29 July 2020

Mr David Thodey AO
Chair
Federal Financial Relations Review (New South Wales)

By email: FFRReview@treasury.nsw.gov.au

Dear Mr Thodey

Draft Report of Federal Financial Relations Review

The Financial Services Council (**FSC**) welcomes the release of the Draft Report of the Federal Financial Relations Review (**the Review**). The Draft Report details the case for wide ranging reforms to State taxation which would provide significant economic benefits to the state of New South Wales (**NSW**).

This response by the FSC provides additional context and comment on the Draft Report, and focusses on sections of the Draft Report that are of relevance to FSC members.

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

Insurance Taxes

The FSC welcomes the Draft Report's recommendation to abolish insurance duties for life and general insurers. The Draft Report's findings are consistent with the FSC's criticisms of these taxes, as set out in the FSC submission to the Review. We particularly welcome the Review's draft findings that these taxes can lead to underinsurance and non-insurance which is a "national crisis" that has "serious human and social consequences". The FSC supports the Review's draft conclusion that these insurance specific taxes should be urgently abolished (Draft Report at page 65).

Where the Draft Report distinguishes between types of insurance, it is largely focussed on general insurance. However, many of the statements in the Draft Report also apply to life insurance, and the FSC submits that it would be appropriate for the final report of the Review to state this explicitly.

The FSC also submits the Review should acknowledge the following arguments against taxes on life insurance (as detailed in Section 3 of the FSC submission to the Review):

- The complexity and compliance costs of taxes on life insurance are unnecessarily high, with a vast array of rates, bases and jurisdictional definitions across the eight jurisdictions for the same product;
- These taxes imposed in Australia are high by comparison with other developed countries;
- The taxes are regressive – in particular, the taxes have a proportionately higher burden on poorer households than richer households; and
- The revenue from the tax base is volatile, which creates significant challenges for Budget forecasting and stability, and makes them unsuitable for a secure revenue base.

We draw the Review's attention to an estimate published recently by the FSC that State duties on life insurance products erode retirement savings in superannuation by $235 million per year.[1] The details of this calculation are Attached.

More generally, the FSC considers that any final proposal from the Review that may lead to tax increases on insurance would increase the cost of premiums leading to increased underinsurance and non-insurance. As a consequence, where life insurance affordability decreases, the Federal social welfare system is invoked as the "provider of last resort" for more families struggling following the death or serious injury of a loved one.

Stamp duty on land transfers

The FSC supports the proposal in the Review to abolish stamp duty on land transfers (conveyances) and replace it with a broad-based land tax. We note there are concerns with the approach 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. As the Review notes, the ACT approach 'prolongs any community opposition' to the transition, and therefore the reform may not be sustained. It would be preferable to use approaches that are less susceptible to reversal.

Federal funding system

The FSC supports the Review's proposal that a State undertaking major productivity-enhancing tax Reforms should not be disadvantaged through a lower GST share (Draft Report at page 53). We also see merit in the Review's proposal to develop a model for sharing personal income tax revenue with the States (Draft Report at page 63) as this will provide stronger incentives for States to undertake worthwhile tax reform.

Payroll tax

The FSC notes it is unlikely that there will be adequate public support for the Review's model involving the removal or substantial reduction of the payroll tax exemption threshold (Draft Report at page 81). Given this difficulty, the FSC considers the Review should recommend other more targeted reforms, including the reform advocated by the FSC in our original submission to the Review, specifically:

- remove payroll tax from the payments by financial advice licensees to financial planning businesses (see FSC submission at Section 5).
- move to a harmonised collection mechanism for payroll tax (see FSC submission at page 6).

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[1] see Page 5 of FSC (2020) Accelerating Australia's Economic Recovery.

The Review could present these as a fallback option if the Review's preferred model is not adopted.

Modelling of taxes

The modelling quoted by the Review finds that taxes on insurance are inefficient, with the rate of payroll tax slightly less inefficient, and both taxes are found to be more inefficient than the GST (Draft Report in Figure 2). This ranking is broadly consistent with a number of other studies cited in the FSC's submission to the Review (see FSC submission at pages 10–13). However, we noted in our submission to the Review that the analysis of life insurance taxes may understate the inefficiency of the taxes imposed on life companies (see FSC submission at pages 31–32).

The modelling for the Review finds company tax is highly efficient (see Draft Report at Figure 2). This result is hard to reconcile with the ranking in all other relevant modelling, including those cited in the FSC's submission to the Review, which find company tax is highly *inefficient*. The result in Figure 2 is also inconsistent with the recommendations of the IMF and OECD that company tax reductions are a priority for Australia[2] and inconsistent with substantial empirical evidence, including from Australia, indicating company tax is one of the most inefficient taxes.[3]

Conclusion

The FSC commends the NSW government on its Report and would welcome the opportunity to discuss this submission and the broader policy issues further. For further discussions please contact me on XXXXX

Yours sincerely,

[Signed]

Michael Potter
Senior Policy Manager, Economics & Taxation

[2] IMF Australia Article IV Consultation, 2015, 2017, 2018, 2019 and 2020 and OECD Economic Surveys for Australia for 2012, 2013, 2015, 2017 and 2019.

[3] See Page 5 of FSC (2020) Accelerating Australia's Economic Recovery and the section on company tax in FSC Submission to Federal Parliamentary Inquiry into Diversifying Australia's Trade and Investment Profile.

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.