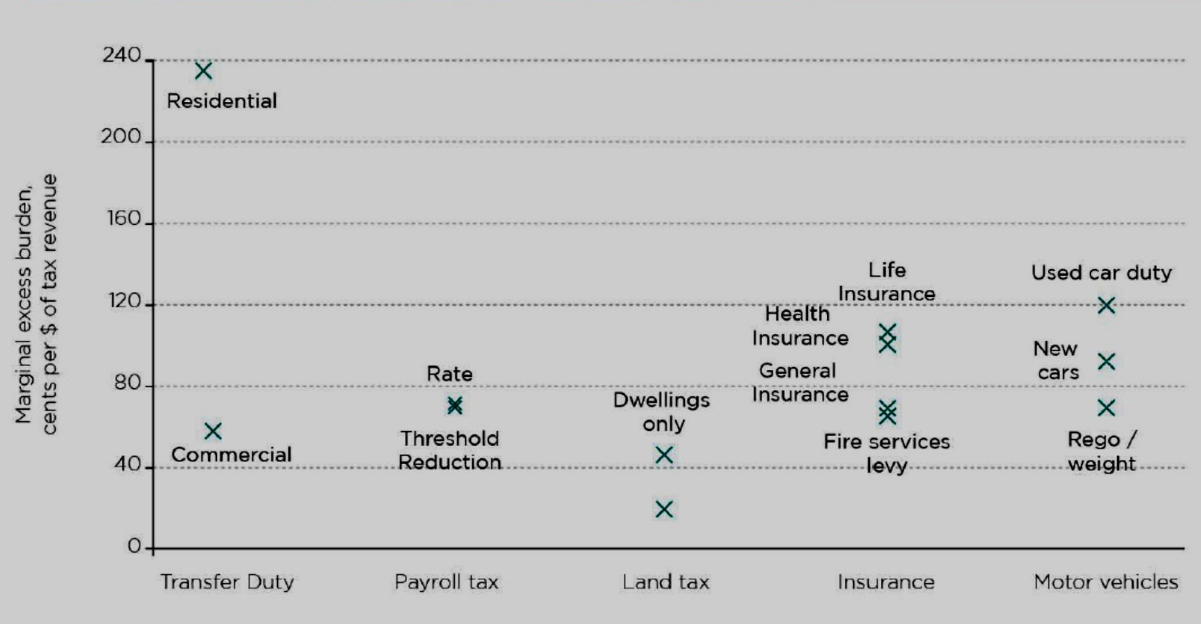
Notwithstanding this concern, we note that duties on life insurance are still found to be inefficient. This is shown clearly in this graphic taken from the NSW Productivity

[14] Chris Murphy (2016b), “Efficiency of the tax system: a marginal excess burden analysis”, *ANU Tax and Transfer Policy Institute Working Paper*, 4/2016

[15] Nassios, J., J. R. Madden, J. A. Giesecke, J. M. Dixon, N. H. Tran, P. B. Dixon, M. T. Rimmer, P. D. Adams and J. W. Freebairn (2019). *The economic impact and efficiency of state and federal taxes in Australia*. CoPS/IMPACT Working Paper G-289.

Commission's discussion paper, which is likely to be based off similar results to the published CoPS paper:[16]

FIGURE 7.4: ESTIMATES OF ECONOMIC COST OF NEW SOUTH WALES TAXES

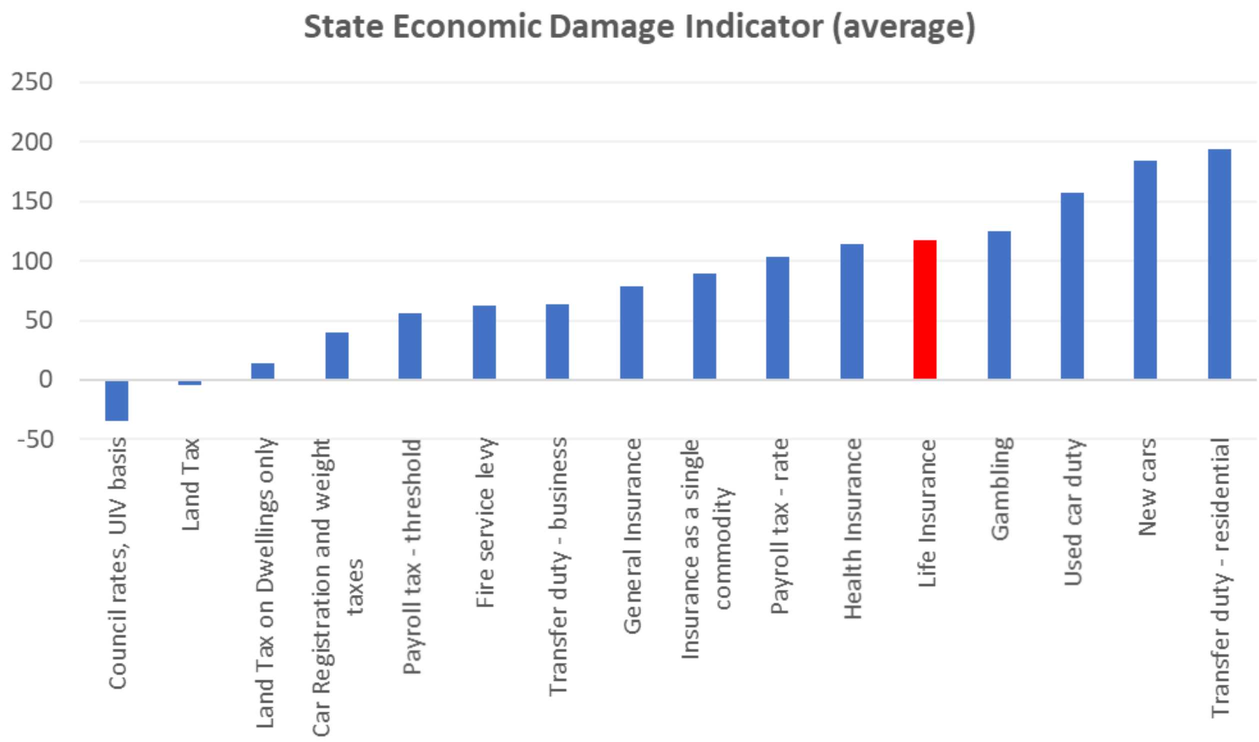


Source: CoPS (2018).

The inefficiency is also shown in the average State Economic Damage Indicator for the published CoPS study,[17] which measures the impact of life insurance duties on Gross State

[16] Note the brightness and contrast in this graphic has been adjusted to improve readability.
[17] See footnote 15

Product. The following diagram is based on the data in Table 2-1 of the published CoPS study:



3.3 Compliance costs

A previous survey by the FSC has shown the compliance costs of duties on life insurance are substantial – the industry-wide cost was estimated at $85.455 million in 2015, and had grown by 16 per cent over the preceding 7 years.[18] This compared with total stamp duty revenue of $94.7 million in 2014:[19] so compliance costs were about 90 per cent of revenue in 2015 (ignoring revenue growth to 2015 – including this would make the comparison worse).

A major reason for the substantial compliance costs of from insurance duty is the high level of complexity of the insurance duty regimes across the States. The FSC is separately providing detailed information on this complexity to the NSW Productivity Commission.[20]

The following is an outline of some compliance costs for life insurance companies. These have been factored into the compliance cost estimates above.

Systems administration

- adapting systems to take into account rate changes and complexity in characterising a product with all the different riders and elements which make up the product;

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18 FSC Submission to Tax White Paper.
19 See FSC submission to 2015 Tax White Paper
20 Note this information is confidential as it represents valuable intellectual property for FSC members.

- systems used by insurers were generally acquired some time ago and have been heavily customised—as a consequence they don't tend to automatically characterise a product and require significant manual reprogramming;
- cost of designing new systems and configuring rules to automate the calculation of insurance duty is significant (mainly due to the different rules and to a less extent the different rates); and
- a manual process is usually needed to extract what actual tax should be paid to each of the State Revenue Offices.
- insurers must separately determine stamp duty liability for individual members of different group insurance products residing in different States.

Legal and Tax Advice

- determining the characterisation of life policy riders can be a very complex task and this generally necessitates the services of an in house lawyer or external legal counsel;
- where in-house lawyers or tax experts are in doubt over characterisation they may choose to seek external advice; and
- some insurers take external advice in respect of product characterisation, but even this can sometimes be inconclusive with a variety of views being expressed as to characterisation.

Dealings with State Revenue Offices

- significant cost of external audits if liabilities are later reviewed – an increasingly relevant point with the respective State Revenue Offices being increasingly active in stamp duty audits;
- resolving issues around refunds and overpayments if a liability is (in the Commissioner's view) incorrectly calculated;
- obtaining refunds of overpayments from State Revenue Offices can be both time consuming and costly; and
- reporting varies by State, so for example, data might be collated monthly, but in SA reporting is required annually so it becomes necessary to aggregate the data.

Staff and time costs

- high costs (staff and time) associated with tracing through to life insured – for example, the sale of a policy in Queensland to a trustee of a superfund in NSW for a life insured that resides in Adelaide;
- significant training costs associated with educating people on how to calculate across each State; and
- significant resources required to make product changes to accommodate changes in tax arrangements.

3.4 Underinsurance in Australia

Research shows there is a substantial problem with underinsurance for life insurance products in Australia.

- KPMG estimated[21] the disability underinsurance gap was $304 billion per year in 2014. This estimate includes existing levels of insurance, including inside superannuation.
    - The report found 77 per cent of Australians in the age group 45 to 64 are underinsured.
    - If Australians were adequately insured, social security benefits could be reduced by a minimum of $340 million in the first year, even before the impact of foregone tax revenue is taken into account. After ten years, the total welfare spending savings to government from more adequate disability insurance was estimated to exceed $2.5 billion.[22]
- A separate report by KPMG[23] estimated the level of underinsurance of the lives of employed people against premature death in Australian families was $800 billion in 2013.
- The latest underinsurance estimates from Rice Warner[24] is $2.2 billion for income replacement life cover, $5.8 billion for TPD cover, and $353 million for income protection cover.
    - The cost of underinsurance for the Federal Government is estimated at $54 billion per year for life cover, $500 million for TPD cover, and $692 million for income protection cover.
    - Note more recent analysis shows in many cases income protection insurance offered inside super provides a net benefit to the combined budgets of all Australian governments – see Section 3.5.

All the above estimates are from before the implementation of several Federal legislative changes (Protecting Your Super and Putting Members' Interest First) that might be increasing the level of underinsurance.

This is a significant level of underinsurance and is especially concerning considering that most working Australians have default life insurance cover held within group schemes in superannuation funds.

Duties on life insurance have a substantial impact on underinsurance: the duties increase the prices of life insurance products, and this in turn reduces the purchase of insurance. For example, three US studies shown in the table below find a significant decline in the purchase of life products when price increases (including due to taxes). The highest estimate is that an

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[21] KPMG (2014) Underinsurance – Disability Protection Gap in Australia, report for FSC
[22] KPMG (2014) Underinsurance Disability Protection Gap in Australia, report for FSC
[23] KPMG (2013) Death and TPD underinsurance, report for FSC
[24] Rice Warner (2017) Underinsurance in Australia. This report finds is a small level of overinsurance for basic life cover, but finding covers a period before Federal legislative changes that are reducing cover, and the overinsurance becomes underinsurance when insurance is compared against the median level of cover rather than the mean.

increase in price by ten percent (roughly the amount of stamp duty levied by State Governments on annual premiums) reduces insurance purchase by 9.2 per cent.

Table 1 – estimates of responsiveness of demand for life insurance to price

Product	Price elasticity (responsiveness of demand to price)	Report
Yearly renewable term life insurance	−0.4 to −0.5	Pauly et al. (2003)[25]
Term life insurance	−0.66	Viswanathan et al. (2007)[26]
Whole life insurance	−0.71 to −0.92	Babbel (1985)[27]

Note: Price elasticity, or responsiveness of demand to price, is the per cent change in demand for a one per cent change in price.

These figures are less applicable to insurance provided inside super, which involves auto-enrolment (so demand is less responsive to price). Instead, the duties paid on life insurance inside super directly lead to reduced retirement savings, but unlike life insurance they do not provide any direct benefits to individuals who are insured.

3.5 Life insurance inside super – impact on Government budgets

There has been some debate at a national level that life insurance provided inside superannuation is a drain on Government Budgets (the budgets of Federal and State Governments). However, research released by the Productivity Commission in early 2019 indicates this concern is largely misplaced – in summary:

- Income Protection (**IP**) insurance obtained inside super provides substantial savings to governments for middle- and higher-income couples and individuals.
    - This means any IP underinsurance comes at a net cost to governments.
- Total and Permanent Disability (**TPD**) insurance obtained inside super has a small cost or benefit to governments for middle- and higher-income couples and individuals (TPD provides a reasonably large benefit to governments for higher income singles).
    - This means TPD underinsurance for high income singles comes at a net cost to governments, while TPD underinsurance for other categories of individuals has small impact on government budgets.
- Both IP and TPD insurance obtained inside super is subsidised by governments for lower income couples and individuals.
    - This means IP or TPD provided to low income earners is more affordable than it would otherwise be because of the net subsidy. In addition, any cut in this net subsidy would

[25] Mark V. Pauly, Kate H. Withers, Krupa Subramanian-Viswana, Jean Lemaire, John C. Hershey (2003) *Price Elasticity of Demand for Term Life Insurance and Adverse Selection*, NBER Working Paper 9925.

[26] Viswanathan, Krupa S., Jean Lemaire, KateWithers, Katrina Armstrong, Agnieszka Baumritter, John C. Hershey, Mark V. Pauly, and David A. Asch (2007) "Adverse selection in term life insurance purchasing due to the BRCA 1/2 genetic test and elastic demand". *Journal of Risk and Insurance* 74: 65–86.

[27] Babbel, David F (1985) "The price elasticity of demand for whole life insurance". *Journal of Finance* 40: 225–39.

provide long-term benefits to Government budgets but it will also make low income earners worse off as they would lose the existing Government subsidy.

Further details are in Attachment B.

4 Collection of payroll tax by Australian Government

As argued in Section 2.2 above, the FSC recommends the NSW Productivity Commission consider recommending transferring the administration and collection of payroll tax to the Australian Government in conjunction with other States. This could involve basing payroll tax calculations and payments off STP/PAYG data and having a less frequent return (perhaps annual) that covers any amounts not included in STP. The ATO would distribute the payroll tax to the States, subtracting an administration fee, in the same way as is done for the GST. There would be no change to compliance/audit arrangements.

The potential benefits of this change are outlined below.

For States:

- Reduced administration costs, as the costs for the Australian Government to collect payroll tax are most likely lower than for State Revenue Offices.
    - No need to have separate payroll tax collection systems in each State, each requiring updating over time.
- Consistent payroll tax data and payments with Australian Government data and payments for PAYG.
    - If payment is aligned with PAYG, this will bring forward some payroll tax payments – however at a cost to business, so a return of this benefit to business would probably be appropriate.
- Easier to have further harmonisation of payroll tax approaches across States – however States can retain different approaches if they choose.
- Contributes to State government reductions in 'red tape'.
- Potential to expand to other taxes if this approach works.

For business taxpayers:

- Single reporting and collection mechanism across payroll tax and PAYG, removing duplication of up to 8 different systems.
    - Reduced business red tape, reduced administration and compliance costs.
- Reduced likelihood of mistakes in tax reporting and payment.
- Streamlined tax reporting.
- Potential to manage taxes from multiple jurisdictions using one portal.
- Potential to expand to other taxes if this approach works.

For Australian Government:

- Contributing to reduction in red tape.
- Increased efficiency of the tax system.
- Improved consistency and integrity of tax data, allowing improved data insights.

- Significant increase in ability to use matched data on payroll tax for statistical, economic, and compliance reasons.
- No cost to Australian Government as costs passed on to States (similar to GST).

5 Payroll tax and financial advice

5.1 Regulatory Overview

In order to provide financial services in Australia, a person must hold an Australian Financial Services Licence (**AFSL**), be an 'Authorised Representative'[28] of an Australian Financial Service Licensee (**Licensee**) or be entitled to rely on an exemption.[29] Licensees must satisfy strict financial and conduct requirements, including requirements as to compliance procedures as well as supervision and training of representatives.

The financial planning industry is made up of a wide spectrum of practices, including large corporate financial planning practices with many employed advisers, and small financial planning practices which could be run by a sole trader or could be an incorporated entity comprising of a sole financial planner (**Financial Planner**). Financial Planners are more likely to seek 'authorisation' from an existing Licensee such as a bank, dealer group or insurer, than apply for their own AFSL.

Typically, a Licensee will enter into a written agreement known as an "Authorised Representative Agreement" with the Financial Planner which, amongst other things, clarifies the scope of the licence authorisation, imposes restrictions on sub-authorisations, and permits the Financial Planner to represent themselves as an Authorised Representative of that Licensee.

Licensees are required to notify the Australian Securities and Investment Commission when an Authorised Representative is appointed. It is important to note that not all employees, or directors, of a Licensee are 'Authorised Representatives' but are 'representatives'. Appointment of Authorised Representatives is granted with a written notice that specifies the financial service to be delivered or financial service to be delivered on the behalf of the Licensee.[30]

5.1.1 Liability

As a direct consequence of the introduction of the licensing provisions in Chapter 7 of the Corporations Act (**Licensing Framework**), and subject to limited exceptions, where a Financial Planner is an Authorised Representative of a Licensee, the Licensee is jointly responsible to the client, for the conduct of that Authorised Representative, whether or not the Authorised Representative's conduct is within the authority granted by the Licensee.[31] In that way, the Licensing Framework operates as a form of consumer protection by ensuring

[28] namely, a person authorised in accordance with section 916A or 916B of the Corporation Act 2001 to provide a financial services or financial services on behalf of the AFS licensee
[29] See *Corporations Act 2001* (Cth) *ss* 766A and 911A.
[30] 'Appointing and ceasing an AFS authorised representative'. ASIC.
[31] s917B Corporations Act

that the client has recourse against the Licensee for the conduct of the Authorised Representatives in the provision of financial services.[32]

Although it is more of an exception than standard practice, the Corporations Act permits Financial Planners to act as an Authorised Representative of more than one Licensee where both Licensees provide their consent. While the general conduct of Authorised Representatives and their overall compliance with the licensing provisions of the Corporations Act is monitored by the Licensee, in practice the Authorised Representative continues to carry on their own separate business under the relevant authorisation by the Licensee to conduct that part of their business that requires the authorisation.

5.2 Differing business models

5.2.1 Dealer Groups

Financial Planners may be Authorised Representatives of any type of Licensee including a Dealer Group. A Dealer Group is a Licensee allowing Authorised Representatives to utilise its AFSL to provide financial services. Some Dealer Groups have Authorised Representatives who are employees of that Dealer Group and work under the direction and control of the Dealer Group as their employer. However, the majority of Authorised Representatives are independent Financial Planners who operate their businesses entirely independent from that of the Dealer Group and are simply Authorised Representatives under that Dealer Group's AFSL as it is a legal requirement that financial services may only be provided under an AFSL.

5.2.2 Payments by Financial Planners for Dealer Group services

Dealer Groups typically collect all fees and commissions due to its Authorised Representatives from the product issuers and then remit those funds to the relevant Authorised Representative. This arrangement is also good for product issuers as they do not have to pay hundreds of Financial Planners, they simply pay the Dealer Group.

Financial Planners have to pay the Dealer Groups for the services the Dealer Group provides to the planners, including allowing the Financial Planner to provide financial services under the Dealer Group's AFSL. The fee structures of Dealer Groups vary. Some Dealer Groups deduct a percentage from the money they collect from the product issuers for the financial planner, others solely charge an annual fee, or it may be a combination of the two.

It is important to identify that any money passing through the Dealer Group to an Authorised Representative is not a payment by the Dealer Group to the Authorised Representative, but simply the Dealer Group remitting to the Authorised Representative, money that is due to it by the clients and product issuers. Dealer Groups do not pay money to Authorised

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[32] Section 911A(2) provides an exemption from the requirement to hold a licence where a person provides the service as a *"representative"* of a licensee. See, then, the definition of *"representative"* of a licensee in s 910A, as including an *"authorised representative"* of a licensee, and the definition of an *"authorised representative"* in s 916A as a person authorised *"for the purposes of Chapter 7"* to provide financial services *"on behalf of"* the licensee but only *"for the purposes of this Chapter."*

Representatives for services provided, to the contrary in fact, it is the Authorised Representatives that pay a fee to the Dealer Group for utilising its AFSL.

5.2.3 Goodwill and client base

Despite their authorisation, Authorised Representatives are often small independent Financial Planners who generate their own client base, conduct business under their own business name, occupy their own premises, set their own office hours, engage in their own marketing activities, procure their own software and systems, and manage their own accounting.

By operating their own independent business, Authorised Representatives generate goodwill in their business and are entitled to sell their business as a going concern, or sell their book of clients to another Authorised Representative who may be authorised by another Licensee. Sales such as this do not generally require consent of the Licensee. An Authorised Representative is entitled to change Licensee, in which case their portfolio of clients moves with them. Authorised Representatives run their businesses completely independently from that of the Licensee and will negotiate fees directly with clients for the services they provide.

In that sense the business of Authorised Representatives in the context of financial planning businesses can be likened to franchisees, often obtaining support from the Licensee but generating and dealing with their client base directly.

5.2.4 Provision of services

In our view, it is clear that Authorised Representatives do not provide a service to the Licensee. The Authorised Representatives provide services to clients through the provision of financial advice and arranging for the dealing of financial products. Authorised Representatives enter into arrangements directly with their clients for the delivery of services and payment of fees and these arrangements could be in the form of annual service agreements or ongoing fee arrangements. The Licensee does not have day to day control over the way the Authorised Representative provides services to their clients and the Authorised Representative provides its services under its own business brand.

While the Licensing Framework may be construed as deeming the financial services provided to the client by the Authorised Representative to be provided 'on behalf of' the Licensee, and this has often been raised by Revenue NSW as the similarity between the authorisation of Financial Planners and the engagement of employees, this is not in our view entirely accurate.

In our view, the conditions that are created, particularly with respect to the oversight of the Authorised Representatives which may be seen as indicative of an 'employee like' relationship, is merely a function of the Licensing Framework. The Licensee is concerned only that its licence conditions and authorisations are not breached, and in reality the deeming provisions are confined solely to the Licensing Framework without contemplating any wider application.

Indeed, more recent regulatory reforms have focused squarely on Financial Planners providing services to the clients as principal (not on behalf of the Licensee) and being civilly liable (personally) where conflicted remuneration is received from a Licensee.[33]

In summary the points arising from the above are as follows:

- Financial Planners are independent businesses who manage their own client base and negotiate fees directly with clients for the services they provide to those clients.
- Financial Planners pay a fee to the Licensee for the grant of a licence authorisation but do not provide services to the Licensee.
- The licensing framework that overlays the business of planners operates as a form of consumer protection and does not contemplate any wider application.
- The previous NSW Government policy introduced in 2003 that provided an exemption for financial planners from payroll tax acknowledged the unique challenges the licensing regime caused and gave a clear exemption from the tax.

5.3 Legislative History – the contractor provisions

Historically, payments to persons who were not characterised as employees (including independent contractors) were not subject to payroll tax. Victoria first enacted 'contractor provisions' in 1983, with New South Wales following in 1985.[34] Those contractor provisions formed part of the *Payroll Tax Act* 1971 (**1971 Act**) of each State and have carried through into the *Payroll Tax Act 2007* (NSW).

In his second reading speech to the Legislative Assembly of New South Wales, the Minister for Employment and Finance said of the original New South Wales provisions that *"(b)ona fide independent contractors will not be caught by the legislation."*[35] Further, referring to the arrangements within the scope of a *"relevant contract"*, the explanatory note (**EN**) stated that they were *"directed to capture several means of disguising the employer-employee relationship by contractual arrangements which have been increasingly resorted to in recent years by persons seeking to defeat the objects of the Principal Act."* The EN continued by stating that *"(t)he definition contains appropriate exclusions, so the parties to genuine service contracts will not be prejudiced."*[36]

5.3.1 Implication of changing licensing framework

Since the Contractor Provisions were originally enacted over 30 years ago, various regimes to regulate the financial planning industry have been introduced. These varying regimes, including the requirements for the authorisation of Financial Planners, and the introduction of the Future of Financial Advice reforms, have resulted in different kinds of contractual obligations between parties which would not have been contemplated at the time of enactment of the Contractor Provisions.

[33] See *Corporations Act 2001* (Cth) s 961Q.
[34] See the *Pay-roll Tax (Amendment) Act* 1983 (Vic) s 7 of which inserted s 3C into the *Pay-roll Tax Act* 1971 (Vic). See also the *Pay-roll Tax (Amendment) Act* 1985 (NSW) s 4 and Sch 1 of which inserted s 3C into the *Pay-roll Tax Act* 1971 (NSW).
[35] Hansard, Legislative Assembly, 13 November 1985, p 9558.
[36] Explanatory Note to the Pay-Roll Tax (Amendment) Bill 1985.

Importantly, the characterisation of the relationship between a Financial Planner and client is driven by regulation. That is, it is only because of the unique nature of the Licensing Framework as it applies to Financial Planners that the payroll tax consideration arises. This is evident when considering that other small business entities which act in a similar manner to Financial Planners, including with respect to servicing of their own clients, are not caught by payroll tax obligations as they operate outside of the Licensing Framework (for example under a commercial franchise).

The legislative exemption provisions acknowledged that Financial Planners, while operating under the umbrella of an AFSL, were in reality operating independent businesses providing services directly to their own clients. The understanding that the Financial Planner is working for the client or investor themselves is articulated in the Hansard[37] report published following the introduction of the amending Parliamentary Bill introducing the specific exemption in the 1971 Act as follows:

> *Exemption of financial planners: In a September 2002 report, two special advisers, Associate Professor Neil Warren and Penny Le Couteur, recommended an exemption for remuneration paid to financial planners who are not common law employees. The bill implements this recommendation, thereby extending an existing exemption that applies to insurance sellers. This exemption recognises that there have been changes in the financial planning industry since the 1980s which have seen the role of independent life insurance sellers expand into sales of other forms of investments. These salespeople are required to act in the interests of the investors, and are therefore working for those investors rather than the investment house.*
>
> *The criteria for the exemption were developed in consultation with representatives of professional and employer bodies, including the Financial Planners Association and the Investment and Financial Services Association, and are based on the Commonwealth exemption from the alienation of income legislation for certain agency arrangements. In order to remove uncertainty about the application of the current legislation to financial planners, holders of Australian financial services licences under the Commonwealth Corporations Act 2001 were granted approval to apply the exemption from 1 July 2003, pending the passage of retrospective legislation to confirm the exemption. The bill contains transitional provisions giving effect to this approval.*

The exemption that was inserted into the 1971 Act was broadly expressed in section 3A(5A) which stated that:

> *(5A) The wages that are liable to taxation under this section do not include amounts paid or payable by an AFS licence holder in respect of services provided by a financial planner if the exemption conditions are satisfied.*

[37] NSW legislative Assembly Hansard Full Day Transcript 10 June 2005.

The exemption was removed on harmonisation of the legislation after discussions with industry – however it was expected that the general exemptions available for payroll tax would continue to apply in relation to payments to Financial Planners.[38] This position is reflected in the NSW Budget Statement 2007-08 that:[39]

> *"Some specific exemptions have to be removed in New South Wales to achieve the harmonisation with Victoria sought by business. However, it is expected their removal will have little practical effect or can be offset by the introduction of payroll tax rebates in New South Wales. From 1 July 2007:*
>
> *♦ the specific exemption for wages paid to financial planners under relevant contract provisions will be removed. However, most financial planners will continue to be exempt under other general exemptions.*
>
> *…*
>
> *Overall, this State initiative will reduce business compliance costs and is expected to have no significant impact on total payroll tax revenue."*

Despite the clear statement above, over the course of the past 5 years, NSW Revenue has pursued Financial Planners for the payment of payroll tax and has shown that rather than being a tax that has 'little practical effect', it is instead a major financial burden for Financial Planners with complex rules that are difficult to understand and comply with.

The clear intent of the 2007–08 Budget is not being adhered to. Not only is the removal of the exemption having a material, practical impact on businesses, the change is not reducing compliance costs, and in addition it is conceivable that the initiative is having a significant impact on total payroll tax revenue.

In summary:

- The clear intention of the legislature with the introduction of the 1971 Act was to address anti-avoidance and was expressed to ensure that parties to genuine service contracts would not be prejudiced by the imposition of payroll tax.
- Financial Planners were regarded as independent businesses acting in the interests of their own clients and justified exemption from payroll tax on this basis. This has not changed.
- The contractual arrangement arising between the Financial Planners and Licensees resulting from the Licensing Framework would not have been contemplated at the time of enactment of the Contactor Provisions, and it is only the overlay of the Licensing Framework to their business that causes payroll tax apply.
- This is evidenced by comparable businesses operating similar models (such as franchisors) but who operate outside of the Licensing Framework, not being caught by the payroll tax obligations.

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[38] NSW Treasury Explanatory Note.
[39] NSW Budget Statement, 2007-08, "Budget Paper 2" page 3-11

- The legislature clearly represented to the industry that harmonisation of the legislation would have little real impact on Financial Planners.
- The contractor provisions were meant as anti-avoidance rules which were never intended to apply to genuine independent businesses such as financial planners.

5.4 Current Legislative Framework

Under the *Payroll Tax Act* 2007 (NSW) (**Payroll Tax Act**) an employer by whom taxable wages are paid or payable is liable to pay payroll tax on the wages.[40] Amongst others, an employer is defined as "*a person to whom during a financial year, under a relevant contract the services of persons are supplied for or in relation to the performance of work.*"[41]

Where a 'relevant contract' is in place, the Contractor Provisions of the Payroll Tax Act will apply. A 'relevant contract' is defined as:

> *a contract under which a person (the designated person) during that financial year, in the course of a business carried on by the designated person*
>
> *(a) supplies to another person services for or in relation to the performance of work; or*
>
> *(b) has supplied to the designated person the services of persons for or in relation to the performance of work ..."*

For the purposes of the Payroll Tax Act, "amounts paid or payable by an employer during a financial year for or in relation to the performance of work relating to a relevant contract" are taken by section 35(1) to be wages paid or payable during that financial year. The person who performs the work is taken by section 34(a) to be an employee.

In this regard, the contracts between the Licensees and Financial Planners (as Authorised Representatives) are said to be relevant contracts, an approach adopted by the courts (*Bridges Financial Services Pty Ltd v. Chief Commissioner of State Revenue (NSW) 2005 ATC 4735*). However, the agreements between Financial Planners and Licensees vary substantially in practice and so in order to determine whether in fact an agreement contract falls within the Contractor Provisions requires scrutiny of each agreement.

5.4.1 Exemptions

Section 32(2) of the Payroll Tax Act outlines various exceptions to there being a relevant contract.

One of the main exceptions is the 'other persons exclusion' which is found in section 32(2)(c) in which paragraphs (i) and (ii) excepts the situations where in the course of a business carried on by a designated person the designated person is supplied by a person ("the contractor") with services for or in relation to the performance of work where the work to

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[40] s7 Payroll Tax Act 2007 (NSW)
[41] s33(1)(b) Payroll Tax Act 2007 (NSW)

which the services relate is performed by two or more persons employed by, or who provide services for, the contractor in the course of a business carried on by the contractor (sub paragraph (i)) or where the contractor is a natural person, by the contractor and one or more persons employed by, or who provide services for, the contractor in the course of a business carried on by the contractor (sub paragraph (iii)), unless the Commissioner determines that the contract or arrangement under which the services are so supplied was entered into with an intention either directly or indirectly of avoiding or evading the payment of tax by any person.

In essence therefore a Financial Planner that engages other persons to assist their business may be exempt. In *Novus Capital Ltd v Chief Commissioner of State Revenue* [2018] NSWCATAD 72 it was held the 'other person exemption' could apply even where a planner consults with another planner.

However, the exception is highly fact specific and difficult for a Licensee to determine. For instance there is uncertainty how the exception operates where a Financial Planner may engage part-time support, and further what other support services count towards the exception (for example, would it extend to book-keeping or reception services). Courts have added to the complexity by suggesting that a wide diversity of services might count (*Bridges Case*) whereas Revenue NSW have tended to take a restrictive view.

There are also practical difficulties in applying other exceptions such as the 90 day rule in section 32(2)(b) and the exemption for the non-work component in section 35. Further exceptions which might otherwise be expected to apply – such as where the contractor supplies services to the public generally – are said by Revenue NSW not to apply as the Licensing Framework construct is that the Financial Planners are supplying services to the Licensee – despite Financial Planners considering the relevant clients as their own.

The result is that Financial Planners inadvertently are captured by the Contractor Provisions but find it difficult if not impossible to apply the exceptions – contrary to the arguments in the 2007–08 Budget (see above). This is further confounded by the requirements under the Payroll Tax Act for the Licensee or Financial Planner to have the burden of proof – such that if they cannot provide clear records then the presumption is that the exception is not met.

In summary:

- The approach of the Courts has been to interpret the relevant contract provisions widely.
- It is difficult due to the factually specific nature of the provisions, their complexity and the burden of proof for Licensees and Financial Planners to fall within an exemption even though as a matter of principle they should in many cases be available.

5.5 Comparisons

5.5.1 Superannuation Guarantee Charge

Compulsory employer superannuation contributions (**Super Contributions**) are regulated by the Superannuation Guarantee (Administration) Act 1992 (**SGAA**) and the Superannuation Guarantee Charge Act 1992.

Pursuant to the SGAA, Super Contributions are imposed on an employer's superannuation guarantee shortfall for a quarter and are payable by the employer.[42] A superannuation guarantee shortfall is calculated by reference to the "quarterly salary of wages base" for the employer in respect of the employee for the quarter.[43]

'Salary or wages' includes payments under a contract that is wholly or principally *for the labour of the person* where that person *is an employee* of the other party to the contract [44] (emphasis added).

As such where a payment made to a person is not categorised as 'salary' or 'wages', Super Contributions are not payable. As salary or wages are only payable where a person is an employee and as a result Super Contributions are not payable in respect of persons who are independent contractors.

This means the approach taken for Financial Planners in relation to payroll tax is inconsistent with the approach taken for superannuation.

5.5.2 Contractor or employee assessment

Whether or not a person is an employee or independent contractor is determined by considering a range of factors. The common law position with respect to the assessment was recently clarified in the case of *ACE Insurance Limited v Trifunovski [2013] FCAFC 3* and this position aligns with the guidance provided by the Australian Tax Office (ATO) including as set out in its *Superannuation Guarantee Ruling SGR 2005/1.*

Broadly, where a person is operating their own independent business, has control over their work and has freedom over the way work is done (subject to the specific terms of the agreement), takes commercial risks and is legally responsible for the work and cost of rectifying any defect in their work, provides all or most of the equipment, tools and assets to complete the work, is paid directly for a result achieved (including per hour or per item), and has the ability to delegate or subcontract, then that person is an independent contractor. Conversely, where a person is paid for the time worked, is provided with the equipment and tools to carry out their work, takes no commercial risks, does not operate independently and is directed in the way in which they must carry out their work, then that person is likely to be an employee for the purpose of assessment.

When determining if a person is a contractor or an employee no one factor is determinative of the relationship, the totality of the relationship between the parties must be considered.[45]

Although each individual arrangement between a Licensee and Authorised Representative will turn on its own facts, in the clear majority of cases the Financial Planners who are Authorised Representatives run their business independently and comfortably meet the common law test and ATO characterisation of independent contractor. This is the accepted position across the financial services industry, and in practice Super Contributions are not

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[42] S16 SGAA and s17
[43] S19(1) sgaa
[44] S12(3) SGAA
[45] Para 9 Superannuation Guarantee Ruling SGR 2005/1

paid by Licensees in respect of Authorised Representatives unless they are employees of the Licensee.

In our view it is clear that an Authorised Representative Agreement itself cannot be characterised as a contract that is wholly or principally for the supply of labour of the Authorised Representative to the Licensee. While it is a written document required to be entered into under the Licensing Framework, it is not evidence of an employment relationship.

In line with the view of the Federal Court and the ATO, it is the totality and reality of the relationship that must be considered.

5.6 The Economic Inefficiencies of Imposing the Tax on Planners

The way that payroll tax is imposed by the Contractor Provisions affect primarily small Financial Planners (single Authorised Representatives). This is because once there are two or more Financial Planners in a practice the 'other persons' exception applies.

The tax imposition on small Financial Planners is regressive and inefficient because:

- it is imposed on Financial Planners businesses least equipped to deal with the administration burden;
- it acts as a disincentive for new Financial Planners to enter the industry as single Authorised Representatives;
- the cost of complying with the tax requirements and keeping sufficient records to maintain an exemption (if available) far outweigh the actual tax collected;
- it is difficult to apply in practice as the legislation is complex, difficult for even Courts to apply and largely misunderstood; and
- the position is made more difficult by State Revenues Offices in different jurisdictions taking different approaches to how the provisions apply.

In 2013 the FSC commissioned a report by Independent Economics, at Attachment C. The report concluded that in relation to Sole Trader Financial Planners (**STFP**):

> *Given these supply and demand characteristics of STFPs, it can be concluded that STFPs are genuine independent businesses competing in the small business segment of the market for financial planning services. Therefore, as part of making the payroll tax system as efficient as possible, competitive neutrality requires that, like other small business financial planners, they should be eligible for the small business exemption.*
>
> *STFPs are "Authorised Representatives" of Licensees for the narrow and specific purpose of satisfying the legal requirement to operate under an AFS Licence. As part of this, they receive their income via the collection mechanism provided by the Licensee. However, they receive only limited direction from the Licensee, consistent with the conclusion above that they operate as independent small businesses.*

Given that STFPs are genuine independent small businesses, attempting to deny them the small exemption from payroll tax on the false premise that they are not, is a highly inefficient way to seek to raise revenue. Such a policy measure would require STFPs to incur the costs of proving to state authorities what is already apparent: that they are small businesses in their own right. The consequence of most or all of them doing this is that little or no additional revenue would be raised. Hence, high costs would be incurred for a low revenue gain. This high "excess burden" means that this policy measure would be a highly inefficient way to raise revenue.

As such there is no sound economic basis for pursuing Financial Planners. To do so will merely impose high additional costs on small businesses that are the least equipped to handle the burden.

In summary:

- The imposition of payroll tax affects predominantly small Financial Planners and the burdensome costs of compliance acts as a disincentive for new Financial Planners to enter the market.
- Small Financial Planners are genuine independent businesses in the small business segment of the market and are disadvantaged in comparison to small business owners operating in alternate industries.
- Economic analysis suggests that applying payroll tax to small Financial Planners is an inefficient way to seek to raise revenue as it in effect decreases productivity and competition.
- The previous NSW Government policy introduced in 2003 acknowledged the unique challenges the licensing regime caused and gave Financial Planners a clear exemption from payroll tax.

6 Attachment A – concerns with CoPS modelling in relation to life insurance

The CoPS paper states:

> *"Life insurance duty is defined as a proportion of the insured sum, rather than the premium. For term and non-group term insurance policies, the applicable rates are:*
>
> *o $1 for the first $2 000 of the sum insured, or a maximum of 0.05 per cent;*
>
> *o $0.2 for every $200 in excess of the first $2 000 of the sum insured, which is broadly equivalent to a tax rate of 0.1 per cent of the sum insured beyond $2000."*

This is the only stamp duty rate which is applied to the paper's conclusions.

This statement about the applicable rate for life insurance is flawed.

The applicable rates of stamp duty for life insurance as expressed in s. 243 of the NSW Duties Act. The highlighted text shows the error in the modelling.

> *243 WHAT DUTY IS PAYABLE?*
>
> *(1) Policies of life insurance, other than a temporary or term insurance policy or trauma or disability insurance*
>
> *The amount of duty chargeable on a policy of life insurance, other than a temporary or term insurance policy, a trauma policy, a TPD policy or a disability income policy is:*
>
> *(a) on the first $2,000, or part of $2,000, of the sum insured--$1, and*
>
> *(b) for every $200, or part of $200, in excess of the first $2,000--20 cents.*
>
> *(2) Temporary or term insurance policies The amount of duty chargeable on a temporary or term insurance policy, other than a group term insurance policy, is 5% of the first year's premium on the policy.*
>
> *(2A) Group term insurance policies The amount of duty chargeable on a group term insurance policy is:*
>
> *(a) 5% of the first year's premium on the policy, and*
>
> *(b) 5% of the amount of the premium (if any) payable in any succeeding year in respect of each additional life covered by the insurance policy (that is, each life that was not covered during the previous year).*
>
> *(3) Life insurance riders The amount of duty chargeable on a life insurance rider is 5% of the first year's premium on the life insurance rider.*

(4) Trauma or disability insurance The amount of duty chargeable on a trauma policy, a TPD policy or a disability income policy is 5% of the premium paid to effect the insurance.

(5) In this section:

"disability income policy" means a policy of insurance under which an amount is payable as a replacement of income in the event of the disablement of the insured by accident or sickness.

"group term insurance policy" means a term insurance policy that applies in respect of the lives of a specified group of persons, being a group the membership of which may change during the term of the policy.

"TPD policy" means a policy of insurance under which an amount is payable in the event of the total and permanent disablement of the insured by accident or sickness.

"trauma policy" means a policy of insurance under which an amount is payable in the event of the insured being found to have a stated condition or disease."

Far and away the most prevalent types of life insurance are:

- "temporary or term insurance policies",
- "group term insurance policies" and
- "life insurance riders"

for which the stamp duty rate is 5% of the 1st year's premium; and

- "Trauma or Disability insurance"

for which the stamp duty rate is 5% of all premium receipts.

The rate used by the paper (based on 'sum insured'), is applicable to 'Insurance Investment Bonds' (both investment linked and investment account) which comprise a relatively small part of today's life insurance market and to whole of life and endowment insurance policies, which have ceased to be issued by the industry and so no longer comprise any material portion of the market for stamp duty purposes.

The paper states:

"In order to calculate the SEDI and excess burden of life insurance duties, we derived an estimate of the duty rate as a proportion of premiums collected, rather than the current basis, i.e., as a proportion of the insured sum."

The conclusion is that the calculation by the paper of the excess burden of life insurance duties seems likely to be flawed.

7 Attachment B: Productivity Commission modelling on life insurance inside super

The Productivity Commission's final report into superannuation included modelling of the impact of Income Protection (IP) insurance and Total and Permanent Disability (TPD) insurance on Government Budgets. The modelling included the impact on ***all*** Government Budgets – Commonwealth, State and Territory.

The modelling only covered IP and TPD insurance purchased insider super, not purchased outside super, and life insurance cover was excluded (because the modelling was too complex).

7.1.1 Methodology

The benefits to Budgets from IP and TPD insurance are from:
- Stamp duty on insurance premiums
- Reduced Government spending on income support as a result of people making insurance claims. TPD and IP mainly reduce Government spending on the Disability Support Pension (DSP).
- Income tax on some insurance payouts.

The costs to Budgets from IP and TPD insurance are from:
- The tax deductions for premiums
- Erosion of super balances causing increases in Age Pension spending and reduced tax revenue from super fund earnings

The modelling results are expected Net Present Value to Governments of particular individuals taking out IP or TPD insurance, taking into account probabilities of claim.

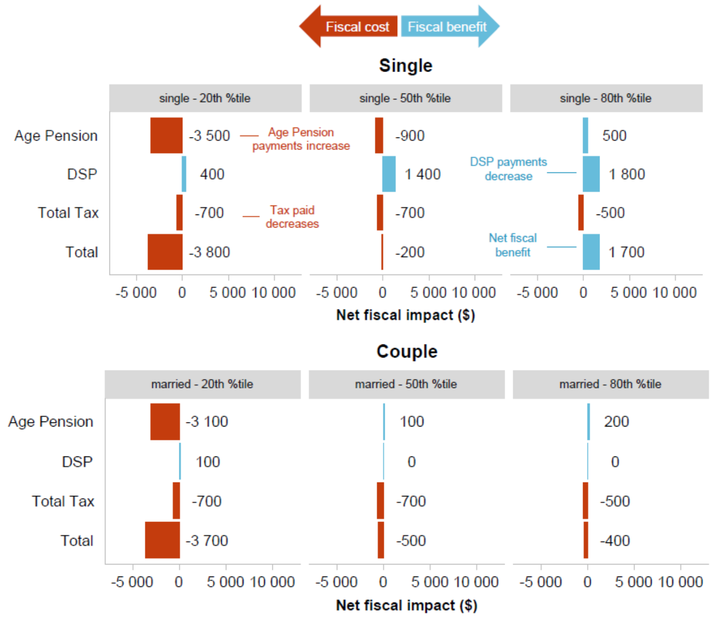
7.1.2 Results

The overall results were in general:
- IP insurance provides substantial savings to the Government for middle- and higher-income couples and individuals.
- TPD insurance has a small cost or benefit to Government for middle- and higher-income couples and individuals (TPD provides a reasonably large benefit to Government for higher income singles).
- Both IP and TPD insurance is subsidised by the Government for lower income couples and individuals.
- The net tax concession for IP and TPD insurance is progressive, with a larger concession provided to low income earners and a smaller concession to middle- and higher- income earner.

The main results are shown below. The Commission's report included numerous scenarios that varied the assumptions used, but the results were broadly similar.

Figure 9.5 **Net fiscal impacts of TPD insurance**[a]

Selected cameos

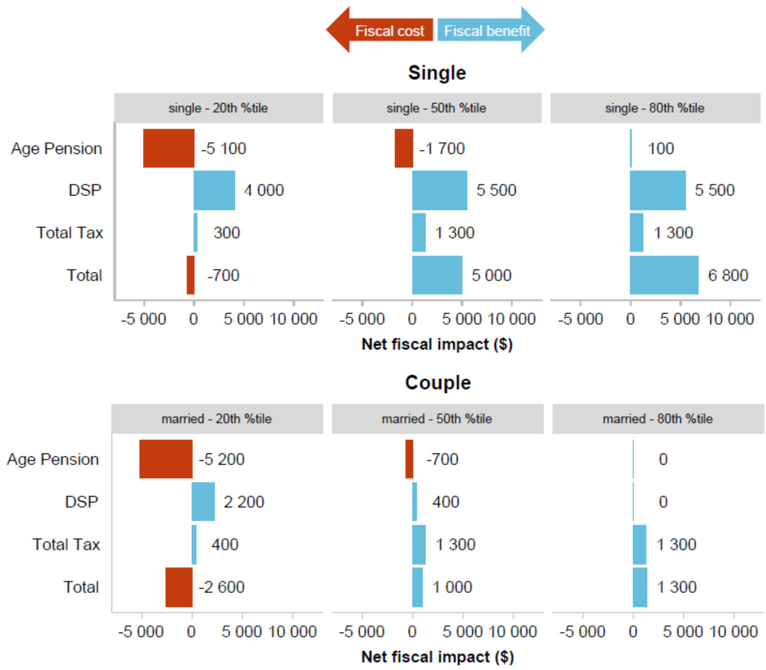


a All results are presented as NPVs and represent the weighted sum of all the possible outcomes (that is, never claiming, claiming at 22, etc.) that an individual can face.

Source: Productivity Commission estimates.

Figure 9.6 **Net fiscal impacts of IP insurance**[a]

Selected cameos



a All results are presented as NPVs and represent the weighted sum of all the possible outcomes (that is, never claiming, claiming at 22, etc.) that an individual can face. Cameo modelling is for an IP policy with a two year benefit.

Source: Productivity Commission estimates.

7.1.3 Discussion

The Productivity Commission's conclusion/summary suggested the modelling results were somewhat negative for insurance in super, but the results are actually quite positive, as they demonstrate:

- Restricting IP insurance for middle- and higher-income people could easily cost the Government money in the long term.
- Any short term budget benefit from restrictions on TPD insurance for middle- and higher-income people are likely to disappear in the long term.
- Restricting IP or TPD for low income earners would provide a long-term benefit to the Government budget, it will also make low income earners worse off as they would lose the existing Government subsidy.

Note:

- The Commission's modelling may underestimate the benefits of IP and TPD to Government Budgets as it does not include taxes on the insurance margin.
- The modelling does not include the benefit of IP and TPD insurance to individuals which is substantial for those who make a claim.
- The Commission's modelling does not measure the impact of IP or TPD insurance on the Budget overall, just the impact on an individual-by-individual basis, and only in expectation.
- The modelling does not include life insurance cover or any insurance purchased outside of super.