21 September 2020

Mr Peter Achterstraat AM
NSW Productivity Commissioner

Dear Mr Achterstraat

Green Paper: Continuing the productivity conversation

The Financial Services Council (**FSC**) welcomes the release by the NSW Productivity Commission (**The Commission**) of the Green Paper Continuing the Productivity conversation (**the Green Paper**). The Draft Report details the case for substantial reforms, including to State Taxation.

Given the economic challenges facing the NSW and Australian economies due to the COVID-19 induced recession, it is urgent that action be taken to reform inefficient taxes which depress wages, consumption and economic growth, and diminish State government revenue. The headwinds facing our economy are likely to be pervasive and long-lasting. The issues addressed by the Green Paper therefore have a heightened level of urgency.

About the Financial Services Council

The FSC is a leading peak body which sets mandatory Standards and develops policy for more than 100 member companies in Australia's largest industry sector, 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.

FSC response to Green Paper

This submission comments on areas of particular interest and expertise of the FSC's members.

State taxes overview

The FSC supports the Green Paper's Draft recommendation 8.1: Set out a program to move to efficient state taxes:

> *"Replace inefficient taxes with more efficient ones. Start by replacing transfer duty with a broad-based land tax. Before proceeding, identify how various designs will improve the economy and the state budget, and how adverse impacts on various groups can be minimised.*

We note there are concerns with the approach to reform of property stamp duty being adopted in the Australian Capital Territory (**ACT**) which involves slowly replacing stamp duty with land tax. This approach has resulted in a higher land tax burden on businesses in some cases. The NSW Review of Federal Financial Relations (**The Thodey Review**) notes the ACT approach 'prolongs any community opposition' (page 51) to the transition, and therefore the reform may not be sustained. It would be preferable to use approaches that are less susceptible to reversal.

Payroll Tax

We support the move for a national, harmonised payroll tax system (Draft recommendation 8.1) and agree that this would bring considerable efficiency improvements for all taxpayers. We also support a single inter-jurisdictional body to coordinate the adoption of a consistent approach to the administration of the payroll tax system in different jurisdictions, particularly where such a body would ensure the application of identical procedures (such as online lodgement data) and definitions (such as the definition of "employee") uniformly across Australia.

Indeed, if the Commission wished to go a step further to achieve maximum efficiencies, the FSC has previously proposed[1] a single return lodgement and payment method through the Federally managed myGov account system, and then dispersed to the States.

Life insurance tax

The Commission focusses on a limited range of tax reforms in the Green Paper. However, noting the urgent need for reform, the FSC urges the Commission to recommend bolder tax reforms in line with the draft recommendations of the recent Draft Report of the Thodey Review (page 11):

> *All specific taxes on insurance products, including the Emergency Services Levy in New South Wales, should be abolished and replaced by more efficient and broad tax bases, to improve the affordability and uptake of insurance.*
>
> *To reduce the cost of insurance and enable fairer ways to fund the fire and emergency services, the Government should reconsider applying a levy on property owners and should also consider combining this with any future broad-based land tax. The reform should follow a detailed consideration and modelling process to carefully consider the impacts on different taxpayers.*

This broader tax reform agenda would be consistent with the recommendations of numerous reviews and inquiries, as listed in the FSC's submission to the Commission. We submit there is a complete lack of adequate policy rationale for an additional or extra tax on insurance policies, similar to the taxes on gambling or tobacco, given that insurance is a social benefit whereas gambling and tobacco use can have significant societal costs.

The discussion paper issued for the Commission's review acknowledged the inefficiency of these taxes (see pages 97 and 98). This is supported in numerous reviews and reports that found insurance taxes are some of the most inefficient taxes in Australia.[2] Figure 8.3 in the Green Paper shows taxes on general insurance are inefficient, but other studies cited in the FSC submission (including the study cited in Figure 8.3) show the efficiency costs of taxes on insurance are substantially higher.

This was acknowledged in various other tax reviews that found:

- "*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.*" (IPART (2008) Review of State Taxation - final report);

[1] See FSC first submission to this review, section 2.2.

[2] See citations and quotations on pages 9 to 14 of FSC submission.

- "*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"*. (Henry Tax Review final report (Australia's Future Tax System, page 469).
- The Thodey Review (see excerpt earlier).

The FSC submits there are significant additional reasons for removing taxes on insurance:[3]

- There are no market failures that justify an additional taxation on insurance.
- They are taxes on prudence, self provision and good risk management practices.
- The underinsurance caused by the tax leads to increased costs to Governments who often provide public assistance to people who are underinsured.
    - Underinsurance is most likely to occur for who are least able to afford the financial consequences of the loss that insurance would have covered.
- The taxes are regressive, having a greater relative impact on the less well off and a smaller relative impact on the rich (see page 9 of FSC submission).
- The stamp duties on life insurance imposed a cost of $235 million on superannuation in 2018–19 according to FSC calculations (see details in Attachment).[4] The harmful impact of this tax on retirement assets and incomes would be substantially larger due to the compounding effect of superannuation over a long accumulation period.
- They are a volatile revenue source, creating uncertainty in Government budgets (see page 8 of FSC submission).
    - We note the Green Paper highlights the volatility in total dollar terms, particularly in Figure 8.2, but examining volatility as a share of the tax base or variation of growth rates shows insurance taxes have substantial variability.
- They have high compliance and administration costs. An FSC estimate is that the compliance costs are 90 per cent of revenue (see page 14 of FSC submission).
- The rates of taxation are high by comparison with other developed countries.

Given these reasons, the FSC argues there is a compelling case for removing insurance taxes as a priority, and recommend that the Commission elevate the priority attached to this tax reform.

More generally, we note the Commission may be considering other proposals that may lead to tax increases on insurance. This approach would compound many of the problems raised above with taxation on insurance, including increased underinsurance and non-insurance and an increased call on Government support.

Broader tax reform

The FSC also supports the second part of recommendation 8.1:

> *Propose, for consideration by the Board of Treasurers, the establishment of a single interjurisdictional body to coordinate the adoption of a consistent approach to the administration of payroll tax systems in all states and territories."*

The second part of this draft recommendation should help overcome the lack of action on meaningful tax reform. This is an intention we support.

[3] See FSC first submission to this review, section 3.
[4] see Page 5 of FSC (2020) Accelerating Australia's Economic Recovery.

Conclusion

The FSC commends the Commission on the Green Paper and would welcome the opportunity to discuss this submission and the broader policy issues further. For further discussions please contact me on [redacted]

Yours sincerely,

[redacted]

[redacted]

Attachment: Calculation of estimated tax impost on life insurance products

The figure in this submission is that state duties on life insurance products inside superannuation raised $235m in the 2018–19 financial year.

This figure is based on a survey of life insurers the FSC conducted seeking to determine the total amount of stamp duty paid by life insurers each year for the period 2010 to 2014.

As this survey covered a large part of the industry, but not all insurers, this figure was grossed up to generate an estimate of revenue for all life insurers.

This revenue figure was then divided by historical figures of gross policy revenue for the relevant (and available) years to generate an effective tax rate for the whole industry.

This effective tax rate was then applied to gross policy revenue for 2018–19 for group insurance to generate an estimate of stamp duty revenue from group insurance for 2018–19.