

**TAXING THE TAXED - DUPLICATION OF TAXATION IN PROPERTY
INSURANCE AND ITS SOCIETAL IMPLICATIONS**

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ABSTRACT

This paper examines the recommendation by the Henry Report that the methodology for taxing insurance policies be modified. The imposition of a Fire Services Levy, stamp duty and Goods and Services Tax (GST) duplicates the amount of tax paid on insurance policies. The paper will explore the fiscal strength of these taxation implications in ensuring stability and predictability. The paper will thus focus upon the way that taxation implicates social preparedness for risk minimisation and a reduction in reliance upon the government particularly after catastrophic events. Ultimately the paper seeks to align the taxation pedagogy with the societal implications tax has on the insurance market. The paper will do this through the lens of enabling greater access to insurance and promoting community resilience.

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I INTRODUCTION

A society that learns from catastrophes, that changes its laws, strengthens its infrastructure and repairs mistakes is a society that deserves the respect of its people. To ignore the lessons of history is to condemn us all to repeat its mistakes.¹

In adhering to the profound words of Justice Kirby we must change the way insurance transactions are taxed. Australia's Future Taxation Report ('Henry Review') of May 2010 sparked a ring of outcry about the current taxation system and in particular the way general insurance is taxed.² Subsequently the Final Report of the Royal Commission on the Victorian Bushfires³ brought further scathing criticisms about the way insurance is taxed. The basis for criticism is that high numbers of uninsured and inadequately insured individuals, particularly in Victoria (and New South Wales) but also to a lesser extent the other states, are being forced out of the insurance market due to cost rather than choice.⁴ The system is criticised as being inefficient, ineffective and inequitable in the way that it taxes insurance products. Although vehement opposition to state taxes on insurance has been more visible in 2010, this is a debate which has gained momentum over a number of years.⁵ In 2003 the taxation problems were attributed to the collapse of the former insurance giant, HIH Insurance.⁶ Even the States themselves have recognised that taxing insurance transactions is undesirable.⁷ This begs the question: given there are so many proponents for the abolition of the current taxation regime why is the system of taxing insurance stagnant? Why does its inefficiency continue to fester resulting in insurance exclusivity, increasingly exposing the government to liability after major events? The duplication or 'cascading effect'⁸ of the current taxation regime as applied to insurance is the result of the Fire Services Levy (in Victoria and New South Wales) and the GST in all states. These are cumulatively added to the policy cost and this is then subject to stamp duty. Ultimately this places a disproportionately high burden upon those prudent enough to insure. Those who are

¹ Michael Kirby, 'After the Fires Die Down and the Lawyers Depart' (Paper presented at Australasian Fire & Emergency Services Authority council Annual Conference, Darwin, 9 September 2010) 4.

² Ken Henry, *Australian Future Tax System: Final Report* (Australian Government Publishing Service, 2010).

³ Victoria, Royal Commission into the 2009 Victorian Bushfires, *Final Report* (2010) Summary, 36, Recommendation 64.

⁴ Similarly the National Insurance Brokers Association also claims that the Fire Services Levy, stamp duty and other taxes constitute a direct means of discouraging the uptake of insurance in the community. See National Insurance Brokers Association, 'National Insurance Brokers Association Insurance Taxes Discussion Paper: What you need to know about taxes on insurance' (Report, National Brokers Association, May 2009).

⁵ State Business Tax Review Committee, *Victoria: Review of State Business Taxes*, Summary Report, February 2001, Recommendation 1(1), Recommendation 5; Commonwealth, Royal Commission on the Failure of HIH Insurance, *Final Report* (2003) Vol 1, Recommendation 55 – 8; Michael Keating et al, *IPART (Independent Pricing and Regulatory Tribunal of New South Wales) Review of State Taxation- Report to the Treasurer* (2008) Recommendation 8 – 10.

⁶ Commonwealth, Royal Commission on the Failure of HIH Insurance, *Final Report* (2003) pt 3, Recommendation 56 [10.3.3]

⁷ Neil Warren, 'Intergovernmental Fiscal Arrangements as a Constraint on State Tax Reform under Henry' (Paper presented at Conference on Australia's Future Tax System: A Post- Henry Review, Sydney, 21 – 23 June 2010) 43.

⁸ Justice Owen, Commonwealth, Royal Commission on the Failure of HIH Insurance, *Final Report* (2003), pt 3 [10.3.3]

insured are paying for the fire prevention services in Victoria and New South Wales. In all states, those who are insured contribute to a substantial proportion of the overall tax revenue, effectively enabling others to free ride and still have access to the same services.⁹ The taxation burdens can double the base premium. The problem is further complicated by the lack of transparency preventing many from understanding or even knowing that the cost of insurance is substantially increased by these taxes. The implication of having a defunct taxation system with its surrounding uncertainty is detrimental domestically. Furthermore it is also 'damaging our international competitiveness'.¹⁰ Therefore we should take heed of the advice of the Honourable Justice Kirby and 'repair mistakes'¹¹ implementing a much fairer system. As Justice Kirby highlights, the failure to 'ignore the lessons of history is to condemn us all to repeat mistakes.'¹²

The absurdity of the taxation regime is exemplified by the fact that insurance products are often taxed at the same level as luxury items such as alcohol, gaming and tobacco products.¹³ This sends out a confusing message to consumers suggesting that insurance is a luxury product rather than one of necessity. The bulk of transactions which are taxed at a high rate are aimed at 'discouraging activities deemed to have negative side effects.'¹⁴ However, insurance is in every way beneficial for society and taxing insurance products in such a way leads to market distortion.¹⁵ This paper does not advocate insurance as being compulsory, rather that the insurance market with its tax ramifications be modified to facilitate choice by aborting current practices which result in insurance being an elusive product. Greater access will only arise when insurance is affordable, thus a disbandment of the current practices making the cost of insurance simply unattainable must be undertaken.¹⁶ The way insurance is taxed requires a choice as to 'how much inequity is allowed according to institutions, norms, laws, policies and programs.'¹⁷ A high level of insurance amongst society not only benefits individuals by providing them with financial security, but also has sociological benefits. The primary sociological benefit of high levels of insurance is that it reduces the level of

⁹ Keating et al, above n 5, 1.

¹⁰ Ken Henry, 'Confidence in the operation of the tax system' (Paper presented at Taxation Institute of Australia Conference, Sydney, 13 March 2009) 42.

¹¹ Kirby, above n 1, 4.

¹² Ibid.

¹³ This can clearly be illustrated by the fact that during the period 1998 – 1999 to the period 2007 – 2008 the average amount of tax received in Victoria from gaming machines was \$878m whereas the average taxes on insurance during the same period was \$858m per year. See Insurance Council of Australia, Submission to the Victorian Parliamentary Economic Development and Infrastructure Committee, *Inquiry into State Government Taxation and Debt*, October 2009, 3; National Insurance Brokers Association, above n 4.

¹⁴ Zsolt Darvas and Jakob Von Weizsacker, 'Bruegel Policy Contribution: Financial Transaction Tax: Small is Beautiful' February 2010, 7 <<http://www.bruegel.org/publications/publication-detail/publication/373-financial-transaction-tax-small-is-beautiful>>

¹⁵ Darvas and Von Weizsacker, above n 14; Richard Tooth and George Barker, 'The Non- Insured: Who, Why and Trends' (Discussion Paper, Insurance Council of Australia, 2007) 29.

¹⁶ Dr Henry focuses upon the need for the taxation system to facilitate individuals with choice whereby through such choice they can effectively support themselves rather than the current system which seems to be 'locking people into the welfare system, potentially entrenching chronic deprivation' and encouraging reliance upon welfare. See Ken Henry, 'How much inequity should we allow?' (Paper presented at Australian Council of Social Service National Conference, 3 April 2009) 28 – 9.

¹⁷ Ibid 22.

governmental dependence. We cannot continue taxing the taxed, forcing the most vulnerable members of society out of the insurance market due to the enormous financial burden of insurance which is largely attributable to tax.¹⁸ The outcome of prohibitive costs creating high levels of under insurance and uninsured individuals is that after an event causing widespread loss there will be large government expenditure on the recovery phase as most of these people will not be able to fund their own recovery in the absence of insurance. This in turn will increase the cost of insurance, perpetrating the vicious cycle of more uninsured individuals who will rely upon the government after a loss bearing event. This will inflate government spending on disaster recovery and thus reduce available revenue in other areas. It would be much better to reduce the costs of insurance by lowering the tax burden and thus promoting greater resilience.¹⁹

In Victoria the problems with taxing insurance can be exemplified by the fact that 59.6% of the total number of uninsured and inadequately insured people would have reasonable levels of insurance cover if these consumers were not subject to either the Fire Services Levy or stamp duty on their policies.²⁰ In Australia the last few years have seen a marked increase in the number of weather related disasters which are becoming increasingly frequent and increasingly severe.²¹ Given the reality of Australia being subjected to an increasing number of natural disasters, rather than retaining a tax system which discourages people from obtaining insurance and having massive government expenditure in the aftermath, it would be much better to create resilient communities.²² Enabling access to insurance would also promote greater equity to ensure the taxation burden is not disproportionately high for those who are prudent enough to insure. Individuals should contribute in fair and reasonable ways to attain a tax equilibrium which promotes stability and predictability. Ultimately the emphasis should be upon 'developing a long term blueprint for a tax-transfer system that is focused on sustainable prosperity for Australia.'²³ Part of the solution to creating a superior taxation system involves the abolition of inefficient state taxes from insurance products.

One of the major implications which cement the current system is the federal/state divide. At the heart of any state reluctance to change the taxation regime is the uncertainty about retaining sufficient taxation revenue to serve the needs of the state. Therefore, from a pragmatic perspective in light of political constraints, in order for the system to be altered it is necessary that a viable option is suggested to replace the tax lost from transactional insurance tax. The states are unlikely to agree unless an alternative can be found to enable the States to continue to offer high levels of services

¹⁸ RACV, Submission to Treasury, *Inquiry into the State Government Taxation and Debt*, October 2009, 1, 3 – 4; National Insurance Brokers Association, above n 4.

¹⁹ Edward Mortimer, Anthony Bergin and Rachel Carter, 'Sharing the Risk: Distributing the Cost of Natural Disasters in Australia' (2011) 1; Council of Australian Governments, *Natural Disasters in Australia- Disaster Insurance*, August 2002, 75 – 80.

²⁰ Richard Tooth, 'An Analysis of the Demand for House and Contents Insurance in Australia: Insurance Council of Australia- Industry Focus' (Report, Insurance Council of Australia, 2007) 2 – 3.

²¹ Karl Sullivan, 'Policy Implications of Future Increases in Extreme Weather Events due to Climate Change' (2008) 23 *The Australian Journal of Emergency Management* 37, 42.

²² Mortimer, Bergin and Carter, above n 19.

²³ Henry, 'Confidence in the Operation of the Tax System', above n 10, 42.

whilst maintaining both current and future economic stability.²⁴ Therefore part of the solution will require agreement between the Commonwealth and the State governments about a workable funding system²⁵ particularly through an increase in collaborative taxation regimes.

II MORE THAN JUST FIGURES...WHERE THE MONEY REALLY COUNTS

The amount of revenue a state receives from taxing the insurance industry forms a large part of the budget of each state. In 2005 – 2006 the cumulative amount of taxes received directly from insurance was \$3.7 billion.²⁶ During this period, Victoria retained the largest proportion of state funding from taxes on insurance, with it amounting to 10.1%²⁷ of the overall taxes for the state for that year.²⁸ In the Northern Territory there was the smallest proportion of funding through taxes on insurance whereby such taxes only amounted to 2.9% of overall funding during the 2005- 2006 period.²⁹ In Victoria alone in the period 1998 – 2008, the average collection of tax from insurance contracts was \$858 million per year.³⁰ In Victoria by the 2009 – 2010 financial year the overall amount which the state received in taxes imposed upon insurance was in excess of \$1.4 billion.³¹ This contributed to the overall tax increase resulting from the Black Saturday fires in February 2009 which saw the need for greater funding for fire brigades.³² Whilst there was obvious benefit to the fire brigade possessing additional funding allowing it to expend more on operational costs, the burden of this money fell heavily upon insurance consumers. This is particularly problematic as ‘most consumers are cost conscious to some degree and the natural tension between cost and level of protection

²⁴ Insurance Council of Australia, *Inquiry into State Government Taxation and Debt*, above n 13, 1.

²⁵ Neil Warren, ‘Policy Forum: The Henry Review of Taxation – The Henry Review, State Taxation and the Federation’ (2010) 43(4) *The Australian Economic Review* 409, 412 – 416; Attorney General’s Department, Parliament of Australia, *Australia’s Future Tax System: Report to Treasurer* (2009) G2- State Reform, Rec 119, 103.

²⁶ Insurance Council of Australia, ‘Current Issues in Brief: Tax on Insurance’ (Report, Insurance Council of Australia, September 2006) 1.

²⁷ *Ibid.*

²⁸ The amounts which of the total budget for each of the states and territories for which insurance taxes formed an essential component can be seen below.

INSURANCE TAXES AS A SHARE OF TOTAL STATE TAXES (2006 / 2007)	
Victoria	10.1%
South Australia	9.7%
Tasmania	7.6%
New South Wales	6.9%
Western Australia	6.7%
Queensland	4.4%
Australian Capital Territory	4.4%
Northern Territory	2.9%

Source: Insurance Council of Australia, ‘Current Issues in Brief: Tax on Insurance’, above n 26, 1.

²⁹ *Ibid.*

³⁰ Insurance Council of Australia, *Inquiry into State Government Taxation and Debt*, above n 13, 1.

³¹ John Lenders and Tim Holding, ‘Financial Report for the State of Victoria 2009 – 2010’ (Paper No 374, Parliament of Victoria, 2010) 14.

³² *Ibid* 130.

purchased drives a tendency for consumers to under insure.³³ In Western Australia during the 2009- 2010 financial year the amount received in state taxes levied through insurance premiums was \$428 million which is an increase of \$22 million from the projected amount.³⁴ Although many states have been vocal in their dissatisfaction with the taxation system and its treatment of insurance policies, the amount of revenue received makes the reality of taxation a numbers game.

Many states forget that tax should be more than just a game involving numbers. Taxation has great sociological implications. Inefficient taxes have the potential to create negative long term economic consequences for individuals and communities. The taxation system, in collecting huge sums of money, directly impacts upon the lives of the most taxed people in our society; those from a low socioeconomic background. The way insurance is taxed is inequitable in that it serves neither horizontal nor vertical equity principles. In a report detailing insurance taxes the marginal excess burden of the insurance taxes was exceptionally high, being 67 cents out of each dollar collected.³⁵ Pragmatically, states do need money to provide facilities and services necessary for any society. However, having a tax system where 67% is already directly allocated to existing revenue concerns without allowing tax revenue for the improvement of services and facilities is simply not beneficial. The question is therefore how to create the most efficient tax equilibrium that has the least implications for society as a whole. The creation of such tax equilibrium would require a reduction in the administrative and other dead weight costs which society currently endures. Essentially reform is needed to move from a narrow tax base towards achieving a tax system founded on broader thematic objectives which benefit more members of society. Instead of having transactional taxes these should be replaced with a 'linear tax'.³⁶ Having a taxation regime based upon linear tax methodology is likely to improve access to insurance and enhance the quality of the insurance product the consumer is receiving.³⁷ This restructure must have due regard for societal concerns and be based on a framework of stability, predictability and equity. Moving away from a narrow tax trajectory (of purely transactional taxes) to a more socialist based tax regime will increase the fiscal strength of the tax system and serve the objectives of stability, predictability and equity.

III FEDERAL/STATE DIVIDE- STATE RELUCTANCE TO DISBAND TAXATION ON INSURANCE THE BULWARK AGAINST CHANGE

Many criticisms about inefficient state taxes fail to mention constitutional limitations. Part of any process to reform the state tax system will require recognition of the 'impediments to implementing state tax reform arising from intergovernmental fiscal

³³ Institute of Insurance Actuaries, 'Submission to the Garnaut Climate Change Review – Update 2011' (3 March 2011) 1, 7 at www.actuaries.asn.au.

³⁴ The Government of Western Australia, *Annual Report on State Finances 2009 – 2010*, September 2010, 140 (Table 2.1 'General Government Operating Revenue').

³⁵ KPMG, *Econtech CGE Analysis of the Current Australian Tax System- Final Report*, 26 March 2010, 44 (Table 5.1).

³⁶ Mikhail Golosov and Aleh Tsyvinski, 'Optimal Taxation with Endogenous Insurance Markets' (2007) *May Quarterly Journal of Economics* 487, 522 – 3.

³⁷ *Ibid.*

arrangements'.³⁸ These impediments are an important consideration as these will determine whether the states will be realistically willing to disband transactional taxes such as those on insurance. Consideration of such impediments also postulates what needs to be implemented to facilitate the removal of inefficient state transactional taxes. Although theoretically possible to encourage the states to surrender their taxation of insurance, the stronghold on the ability to raise such substantial revenue is likely to be held with an iron grasp. From an economic standpoint, the collaboration of the states in a more centralised system of taxation would be 'more feasible as better flows of information between taxpayers and administrators'³⁹ would be provided. The way the current taxation system is predicated provides no real incentive for individual states to undertake radical reforms or to abolish transactional taxes.⁴⁰ In fact it has been suggested that the states who do this are faced with three potential problems:

- Firstly, economic uncertainty whereby a state may have to be much more competitive to gain even the same level of funding.⁴¹
- Secondly, there are political problems for the state who implements such changes due to a society being content to retain the status quo.
- Lastly there are also risks in the way a new system would be run, enforced and administered and the costs associated with these implementation regimes.⁴²

The constitutional implications entrenching the intergovernmental grant system act as a disincentive for states to abolish insurance based taxes. States are reluctant to disband such taxes and they often acknowledge the fiscal weakness of a taxation regime heavily reliant upon transactional taxes.⁴³ However, any suggested rectifications of the state taxation regimes have political considerations, particularly due to the potential for Commonwealth fiscal dominance which may lead to the Commonwealth exerting economic control so that it can shape the affairs of each state. In particular, the states are concerned about the current system of fiscal federalism in Australia due to which, essentially rather than risking economic uncertainty, the states retain transactional taxes as a source of state revenue.

If the states surrender their power to tax insurance transactions and thus accept a significantly reduced state budget, there will need to be an increase in Commonwealth grants. However at the moment there is great variance in the way that grants are provided which impinges upon the way that insurance is taxed in each of the states. The main problem with the Commonwealth's ability to give financial grants to the states is that under s 96⁴⁴ the Commonwealth effectively controls the allocation and spending of money. 'The real politick of fiscal federalism in Australia is that the Commonwealth collects the lion's share of revenue and then exerts fiscal leverage over the states.'⁴⁵

³⁸ Warren, 'Intergovernmental Fiscal Arrangements as a Constraint on State Tax Reform under Henry' above n 7, 4.

³⁹ Ken Henry, 'The Future of State Revenue' (Paper presented at Commissioners' Conference, Sydney, 27 March 2009) 36.

⁴⁰ Warren, 'The Henry Review, State Taxation and the Federation', above n 25, 419 – 20.

⁴¹ Ibid.

⁴² Warren, 'Intergovernmental Fiscal Arrangements as a Constraint on State Tax Reform under Henry', above n 7, 52.

⁴³ Ibid, 43.

⁴⁴ *Australian Constitution*.

⁴⁵ Patrick Keyzer, *Principles of Australian Constitutional Law* (LexisNexis Butterworths, 3rd ed, 2010) 258.

The outcome of this is that it may allow the Commonwealth to dictate to states by imposing terms and conditions which must be agreed to prior to funding being allocated.⁴⁶ The alternative for a state asserting their autonomy and failing to accept any terms or conditions imposed on Commonwealth grants could result in the denial of sufficient revenue which a state needs to provide basic services and facilities. Therefore the problem with state taxes is not merely a problem with the legal regulatory regime for transactional taxes but a more deep seated issue surrounding federalism.

If the Australian Government is serious about state tax reform, it must acknowledge that it will not and cannot be undertaken by the states alone. This is not because they oppose reform...rather it is because the benefits from the state "going it alone" only marginally accrue to the state itself...there is not the funding available in the short to medium term to ensure "every state is a winner".⁴⁷

Therefore any resolution needed to fix problems with transactional taxes on insurance must encompass political and economic aspects. Reality dictates that taxation outcomes are coloured by the political and economic factors, most of which are often ignored.

It is not only the practicalities of the system which need to be reconsidered but also the entire methodology upon which the system is based. It has been suggested a more favourable methodology to produce efficient taxation outcomes which in turn better facilitate the participation of each of the states is to adopt a 'bottom up'⁴⁸ approach. This 'bottom up' approach would determine the amount of taxes each state realistically needs for proper operations, services and facilities. The amount of money needed for the basic operations must then be the very minimum amount provided. The states should be given additional funds based upon practical considerations about the increasing cost of providing services and facilities for that state. There must also be a reduction in the conditions imposed upon Commonwealth funding that is provided to the states. If states are satisfied at the outset they would be given an unconditional minimum amount of money which would be sufficient for the operation of that state, this is likely to enable them to better make a decision about their financial ability to abolish taxes on insurance. Currently, given the 'state revenue offices are responsible for the collection of over \$45billion in taxes each year',⁴⁹ they are a crucial part of the Australian tax system. State taxes are a serious matter. Thus the requirement of the states that they retain their autonomy if they abolish transactional taxes should be seen as a legitimate concern to address in the reform process. The maintenance of state autonomy in an increasingly centralised system may require a greater bargaining process as a requisite methodology to be employed in the creation of a more equitable, stable and predictable system.

States should be given recognition for innovation and efficiency within the way the taxation revenue is allocated. Efficient states should be rewarded.⁵⁰ Rewarding

⁴⁶ *Victoria v Commonwealth* (1926) 38 CLR 399, 417; *South Australia v Commonwealth* (1942) 65 CLR 373.

⁴⁷ Warren, 'Intergovernmental Fiscal Arrangements as a Constraint on State Tax Reform under Henry', above n 7, 52.

⁴⁸ *Ibid* 46.

⁴⁹ Henry, 'The Future of State Revenue', above n 39, 32.

⁵⁰ The term efficiency is a difficult concept to define but ultimately what it refers to is the question proposed by the optimal tax theory which essentially requires a balancing between disincentivising work

efficiency and accountability will promote an enhanced system, whilst providing sufficient incentive to continue to operate in an effective manner. Rewarding the efficiency of each of the states should be a key to unlocking the current distortion and providing clarity, certainty and minimising the effect of taxation as a numbers game.⁵¹ Currently if we maintain the status quo and do not reward efficiency, then there is really no incentive for the states to be maintaining and adopting efficient systems. Thus the states have been shown to follow the predictions of behavioural economists: rather than incurring significant expenditure in implementing new and innovative mechanisms to ensure efficiency, states will be more likely to retain the existing regimes as there is no tangible benefit arising from innovation and efficiency in the way that tax is imposed and collected.

With knowledge of the political and economic scope of which our state regulatory tax regimes operate, the paper will now look at the components of the insurance policy costing, in particular paying heed to the taxes applied.

IV FIRE SERVICES LEVY- LACK OF TRANSPARENCY AND ACCOUNTABILITY

A Victoria and New South Wales- Practical Operations of the Fire Services Levy

In Victoria⁵² and NSW the problems with the way insurance policies are taxed begin with the Fire Services Levy. In Victoria 75% of the funding for the Metropolitan Fire Brigade⁵³ and 77.5% of the funding for the Country Fire Authority⁵⁴ comes from the taxes payable on insurance premiums. In NSW 73.7% of the funding for state emergency services must be provided through taxes gained from insurance premiums.⁵⁵

The amount that is chargeable as a Fire Services Levy when added to the initial policy cost will increase the cost of the premium substantially. When the Fire Services Levy is added to the other taxes, being the GST and stamp duty, the cumulative effect of these

or other useful activities due to the tax implications and rather to 'maximise the sum of the utilities of individuals with identical preferences'. See: Reuven S Avi-Yonah, 'Why Tax the Rich? Efficiency, Equity and Progressive Taxation' (2002) 111(2) *The Yale Law Journal* 1391, 1400.

The Inspector General of Taxation has referred to efficient taxes as those which 'do not skew resource allocation decisions across the economy, contributing to a strong, productive economy.' See Australian Government (Inspector General of Taxation) 'Policy Framework for Review Selection' (Issue Paper No 2, Inspector General of Taxation, 2003) http://www.igt.gov.au/content/Issues_Papers/Issues_Paper_2.asp. Essentially the way this paper sees efficiency encompasses ideas from the abovementioned sources but also must be seen within a framework of transparency, accountability and more importantly contextualised in light of the impact it has both upon society and the provision of services particularly the ability to obtain insurance and the implications for inadequate insurance as well as the implications which this has for the individual.

⁵¹ Neil Warren, *Fiscal Equalisation in Australia: High Level VFI and Equity Focused HFE- CESifo DICE Report* (January 2008) 11 – 3 <http://www.cesifo-group.de>.

⁵² The problem with the Fire Services Levy was acknowledged as being problematic with the tax burden on insurance being too high. See: Victoria, *Parliamentary Debates*, Legislative Assembly, 10 November 2009, 3762 (Tim Holding, Minister for Minister for Finance, Work Cover and the Transport Accident Commission).

⁵³ *Metropolitan Fire Brigades Act 1958* (Vic) s 37(1)(c).

⁵⁴ *Country Fire Authority Act 1958* (Vic) s 76(1)(b).

⁵⁵ *State Emergency Services Act 1989* (NSW) s 24F(2)(c).

taxes is that they can increase the base premium anywhere between 50%⁵⁶ to 'a staggering 123%.⁵⁷ This increase reduces and distorts the pool of insured individuals to a small segment of the community and effectively excludes membership. Many individuals and groups who recognise the importance of insurance are forced out of the market not by choice but rather due to the unrealistic financial burden imposed.⁵⁸

B The Blindness Surrounding the Imposition of the Fire Services Levy

Cost is not the only problem with this form of taxation. There are also problems associated with a system that is opaque when it should be transparent. Many do not know about the way taxes on insurance are calculated. Furthermore few know that such taxes are directly attributable to the high costs of insurance.⁵⁹ This tax leads to inefficiency where the 'impost on the insured is too high and has become a disincentive for property owners to adequately insure.'⁶⁰ Taxation works effectively if there is vertical and horizontal equity, yet the current system is not only inefficient but also

⁵⁶ *State Emergency Services Act 1989* (NSW). Furthermore under Schedule 2, Column 1(1) the total amount payable on premiums as an emergency services levy for property is 80% of the premium and for households is 50% of the premium thus adding a considerable expense to the insurance premium. See *State Emergency Services Act 1989* (NSW) sch 2.

⁵⁷ This amount is calculated based upon the percentage increase after the Fire Services Levy, GST and stamp duty is attached to an insurance policy for Victorian country commercial insurance.

Noel Pettersen, 'Fire Services Levy and Insurance Discussion Paper' (Discussion Paper, National Insurance Brokers Association, 2009) 1 <<http://www.niba.com.au/html/37589.cfm>>; Professor Danuta Mendelson and Rachel Anne Carter, *Catastrophic Damages- Liability and Insurance: Australia* (Forthcoming, 2011).

Taxes imposed upon policies to protect private urban dwellings are not as high as country commercial dwellings, yet still add 15-50% to the price of insurance before other taxes is imposed. See Tooth and Barker, above n 15, 4.

⁵⁸ In 2001 a survey was conducted by the Public Accounts Committee suggesting that as many as 39% of the respondents were either uninsured or inadequately insured, much of which was directly due to the increased cost which transactional taxation on insurance imposes.

See Public Accounts Committee, Parliament of New South Wales, *Review of Fire Services Funding* (2004), 54; Insurance Australia Group Ltd, Submission 11 to Treasury, *A National Survey of Small and Medium Business*, July 2001.

This is not a problem which has improved with greatly with the passage of time, rather in Victoria after the Black Saturday fires in 2009 the amount of uninsured or inadequately households was 20%.

See Joshua Whittaker et al, *Victorian 2009 Bushfire Research Response Household Mail Survey* (January 2010) Bushfire CRC < <http://www.bushfirecrc.com/publications/downloads/Mail-Survey-report-10-1-10-rt-2.pdf>>

⁵⁹ Although the insurance companies collect a Fire Services Levy which is a tax on insurance premiums, insurers do not know prior to issuing insurance policies of their exact obligations for a particular year as this is determined by their market share. Therefore insurance companies may either over- or under-collect the Fire Services Levy. If the insurer's estimate is too high a consumer will not be entitled to a reimbursement for the excess tax they were charged. As there is very little transparency and accountability on the part of the insurer to account for each tax dollar raised as a Fire Service Levy, part of the taxation revenue may be a deadweight loss for the government, instead creating a windfall gain towards an insurer's profitability. See Public Accounts Committee, Parliament of New South Wales, *Review of Fire Services Funding* (2004); Victoria, *Green Paper- Fire Services and the Non Insured*, Parliamentary Paper (2009); Property Council of Australia (Victorian Division), *Fire Services Funding Review (A Submission Prepared by the Property Council of Australia)* (2003); Tooth and Barker, above n 15, 37.

⁶⁰ Victoria, *Green Paper- Fire Services and the Non Insured*, above n 59, 2.

inequitable.⁶¹ Fluctuations within the insurance market affect the amount of tax collected. This is not economically sound as it fails to provide predictability particularly as insurance prices continue to sky-rocket. The taxation system must be stable and predictable and not be affected by transactional or other market constraints.

Part of the weakness of the current taxation regime on insurance is that 'the Fire Services Levy is almost a hidden tax and is generally poorly understood by the public. The complexity of the arrangements works against the public understanding.'⁶² Unfortunately the evidence has shown thus in some instances that the lack of transparency has clouded the situation and enabled a greater amount to be expropriated in the form of taxation than actually fully accounted for and expected in terms of the taxation obligation. 'The 2003 Department of Treasury and Finance Review of the Victorian Fire Service Funding Arrangements found that assuming the contributing insurance companies had charged the Insurance Council of Australia recommended rates, in the four years prior to 2003 fire services levy collections had exceeded the amount required to meet statutory contributions by a total of \$46.85m for the Metropolitan Fire Brigade and \$3.68m for the Country Fire Authority.'⁶³ Similarly in New South Wales since 2004 there have been calls to overhaul the existing system for taxing insurance policies. The system is 'inefficient as it distorts economic efficiency by being a significant additional cost (a deterrent) on the purchase of appropriate insurance.'⁶⁴

C Accountability for the Collection of the Fire Services Levy

There is no specific rule dictating what an insurance company must do with any additional funds collected. Historically, money which has been collected under the guise of a Fire Services Levy has been retained if the amount collected exceeded the statutorily required amount. Insurance companies do not even have to inform consumers about any excess tax collected.⁶⁵ One of the big problems with taxation on insurance is that the insurance consumers usually do not even know they are being subjected to such high levels of taxation. The lack of knowledge is prevalent despite the fact that the taxes dramatically increase the cost of them obtaining insurance. The Fire Services Levy is effectively a hidden tax, so not only should the system be rectified but the Australian public has the right to know that they are being taxed on insurance policies. The failure to acknowledge this is said to 'create a "fiscal illusion" effect whereby voters and taxpayers are uncertain about where the final instance of a tax falls

⁶¹ The measure for taxation efficiency is a multitude of various effects of the taxation and can only be discerned by looking at the way in which the taxation is collected, allocated and then distributed. Essentially I am advocating for a taxation regime which has minimal collection costs and which is allocated with distributive justice so that taxation does not impinge upon the ability of individuals to access insurance.

⁶² Pettersen, above n 57, 4.

⁶³ Council Assisting, Submission to the Victorian Bushfire Royal Commission, *2009 Victorian Bushfires Royal Commission- Insurance and the Fire Services Levy*, 2009, 7.

⁶⁴ Public Accounts Committee, Parliament of New South Wales, *Public Accounts Committee- Review of Fire Service Funding* (2004) 53 – 64, 77 – 101.

⁶⁵ Counsel Assisting, above n 63.

and even how much revenue the tax raises.⁶⁶ Taxpayers have the right to know the amount of their tax liability. The current failure to apprise them demands particular attention to the flaws within our current system. There is a need for transparency and accountability in our taxation regime to create equilibrium between collecting tax revenue and promoting an efficient, stable and predictable taxation system which is concerned with the wellbeing of society as a whole. Part of the reform requires institutional change, and part requires a greater public knowledge. Increased awareness of the problems within our taxation system will enable valid criticism in order to promote accountability about the way state taxes are collected and spent.

D Fire Services Levy- The Fiscal Strength of Its Imposition

Problematically, the way the Fire Services Levy applies as a means of taxing insurance policies does not increase the fiscal strength of the tax system. The legislation specifies a minimum taxation burden which must be divided. However, beyond this minimum amount any additional tax which an insurance company may inadvertently collect will not be added to the taxation revenue. Unfortunately the lessons of history have shown us that where there is an excessive amount of tax collected, the system enables any surplus to simply be a windfall gain contributing to the profitability of an insurer.⁶⁷ The fiscal strength of the taxation regime is therefore questionable; not only does it impinge upon the welfare of individuals, subjecting them to distorted costs, but also the government is potentially being robbed of taxation which is instead being absorbed as part of corporate profitability.

E Proposed Review- Victoria's suggested move away from the Fire Services Levy

The current Victorian review of the funding system (Fire Services Levy) has been an opportunity for Victoria to rectify the current situation which fosters individuals being uninsured or inadequately insured.⁶⁸ The Institute of Actuaries of Australia has

⁶⁶ Julie Novak, Kate Herbert and Sinclair Davidson, 'Business Bearing the Burden- The Size and Impact of State Government Business Taxes: The IPA State Business Tax Calculator', Institute of Public Affairs, December 2008, 4.

⁶⁷Rachel Anne Carter, 'Wild Fires- The Legal Regulatory System of Insurance and Emergency Services Funding' (2011) 14 *Southern Cross University Law Review* 75, 75 – 92.

⁶⁸ Although it has been said on 27 August 2010 that the Fire Services Levy would be abandoned in place of a property based levy system operative on 1 July 2012.

See Andrew Main, 'Victoria Abolishes the Fire Services Levy on Insurance', *The Australian* (online) 28 August 2010 <<http://www.theaustralian.com.au/business/victoria-abolishes-fire-services-levy-on-insurance/story-e6frg8zx-1225911077603>> ; Jason Silverii, 'Fire Services Levy Abolition Long Overdue' (Media Release, 27 August 2010) 1 <http://www.aar.com.au/med/pressreleases/pr27aug10_01.htm> ;

Despite the suggestion of change there is still great uncertainty about how this will work in practice and in fact uncertainty as to whether the plan to abandon the Fire Services Levy based upon insurance in favor of a property based levy will go ahead. Although a White Paper on the subject matter of the proposed change was due in February 2011, it still has not been released.

See Department of Treasury and Finance, 'Fire Services Funding Review' (2010) <[http://www.dtf.vic.gov.au/CA25713E0002EF43/WebObj/RevisedToRPDF/\\$File/RevisedToRPDF.pdf](http://www.dtf.vic.gov.au/CA25713E0002EF43/WebObj/RevisedToRPDF/$File/RevisedToRPDF.pdf)>

Furthermore, currently there has also been the failure to release the draft legislation as originally planned based upon the initial agenda for abolishing the insurance based levy system and instead opting for a property based system. The abolition of the Fire Services Levy and the exploration of different models are also not specifically listed as projects in which the Department of Treasury and Finance is currently involved.

commented upon the need for Victoria to abolish the Fire Services Levy in order to remove some of the prohibitive factors increasing the cost of insurance.⁶⁹ The importance of removing the Fire Services Levy in a timely manner can be quantified by the projected increase in adequate levels of insurability resulting from the cost reduction for obtaining insurance coverage. The 2009 Victorian Bushfires Royal Commission recognised the Fire Services Levy as impacting upon the levels of insurability and particularly, attributed to it the low levels of insurance coverage which many of the people most affected by Black Saturday had. One of the recommendations of the Royal Commission was therefore to change the taxation regime to facilitate more individuals to use insurance as an economic self-protection mechanism. Through cooperation between the government and insurers and the provision of monetary incentives for disaster resilient properties, the cumulative effect of this can result in a more disaster resilient society with fewer overall losses.⁷⁰ It was said that it is important to do things which help consumers obtain adequate levels of insurability where 'insurance is the ultimate community product and a key part of the nation's economic infrastructure, underpinning much of our national economic activity.'⁷¹ The inequality of a small proportion of the Victorian people funding the emergency services of the whole state is, however, still a matter which needs to be addressed.⁷² The ultimate question is how to strike the balance between ensuring sufficient funding for our services whilst minimizing onerous burdens on individuals and small businesses. Although it was claimed in late 2010 that there would be changes to the Victorian system in moving away from a system of imposing a Fire Services Levy on insurance premiums there has been no practical advancement. In particular there has not been any publicly released documentation or proposed regimes which could realistically form a new mechanism in the future for collecting the funding for the fire and emergency services in Victoria. The main problem in Victoria is that whilst there is a delay in promoting alternatives, the status quo remains - entrenching a system which due to its inherently high costs ensures that many are uninsured or inadequately insured. Essentially it is important that those who are uninsured or under-insured purchase insurance policies rather than 'rely heavily upon government and public assistance in the event of a disaster like the 2009 Victorian bushfires'⁷³ or after the

Therefore it is still questionable whether the Fire Services Levy will actually be abandoned in practice or whether such promises were merely put onto the political agenda due to the impending state election at the time the comments were made.

See Editorial, 'Clarity Vital on the Fire Services Levy', *The Weekly Times* (online) 16 February 2011 <http://www.weeklytimesnow.com.au/article/2011/02/16/296061_opinion-news.html>

⁶⁹ Institute of Insurance Actuaries, above n 33, 19.

⁷⁰ Commonwealth, 2009 Victorian Bushfires Royal Commission, *Final Report (Volume 2, Part 2- Fire Preparation, Response and Recovery)* (2010) 381 – 4.

⁷¹ Mike Wilkins, 'Building Australia's Resilience to Natural Disaster' (Paper Presented at Address to CEDA, Sydney, 11 April 2011) <<http://www.cgu.com.au/cgu/news-media/cgu-insights/Pages/BuildingAustralia'sresiliencetonaturaldisaster.aspx>>

⁷² Until the system is actually changed and the new change is implemented the insurance industry will continue to contribute more than \$500m per year towards providing funding for the Fire Services Levy. In the year ending 30 June 2011 the insurance industry in Victoria was contributing in excess of \$309m towards the funding of the Country Fire Authority alone. See Country Fire Authority, *Country Fire Authority Summary of Funding 2010*, 2010 www.cfa.vic.gov.au. For corresponding figures for the Metropolitan Fire Brigade see Metropolitan Fire Brigade, *Metropolitan Fire Brigade Summary of Funding 2010*, 2010 www.mfb.vic.gov.au.

⁷³ Insurance Council of Australia, 2009 Victorian Bushfires Royal Commission, *Insurance and the Fire Services Levy: Submissions of the Insurance Council of Australia Ltd* (April 2010) 4.

flooding in Victoria in 2011.⁷⁴ When the system abolishing the current Fire Services Levy is decided upon and implemented it should ensure that it promotes insurance as an essential protection for each individual in society to possess in order to protect their own economic interests.

Secondly, when devising the costing of insurance policies it is necessary that in the future there is an equal contribution of both horizontal and vertical fiscal equity imputed into the mechanism for pricing.⁷⁵ Furthermore in terms of pricing, consumers should be informed about how their policy is calculated and there should be a clear break-up of the different cost components of an insurance premium upon the policy notice.⁷⁶

Rather than focusing upon the recovery phase from a disaster, ensuring that insurance is affordable and accessible to all would be a better way of equipping Australia to absorb and mitigate losses resulting from natural disasters. Greater research must be undertaken into providing affordable insurance to all people, particularly those for whom cost is currently a prohibitive factor forcing them out of the insurance market and thus potentially placing them in the precarious position of financial ruin if a natural disaster occurs. Methods under which the cost of insurance is easier to absorb must also be researched and different proposals suggested to better facilitate the uptake of insurance.⁷⁷ The formulation of possible alternatives to amend the current state tax regime in relation to the imposition of the Fire Services Levy upon insurance needs to be considered very quickly in order for it to be implemented in a timely fashion. Essentially, the tax regime with respect to state transactional taxes, particularly the Fire Services Levy, must keep in mind its impact, that 'almost two million Australian households are thought not to have insurance and it is likely that a larger number are under insured.'⁷⁸ Therefore removing the first level of cascading state taxes on insurance is the first step towards ensuring equilibrium and promoting insurability.

V GOODS AND SERVICES TAX- WHAT VALUE IS ACTUALLY BEING ADDED TO A CONSUMER'S PRODUCT AS A RESULT OF INSURANCE?

There are two separate problems with GST and its application to insurance policies. These are:

1. GST is added to an insurance premium after a Fire Services Levy has already been charged;
2. GST is a value added tax and thus should be calculated in this way, but it is not.

⁷⁴ Although the flooding also occurred in Queensland in January 2011 and the scale of destruction was worse in Queensland, the insurance regulatory regime in Queensland is not premised upon having a fire services levy imposed upon an insurance premium.

⁷⁵ *Ibid.*

⁷⁶ It was recently recognised that there were problems within the insurance industry in informing consumers of what they are covered for and how their policy is ultimately calculated. See Wilkins, above n 71, 2.

⁷⁷ Rachel Carter, Submission No 1 to Senate Economics References Committee, Parliament of Australia, *Inquiry into the State Governments Insurance and the Flood Levy*, 13 April 2011, 1, 8.

⁷⁸ Wilkins, above n 71, 3.

One of the main benefits of GST is that because it is a Commonwealth based tax, it is levied at the same rate around Australia. Given that this is a federal based tax, it would be appropriate for this tax to be abolished which would to a degree alleviate the high levels of taxation on insurance. A token gesture by the Commonwealth to mitigate the harsh effect of 'cascading'⁷⁹ state taxes was that under s78-5(1),⁸⁰ the GST amount will not be levied against any stamp duty payable under an insurance policy. Although theoretically this minimises GST liability, in reality it simply means that stamp duty will be charged last so that it can be charged on both the Fire Services Levy (in Victoria and New South Wales where it is applicable) and on the policy amount inclusive of the GST. Although the effect of this is only a token gesture pertaining to the way that insurance is calculated, it is significant because this is a direct way of implementing Recommendation 56 of the HIH Royal Commission.⁸¹ Implementing this recommendation is a great move. Given its success, why is the government now so hesitant to implement practical changes to the recommendation specified in the many governmental reports, including the Henry Review, detailing the problems with inefficient state taxes on insurance? The main problem with the changes adopted was that in light of the existing taxation burden, the changes to the GST regime were simply too little, too late. The problems with tax on insurance created an enormous burden that is not lifted by exempting from GST any amount of stamp duty payable.

The removal of GST from insurance premiums in its totality would be better suited to rectify the current problems. However an alternate suggestion is that if all of the state taxes (Fire Services Levy and stamp duty) were removed in their totality from insurance premiums, instead GST could be used as an alternate form of collecting revenue. Under this model there could only be one layer of taxation, being the GST, which would be applied at a uniform rate across a variety of goods and services. The existence of this system would render the need for other less efficient transactional taxes to be abolished.

In New Zealand in 1985 there was a move away from transactional taxes to a system whereby there was a GST imposed upon almost all goods and services. The effect of the taxation regime being based upon a more widespread GST regime meant that individual goods and services such as insurance were affected by fewer taxes; in fact there would only be one overarching tax imposed. The way the system in New Zealand operated has enabled the tax system to have a broad base, meaning that the taxation burden was more equally shared by the public generally. Furthermore, due to the GST operating as the overarching taxation system which is in existence, the costs of administering a broad based uniform GST in New Zealand have been relatively low, facilitating the maximum usage of the money collected.⁸² Furthermore, in New Zealand there is great simplicity which in turn eliminates confusion consumers may have in relation to their taxation obligations and thus reduces the incidence of taxation evasion, maximising the

⁷⁹ Justice Owen, Commonwealth, Royal Commission on the Failure of HIH Insurance, *Final Report* (2003), Part 3 [10.3.3].

⁸⁰ *A New Tax System (Goods and Services) Act 1999* (Cth) div 78.

⁸¹ Justice Owen, Commonwealth, Royal Commission on the Failure of HIH Insurance, *Final Report* (2003), Part 3 [10.3.3].

⁸² Marie Pallot and Hayden Fenwick, 'Recent GST Reforms and Proposals in New Zealand' (2000) 10 *Revenue Law Journal* 88, 88 - 90.

amount available for public expenditure. Perhaps it would be useful to use the model adopted in New Zealand for Australian purposes.

Although prima facie the New Zealand system looks relevant, it is essential to determine the differences between Australia and New Zealand to properly determine the viability of having such a system implemented in Australia. Essentially, the biggest difference would be the need for such a regime to be malleable in order to adapt to the Australian system, particularly due to the inherent political differences which aid the suitability of this taxation system within the broader New Zealand social and political system. Importantly, part of the success of the current regime can be attributed to the singular level governance regime. This facilitates greater ease of implementation than would be experienced in Australia, dealing with the constitutional limitations due to the federal/state divide. Furthermore, particularities to the New Zealand system that add to the effectiveness of the regime include political considerations and public input.⁸³ Furthermore, the creators of this taxation reform used the constitutional implications advantageously, culminating in the creation of a tax system now recognised globally for its efficiency. Through such considerations, New Zealand was able to create a system where low levels of taxes were charged, but due to the efficiency in the system the ultimate amount expended on the community was increased.⁸⁴ Problematically, the system cannot be directly transplanted into Australia due to the systematic differences between Australia and New Zealand. Australia should take a lesson from our neighbour and look at the benefits achieved through a broad based low rate tax reform.⁸⁵

The changes to the GST system in New Zealand resulted in taxation being spread over a much broader base. Thus areas which had traditionally experienced piggyback style taxes were often enabled to provide goods and services more affordably, overall, than before the change. Therefore, due to the similarities between Australia and New Zealand, it is quite likely that if there was a change in the system whereby there were fewer taxes upon insurance, this may create an increase in the number of people who are insured and may be a good step towards the overall objective of ensuring that everyone is adequately insured. The changes in New Zealand are also attributed to creating a more equitable and stable taxation system.⁸⁶ Australia should follow its international counterpart and enjoy an efficient taxation system which focuses on equity, stability and predictability rather than the current focus which seems to be only on the amount of tax received. When looking at alternatives to the current system, the

⁸³ Although many commentators have applauded the changes which occurred in New Zealand after the change towards a broader GST system, there have been criticisms of the system suggesting that rather than enhance the fiscal strength of the New Zealand taxation regime, the practical effect has in fact been to weaken it. See John Quiggin, 'Social Democracy and Market Reform in Australia and New Zealand' (1998) 14 *Oxford Review of Economic Policy* 76, 76 - 93.

⁸⁴David White, 'Income and Consumption Taxes in New Zealand: The Political Economy of Broad- Based Low- Rate Reform in a Small Open Economy' in John G Head and Richard Krever (eds), *Tax Reform in the 21st Century* (Kluwer Law International, 2009) 95, 103 - 18.

⁸⁵ It has been suggested that, at least from a theoretical standpoint, the implementation of 'a broad base, low rate tax system provides a useful rule of thumb for an efficient tax system in practice' and that the implementation of this regime was at least initially 'rightly hailed by many at the time as a major improvement in New Zealand's tax settings.' See Norman Gemmill, 'Tax Reform in New Zealand: Current Developments' paper presented at 'Australian's Future Tax System: A Post- Henry Review' Conference, Sydney, 21- 23 June 2010, 4.

⁸⁶White, above n 84, 103 - 18.

Commonwealth government should consider the option of co-operating with the states in order to disband inefficient state taxes in favour of a more widespread GST system which has less negative implications for consumers, particularly in relation to obtaining adequate levels of insurance.

A GST Applied to Insurance

Ideally GST should not apply to insurance policies at all, particularly in light of the other taxes which are already charged upon insurance premiums. It is however important to recognise the reality of the revenue which such taxes bring to a state whereby 'the States now accrued approximately one in twelve tax dollars from taxes on insurance.'⁸⁷ This is manifestly unfair for the insured. Furthermore, as GST is applied at a universal rate across Australia owing to it being a federal tax, there is a failure to provide vertical equity. Therefore those from lower socio-economic backgrounds have a higher tax burden proportionate to the amount they receive as income and thus insurance is even more burdensome than if absolute equity (in the full sense being horizontal and vertical equity) was applied. This is illustrated by the Australian Bureau of Statistics who suggest that consumers in the lowest and second quintile spend in the vicinity of 3.5% - 6% of the household income on insurance whereas those in the highest and fourth quintile on average spend only approximately 2% on general insurance.⁸⁸ The effect of the taxation varies due to the use of horizontal fiscal equalisation where the same tax rate is applied to all. In the case of insurance, the figures illustrate this has been problematic, indicating a consideration of socio-economic factors would be appropriate. The taxation rate should then be adjusted to recognise and rectify the silent factors which impinge upon access to insurance. Those from low socio-economic backgrounds are given a real disincentive to attain insurance due to the flaws inherent in the tax system. This should be rectified because forcing these people out of the insurance market is simply shifting the tax burden to others.

B Adding Value to Insurance- How to Calculate GST on Insurance Policies

The second reason for abolishing the GST on insurance policies is that the way it is calculated on insurance does not serve the objectives of a value added tax. In the insurance context, GST is usually not worked out on the basis of the value insurance adds to property. GST is charged on the policy cost. It is exceptionally difficult to discern the exact value added to property by virtue of insurance. Although theoretically possible for an insurance actuary to do this, it is not a practice which is adopted in Australia. Realistically using insurance actuaries to do this for each transaction would be counterproductive as it would lead to massive administrative costs therefore minimising any success achieved by such a reform. The outcome for insureds at the present is that they are forced to pay the full rate of 1/11⁸⁹ on the cost of the premium rather than the added value which insurance has to the particular property insured. The premise upon which GST was created was to levy a tax of 1/11 of the total value added to a good or service. Yet this is simply not done in practice due to complexity in the calculations to specifically determine the added value. Potentially the difference

⁸⁷ Insurance Council of Australia, *Inquiry into State Government Taxation and Debt*, above n 13, 6.

⁸⁸ Australian Bureau of Statistics, 'Household Expenditure Survey: Summary of Results', 15 February 2006.

⁸⁹ *A New Tax System (Goods and Services) Act 1999* (Cth) div 78.

between the value added to insured property and imposing GST on the policy cost could lead to the collection of different amounts of taxation.⁹⁰ Given the actual value to the property is likely to be less than the total amount of the policy, there is a maximisation of the revenue collected at the expense of forcing some people out of the insurance market.

Tax efficiency is essential whereby rather than collecting more tax it would be better to minimise administrative costs and eradicate dead weight losses. If efficiency, transparency and accountability were applied at every step of the tax collection and expenditure process, less funds would be needed to produce the same outcomes. Rather than focusing upon maximising the revenue, there should be a pedagogical shift towards societal considerations. The efficient use of the taxation revenue would be the first step towards striking the precarious balance between revenue raising and adequate societal considerations of the tax regime.

VI STAMP DUTY- RUBBING SALT INTO THE TAX WOUND

Stamp duty is the final layer of taxation which is imposed upon an insurance transaction. Stamp duty is a state based tax and therefore the range applied to insurance premiums is 8% to 10%.⁹¹ The legislation in all states specifically enables stamp duty to be charged on top of existing insurance taxation; universally being GST and in Victoria and NSW also the Fire Services Levy - escalating the cost of insurance substantially. This effectively promulgates a tax on tax system.⁹² The effect of this on the individual can be seen very clearly through the increase of 78% in the amount of stamp duty collected by most states after the introduction of the GST.⁹³ The real solution to stamp duty on insurance policies would be to have a total abolition, particularly given the problems it causes counteract the benefits derived from the collection of this taxation, leading to high levels of uninsurance and inadequate insurance. However if the states are not willing at this stage to create an abolition on collecting stamp duty, a substantial reduction in the rate of stamp duty is the minimum step that can be undertaken in the interim. The reduction if adopted should only be temporary pending a prompt removal of stamp duty in its totality from insurance policies. The current system is simply rubbing salt into the very deep tax wound which as it festers draws more people away from insurance and sucks more people into a position of potential helplessness. Stamp

⁹⁰For a general understanding of how GST can apply to insurance pay outs and how GST is dealt with in a business context, see JW Durack, 'GST and Insurance' (1999) 28 *Australian Tax Review* 189, 189 - 94.

⁹¹ The amount of stamp duty varies between States. Please see the relevant rates from the specific state legislation below:

- *Duties Act 1999* (ACT) ch 8 (Rate of 10%);
- *Duties Act 1997* (NSW) ss 232(2), 234(1) (Rate of 9%);
- *Stamp Duty Act 1978* (NT) s 49B, sch 1, it 6 (Rate of 10%);
- *Duties Act 2001* (Qld) s 349 (Rate of 8.5% (Class 1 general insurance));
- *Stamp Duties Act 1923* (SA) sch 2, pt 1(1)(ab) (Payment of \$11 per every \$100 of policy or part of policy);
- *Duties Act 2001* (Tas) s 163 (Rate of 8%);
- *Revenue Ruling Pub-DT-2001-4*
- *Duties Act 2000* (Vic) s 179 (Rate of 10%);
- *Duties Act 2008* (WA) s 215 (Rate of 10%).

⁹² *Ibid.*

⁹³ Insurance Council of Australia, *Inquiry into State Government Taxation and Debt*, above n 13, 6.

duty and other taxes are increasing the cost of insurance and this contributes to unacceptably high levels of uninsured and insufficiently insured individuals. We need to rectify this inequity and heal the wounds the current system has created, particularly amongst those who are the most disadvantaged within our society.

VII ACHIEVING EQUILIBRIUM THROUGH PREDICTABILITY AND STABILITY

If state tax reform is to be effective and realistically considered for implementation, a solution must be proposed facilitating the sufficient funding and services of each state at a comparable rate to that which existed under the previous regulatory regime. Australia should no longer be subjected to 'world record levels of state and territory taxes',⁹⁴ particularly in Victoria which has the 'world's highest level of insurance taxes.'⁹⁵ This problem must be rectified for the people of Australia. One suggested solution was to impose a higher rate of GST uniformly and to have this money applied to the states in return for a continued abolition of inefficient state taxes such as those on insurance. The cost of running a State generally does not decrease. Therefore the provision of an amount necessary to fund the basic services and facilities of a society is essential. The best taxation system should possess transparency and accountability but in providing stability will need to be flexible enough to adapt to the needs of all Australians and the needs of those living in each State or territory.

Achieving the correct equilibrium requires efficiency in the use of funds, rather than the current tendency to retain inefficient transactional taxes. The use of transactional taxes evidences taxation becoming merely a numbers game, maximizing revenue without due consideration for the sociological concerns. This is particularly problematic when 'demand for house and contents insurance was negatively correlated to the price of insurance products.'⁹⁶ This also increases the cost to governments after loss bearing events. 'General insurance is integral to the functioning of an efficient and developed economy. Insurance monetizes risk and allows risk to be efficiently transferred across the economy.'⁹⁷ Therefore assessing and implementing change should be positioned as being of political and social importance with rectification required immediately. Simply playing a numbers game with tax affects the lives of individuals and the wellbeing of communities. The other adverse side effect of taxing as a game rather than through sound economic principles is the fact that the government is now exposed to potential liability of up to \$53.3 billion in uninsured property and up to \$48.4 billion in household contents due to problems associated with uninsured and inadequately insured individuals.⁹⁸ If a catastrophic event causes losses of this uninsured property, even if the government only helps finance a portion of the recovery, their liability will still be massive. It would be much better to tax in a manner affording the principles of equity and stability to end the vicious cycle of welfare dependency faced by those unable to pay for insurance. Insurance should not be about compulsion. However, the way insurance is taxed should not operate to make insurance products exclusive. We need to

⁹⁴ National Insurance Brokers Association, above n 4.

⁹⁵ Ibid.

⁹⁶ Insurance Council of Australia, *Inquiry into State Government Taxation and Debt*, above n 13, 11.

⁹⁷ Ibid 3.

⁹⁸ Ibid 9.

stop taxing the taxed and encourage resilient communities rather than nurture a system fostering a vicious cycle of potential government dependency.⁹⁹

VIII TO THE FUTURE WITH FAIRNESS

Reforming the taxation system, although necessary, will not be an easy task. As the paper has shown it will be exceptionally difficult firstly to break through the constitutional impediments. Due to historical dominance¹⁰⁰ and the potential for the Commonwealth to put conditions on state expenditure; the states continue to be reluctant to disband inefficient state taxes in favor of a more centralized system. This is not simply a matter of state autonomy but rather goes to the heart of each state's financial interest whereby currently there is no guarantee that disbanding transactional taxes in favor of a more efficient national system would benefit the needs of the constituents of any particular state.¹⁰¹

It is very clear that our current tax on tax system is forcing many to be uninsured or inadequately insured.¹⁰² The absurdity within the system is that although the Fire Services Levy (in NSW and Victoria),¹⁰³ the GST and stamp duty in all states can increase the cost of insurance policies by as much as 123%,¹⁰⁴ many taxpayers are oblivious to the fact that taxes have been imposed upon their insurance premiums. Consumers have a right to know that a large proportion of insurance premiums are comprised of a tax component. Greater public knowledge of the existent taxes would also ensure greater efficiency in the way funds are spent as well as transparency in the amounts raised. The public involvement would also act to ensure that the current taxation regime is not simply a numbers game, to maximize the revenue attained. Tax reform is however necessary to ensure that there is greater efficiency so that less taxation is charged on insurance premiums. Efficiency and stability would ensure that through a minimum amount of funding the best possible services and facilities can still be provided to the Australian public.

A key change must also come from within the taxation pedagogy whereby taxation must at all times be contextualized within the context of its sociological implications. It is important that the way the state taxation regimes operate facilitates choice within the insurance market. Consumers should not be forced to take the chance of being subjected to a cycle of government dependency simply because the cost of attaining insurance is financially disabling. The exclusivity of the insurance market due to the extraordinary taxation proponent is problematic. This is potentially subjecting the nation not only to instability but also potential indeterminate liability after catastrophic events. Given the current increasingly frequent and increasingly severe weather related disasters causing

⁹⁹ Mortimer, Bergin and Carter, above n 19, 1; Council of Australian Governments, above n 19, 75 – 80.

¹⁰⁰ *Victoria v Commonwealth* (1926) 38 CLR 399, 417; *South Australia v Commonwealth* (1942) 65 CLR 373.

¹⁰¹ Warren, 'Intergovernmental Fiscal Arrangements as a Constraint on State Tax Reform under Henry', above n 7 46.

¹⁰² Warren, *Fiscal Equalisation in Australia*, above n 51.

¹⁰³ Carter, 'Wild Fires', above n 67.

¹⁰⁴ Pettersen, above n 57, 1; Mendelson and Carter, above n 57.

loss,¹⁰⁵ the issue of taxation forcing people out of insurance is a real concern, something which needs to be rectified promptly.

¹⁰⁵ Sullivan, above n 21, 42.