Australian Government

The Treasury

COSTING MINUTE

Date: 13/11/2009
Ref: CQAU 2009-226
File:

To: **Katherine Tuck, Australia's Future Tax System**

Cc: **Scott Bartley, Australia's Future Tax System**

TITLE **AFTS proposal - Abolition of insurance taxes**

SUMMARY OF PROPOSAL

Intent of the proposal

The AFTS Panel are likely to recommend that all state taxes on insurance should be abolished.

Current taxation treatment/problem

All States and Territories (States) impose taxes on insurance. The main insurance tax is the stamp duty on general insurance premiums which all States impose at various rates and with various exemptions. Other insurance taxes are stamp duty on life insurance and term/temporary insurance, the insurance protection tax in NSW, the health insurance levy in ACT and NSW, and insurance companies contributions to emergency services (also known as the fire services levy) in NSW, VIC and TAS.

Insurance tax arrangements vary between States and between products. If life insurance is taxed at all, taxes are light, with marginal rates of around 0.1 per cent on high value products (for example, in NSW, taxes are $1 for amounts insured for $2,000 and 0.1 per cent for amounts over $2,000). Term or temporary products are taxed at around 5 per cent of the value of the premium in most states. Rates for general insurance vary between 11 per cent of premiums in South Australia and 7.5 per cent in Queensland, with rates generally around 10 per cent and some concessional arrangements applying, including a range of exemptions.

These taxes add to the cost of insurance and can lead to under insurance.

Where insurance taxes are embedded in the cost of insurance, these are generally deductible.

Proposed taxation treatment

Abolish all States taxes on insurance (stamp duty on life insurance, temporary/term insurance and general insurance premiums, insurance protection tax, health insurance levy, and insurance companies' contributions to emergency services).

The GST would continue to apply on insurance products.

While the timing and sequencing of the implementation of this proposal would ultimately be determined through a negotiation process with the States, it is likely that the abolition of all insurance taxes could occur at the same time (that is, no phase in arrangements would need to apply).

ELEMENTS AND OPTIONS

Elements

Element ID	Description
A	Abolish all State taxes on insurance (stamp duty on life insurance, temporary/term insurance and general insurance premiums, insurance protection tax, health insurance levy and insurance companies' contributions to emergency services)

Options examined

Option ID	Option	Assumed start date	Was a Departmental Impact Assessment sought?	Was a Tax Regulation Impact (preliminary assessment) sought?
1	A	01/07/2010	No	No

FINANCIAL IMPLICATIONS

IMPACT ON FISCAL BALANCE - ACCRUAL-BUDGET ($m)

Option ID	Year of Maturity	2009-10	2010-11	2011-12	2012-13	2013-14
1	2013-14	-	-4800	-5000	-5200	-5400
	Revenue	-	-4800	-5000	-5200	-5400

- Nil

IMPACT ON UNDERLYING CASH BALANCE ($m)

Option ID	Year of Maturity	2009-10	2010-11	2011-12	2012-13	2013-14
1	2013-14	-	-4800	-5000	-5200	-5400
	Revenue	-	-4800	-5000	-5200	-5400

- Nil

The costing of each option has been undertaken independently from those of other options, meaning that the costs are not necessarily additive.

RELIABILITY

The estimates of the revenue impact are dependant on the assumptions noted in the Assumptions section of this Costing Minute.

COSTING DETAILS

Methodology

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Data

- Expected total insurance tax collections from individual State government Budgets.
- A PRISMOD.DIST run has been requested.

Assumptions

- 59% of insurance taxes are paid by households, and 41% are paid by businesses (ABS input-output tables 2004-05).
- Insurance taxes represent a cost incurred in doing business or incurring income, and are assumed to be passed on to consumers as higher prices. This means there is no clawback of income tax paid by business.
- GST revenue falls due to lower costs being passed on to consumers by businesses through lower prices of goods and services generally. 72% of business revenue is assumed to be subject to GST (from PRISMOD). The marginal propensity to save is assumed to be 13%, with the remainder of the price savings assumed to be spent by consumers on other goods and services, offsetting the reduction in GST revenue. (RBA research discussion paper 2004-01 'The impact of superannuation on household saving').
- There will be some clawback of personal income tax from deductible insurance expenses. These are insurance on rental properties and work related motor vehicle insurance expenses. There could also be an impact on personal income tax and FBT through salary sacrificed vehicles. These impacts will be offset to some degree as the quantity of deductible insurance demanded will increase as a result of the lower price of insurance faced by households. Given the difficulty in quantifying these impacts and the fact that they are expected to be relatively low (significantly less than 1% of insurance tax revenue), they have been ignored for the purposes of this costing.
- In order to test that these impacts will be small, the following assumptions were made:
    - The HES indicates that 1% of household insurance expenditure is in respect of non-owner occupied property. We have also tested the impact on personal tax revenue assuming 3% of insurance expenditure is deductible as a rental property expense.
    - 60% of rental property expenses will be deductible.
    - the average marginal tax rate for people claiming rental deductions is 26.9%
    - 45% of household insurance expenditure is in respect of motor vehicle insurance.
    - 5% of this expenditure will be deductible (this is determined by dividing total motor vehicle expenses in Taxation Statistics by total motor vehicle expenditure reported in the HES).
    - 20% of taxpayers will not use the starndard 2.9% deduction (this estimate is subject to change by HMAU upon finalisation of the relevant costing).
    - the average marginal tax rate for people claiming car expense deductions is 30.4%

- o the price elasticity of insurance demand is -0.87

Additional Information:
We do not foresee any significant transitional impacts resulting from this proposal. Accordingly, the measure will be mature from 2010-11.

ADDITIONAL INFORMATION

Departmental impacts

An assessment of the Departmental Impact has not been requested.

Tax Regulation Impact (preliminary assessment)

A preliminary assessment of the Tax Regulation Impact has not been requested.

All material provided in this minute must be cleared by the Tax Analysis Division incorporated into Executive Minutes, Cabinet Submissions, any other briefing material, or when used for external purposes.

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