COMMONWEALTH OF AUSTRALIA

# Official Committee Hansard

# SENATE

## ECONOMICS LEGISLATION COMMITTEE

**Reference: A New Tax System (Indirect Tax and Consequential Amendments) Bill 1999, and A New Tax System (Indirect Tax and Consequential Amendments) Bill (No. 2) 1999**

MONDAY, 6 DECEMBER 1999

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**SENATE**

**ECONOMICS LEGISLATION COMMITTEE**

**Monday, 6 December 1999**

**Members:** Senator Gibson *(Chair)*, Senator Murphy *(Deputy Chair)*, Senators George Campbell, Chapman, Murray and Watson

**Participating members:** Senators Abetz, Boswell, Brown, Brownhill, Calvert, Conroy, Cook, Coonan, Crane, Eggleston, Faulkner, Ferguson, Ferris, Harradine, Knowles, Lightfoot, Lundy, Mason, McGauran, Parer, Payne, Quirke, Ridgeway, Schacht, Sherry, Tchen and Tierney

**Senators in attendance:** Senators Chapman, Conroy, Gibson, Murphy and Watson

**Terms of reference for the inquiry:**

A New Tax System (Indirect Tax and Consequential Amendments) Bill 1999, and A New Tax System (Indirect Tax and Consequential Amendments) Bill (No.2) 1999

**WITNESSES**

**Committee met at 9.06 a.m.**

**ANDERSON, Mr Peter Maxwell, Manager, Operations, Insurance Council of Australia**

**BARNES, Mr Peter Eric, Group Taxation Manager and Assistant Company Secretary, QBE Insurance, and Member, Insurance Council of Australia**

**JACK, Mr Trevor Bernard, Actuary, Long Tail Business, Suncorp Metway Ltd, Member, Insurance Council of Australia**

**MAGUIRE, Mr Phillip Anthony, Deputy Chief Executive Officer, Insurance Council of Australia**

**CHAIRMAN**—Today the committee is considering A New Tax System (Indirect Tax and Consequential Amendments) Bill 1999, and A New Tax System (Indirect Tax and Consequential Amendments) Bill 1999. The committee's scheduled reporting date is 7 December this year. This is a public hearing and, as such, all members of the public are welcome to attend.

Today we will be taking evidence from witnesses who have made submissions concerning certain provisions of the bill. We will also receive a response from the government officials on comments made during the hearing. To assist all parties involved in the inquiry, I propose that the committee agree to publicly release all submissions received during the inquiry, except those to which confidentiality applies. There being no objection, it is so ordered.

Before we commence taking evidence I wish to state for the record that all witnesses appearing before the committee are protected by parliamentary privilege with respect to evidence provided. Parliamentary privilege refers to the special rights and immunities attached to the parliament or its members and others necessary for the discharge of parliamentary functions without obstruction and fear of prosecution. Any act by any person which operates to the disadvantage of a witness on account of evidence given by him or her before the Senate or any of its committees is treated as a breach of privilege.

I welcome representatives from the Insurance Council of Australia. Do you wish to make an opening statement?

**Mr Maguire**—I would like to make a couple of general observations partly because of the technical nature of the legislation that is currently before the Senate. I open up by saying that the Insurance Council has been supportive of a need for tax reform from the outset and also that general insurance should, in fact, be taxable. However the general insurance industry, by being taxable, is somewhat different from some of the other areas of the financial sector—life insurance, which is input taxed, and health insurance, which is GST free—but, because we are effectively the only part of the financial services sector which is taxable, we have a number of special issues to address.

The special nature of general insurance is probably also exacerbated by the fact that we are at the leading edge of the implementation of the GST. We have about 30 million policies that are issued each year either by way of renewal or new contracts. A lot of those contracts, of course, that are being issued now have a post 1 July 2000 period to them. So that in itself means that a number of issues are being raised by our policy holders.

It is against that background that we do have a couple of concerns that are addressed in this legislation that are for the benefit of our policy holders effectively. One is the fact that we have been concerned for quite a period of time now that the GST not apply to the state stamp duty component of insurance premiums. Also, we have been somewhat concerned to make sure that state stamp duty does not apply to the GST component of insurance premiums.

The other major issue that is addressed by the legislation currently before the Senate relates to effects on our business customers, essentially those that are registered tax entities. Under the legislation, if those businesses claim an input tax credit on their insurance premiums, as they would probably claim an input tax credit on most other business inputs, then effectively they also attract a liability for GST on the claims payout on the existing legislation. As one method of helping to deal with that, there is an opt-in, opt-out provision in the legislation as it currently stands which provides that the only way that registered tax entities can in fact claim the input tax credit is to effectively apply to do so, to register themselves to be able to take that option.

We in the insurance industry have been somewhat concerned at the way in which that would work in reality in the commercial world. As a result of that, we have been cooperating with Treasury and the Australian tax office to develop solutions that would try to remove the problems, especially for small and medium businesses. Therefore, the amendments before the Senate basically do a couple of very important things. Firstly, they fix half of the 'tax on the tax' issue—in other words, they provide that no GST will apply to the state stamp duty amendment. We think that is an excellent step forward in clarifying that side of it. Unfortunately, we still have some issues at state government levels about the state stamp duties applying to GST.

The second and probably more technical area is the removal of what are potentially disastrous effects of division 78 for businesses. The way that division 78 of the legislation operates at the moment is as I outlined a moment ago: if you take an input tax credit, you attract a GST liability on the claim. The amendments before the parliament at the present time mean that registered tax entities will in fact have no GST liability on claims payouts because that GST liability on claims payouts will be offset by the insurance companies' entitlement to claim an input tax credit on claims. So, in the hands of the businesses of Australia, we think that is an excellent development and something to be applauded. Also, most importantly, the amendments before the Senate remove the opt-in, opt-out provision. So, effectively, businesses will not have to work out how these provisions are going to affect them; they can basically, administratively, simply make a claim for an input tax credit on their premiums and get on with things without necessarily worrying about the results.

In conclusion, the Insurance Council certainly supports the amendments and the cooperation that we have received from Treasury and the ATO in developing those. Other than that, we are very much in your hands for whatever questions you may have.

**CHAIRMAN**—Thank you very much, Mr Maguire. Questions, senators?

**Senator CONROY**—As I understand it, and I could be very wrong, most jurisdictions overseas input tax general insurance for GST purposes—that is right, isn't it?

**Mr Barnes**—Yes.

**Senator CONROY**—Could you please take us through the original GST proposals concerning general insurance—what transactions attract GST and where are the credits provided? Can you give us a brief overview because this is probably one of the most complex areas?

**Mr Maguire**—I am trying to think about the right way to approach this.

**Senator CONROY**—I am just trying to get a general framework, then I can move on to more specific questions about the impact of these changes.

**Mr Maguire**—I can make a bit of an attempt to explain it. I am the layman in our delegation—

**Senator CONROY**—Good.

**Mr Maguire**—I will do my best to explain that. In effect, the way in which general insurance is intended to be taxed is on the basis that premiums are to be pooled, claims are to be pooled; you look on the premium total, apply, if you like, the claims total of the pool—in fact, subtract the claims total from the premium pool—and that leaves you with a margin, a value added. It is a value added that is what is aimed at being taxed under the GST.

The reason for that is that to do it on an individual basis is virtually impossible with general insurance because you might pay a $500 motor car insurance premium yet you could have a million-dollar payout. So trying to do it on an individual basis would be quite unwieldy, and the only way you can assess the margin for general insurance is on this pooling arrangement. Is that helpful or confusing?

**Senator CONROY**—Conceptually, I am with you so far. Where do the GST credits come in?

**Mr Maguire**—The credits come in from the insurance company's viewpoint. Our customers will effectively have a premium appointed to them. They will be able to claim an input tax credit on the GST component of that premium. So the business can take an input tax credit in the same way as they would for any other business input. From the insurance company's viewpoint, what we effectively—

**Mr Jack**—An important part of these amendments is that insurance looks exactly the same from the business enterprise's point of view: it is just an input and it attracts an input tax credit. Previously there was an option to claim it, and it is understandable that your average fish and chip shop owner might have said, 'Why should I take that option?' From out point of view it removes that option. They just get it like any other input and claim the input tax credit.

**Mr Maguire**—That is from the insured's perspective. The insurance company's perspective is that we collect the GST on the full amount of the premium, effectively. We return that then to the ATO. The way in which the pooling element I mentioned before allows us to assess what the value added of the insurance side of things is is that we claim an input tax credit on our claims payouts. So we, as insurance companies, are able to get access to that, to have an entitlement to the input tax credit on those claims payouts. That is applied against the GST, and hence the margin is calculated.

**Mr Barnes**—And these changes, via eliminating offsetting, change that regime slightly but leave the same financial result. That has probably confused you.

**Senator CONROY**—And leave the same financial results for you guys?

**Mr Barnes**—And for the insured.

**Mr Anderson**—Basically, the symmetry is that the premiums are taxable in the hands of the insurer and give rise to a credit in the hands of the client and then the reverse happens when a claim takes place—that is, they give rise to a credit in the hands of the insurance company. These amendments are really a mechanism to make the claim payment part simpler.

**CHAIRMAN**—It has certainly made it much simpler for an individual business taking out an insurance policy.

**Mr Maguire**—Absolutely. A lot of businesses have obviously been concerned about how the process would affect them: if they had attracted the GST liability on a claims payout, that could have potentially bankrupted them; and if they had had to make a choice under the opt-in, opt-out provisions—which was the administrative assistance trying to be provided—that could have also been very difficult. This really takes away the concerns for businesses.

**CHAIRMAN**—Sure.

**Senator CONROY**—Is this amendment modelled on that of other countries?

**Mr Barnes**—It is based on the New Zealand model, fundamentally.

**Senator CONROY**—I apologise for asking this—and Hansard may struggle: I wonder if you might demonstrate that symmetry on the whiteboard, if that is not beyond possibility? My apologies to Hansard. I guess if you just talk it through as you are doing it, Hansard will do their best.

**Mr Anderson**—If we consider division 78 as it stands right now—and we are talking about a registered, taxable insured, so it is an ordinary conventional business that is going to be fully GST-able—if we have the insurance company and we have the insured—

**Senator CONROY**—This is a business rather than an individual?

**Mr Anderson**—That is right—a fish and chip shop. When the premium is paid, one-eleventh of it—if you disregard the effect of the state stamp duties right now—goes off to the tax office as a GST and the business claims a corresponding input tax credit. When a claim takes place, the reverse applies, the value flows back the other way. There is a credit in entitlement to the insurance company and one-eleventh of the claim has to go off to the government. The danger of that was that first of all, under division 78 as it currently stands, you had to make sure the cover had been increased to include this one-eleventh component. So there was a danger that the insured may not have realised that, may have claimed the credit inadvertently and not bothered to increase their cover.

Then there were administrative problems. For example, in the states where workers compensation is privatised you could have a claim going off to a third party, and every single time a claim took place there would have to be a separate cheque drawn in favour of the insured and so forth. What these amendments do is to cancel that off against that and we just pay the net amount. So instead of paying, for example, a claim of $11,000, of which one-eleventh goes off to the government and $1,000 becomes a credit, net effect $10,000, you simply pay $10,000 and that is the end of it.

**Senator CONROY**—Are they really the same dollar amounts?

**Mr Anderson**—Yes. Before, if the claim was really $10,000, the insurance company would have needed to pay $11,000 because the insured would have needed to be covered for their GST liability, and the insurance company would claim $1,000, so the net effect would be $10,000. Now, you simply pay $10,000 and that is the end of that.

**Senator CONROY**—And for an individual?

**Mr Anderson**—For an individual this does not apply because they do not claim credits on their premiums. We are talking here purely about registered taxable insureds.

**Senator MURPHY**—The one-eleventh still applies in terms of the premium payment?

**Mr Anderson**—The one-eleventh still applies in terms of the premium payment, yes.

**Senator MURPHY**—Claimants still have the input tax credit claim?

**Mr Anderson**—On the premium.

**Senator MURPHY**—On the reverse claim aspect of it there is no change to existing arrangements?

**Mr Barnes**—It means that no insured has to return GST on their claim, which has to make it simpler for everybody.

**Senator MURPHY**—Because the net effect is the same?

**Mr Barnes—**Yes.

**Senator MURPHY**—It is taking out administrative structures that are totally unnecessary?

**Mr Maguire**—Exactly. If you were running a fish and chip shop, as the senator mentioned, then all you really need to do now is say, 'My insurance premium is just like any other business input, I can claim an input tax credit on it.' But when the claim happens you do not even have to know about how the claim operates; it will just be the way it happens effectively today.

**Senator CONROY—**What happens if you have an underwriting loss? Is there any impact from what is happening here?

**Mr Barnes**—The position with an underwriting loss is unchanged. The result would have been the same before as it is under DAM. Is that what you are asking?

**Senator CONROY**—Okay, there is no change caused by that. But at the moment, putting aside the DAM change, what happens if there is an underwriting loss—are you liable for GST, or do you claim a refund?

**Mr Barnes**—There would be a net refund because there would be a negative value added.

**Senator CONROY—**That is what I thought.

**Mr Anderson**—In any underwriting period, if you—

**Senator CONROY**—I have not got to pay you if you make a loss?

**Mr Barnes**—Yes—on a one-off situation.

**Senator CONROY**—Make sure you thank them! Have you got that, Blair? How did you let that slip through?

**Mr Anderson**—In a particular month, if claims exceed premiums, I guess the insurance company would claim a net refund; if the premiums exceed the claims, you pay over. It is always the net movement between the two.

**Senator CONROY**—So if there is another hailstorm you guys are doing all right.

**Mr Anderson—**Bearing in mind the claims get paid over a long period, but, yes.

**Senator CONROY**—In the GST terms, and no other.

**Mr Barnes—**We will probably be out of business, but—

**Mr Maguire**—If it helps, Senator, we always aim to make a profit.

**Senator CONROY**—How is the investment side of the business treated? Is it input taxed as a financial service or is it all subject to full credit?

**Mr Anderson**—Input taxed. So, to that extent, insurance companies will have to apportion their transactions so that the underwriting part of the business will be fully taxable and the investment part will be input taxed.

**Senator CONROY—**You are answering our questions in advance of us asking them. You are doing very well.

**Mr Barnes**—That is what insurance is supposed to do.

**Senator CONROY**—You are on the ball today. Compulsory third party motor vehicle insurance is a special case under the legislation, at least until 2003. Why are special rules needed for this type of insurance?

**Mr Anderson**—Basically, because of the nature of the business. We are talking about schemes here that are run by state governments, and it very often is not underwritten in the conventional sense of the word. For example, if you take the Victorian TAC, there you simply get an item included in your motor vehicle registration renewal and the TAC itself does not know whether the owner of the vehicle is registered, unregistered or what. You do not get a normal proposal form. Questions are not asked to evaluate the risk, like you do with conventional insurance; it just goes into a big bucket and the claim gets paid out. To give the state government authorities time to, if you like, modify the way they operate, this transitional period was inserted. Other classes of insurance can cope quite easily, but CTP cannot.

**Senator CONROY**—What will state governments have to do differently?

**Mr Anderson**—I guess to be able to—

**Senator CONROY**—Identify the individual?

**Mr Anderson**—Yes, I guess they would need to change their computer systems so they can track back a claim against a particular insured and work out whether that insured is registered or not.

**Mr Jack**—Senator, the implication of the whole approach, whether it is DAM or pre-DAM, is that the cost plus pricing will be different, depending on whether the insured is registered or not. For example, in the one case we would get the DAM, if it was a taxable entity that we were insuring, and in the other case we would not. So, our net cost is different, depending on the registered status of the insured. That is fine. This does not change that, but it does mean that arguably we should be pricing differentially, depending on the taxable status of the insured. For CTP that is very important, because we do not have that information. For most of our commercial lines, we will know that they are taxable or not.

**Senator CONROY**—So this new legislation denies the input tax credit for registered taxpayers until 2003?

**Mr Jack**—For CTP only.

**Mr Anderson**—If you have got a fleet vehicle, that is right; the credit is denied. If you have a got a vehicle fleet and you have got a number—

**Senator CONROY**—Let’s not go there. What is the ballpark figure of the cost of that to registered taxpayers? Has anyone done any assessments?

**Mr Barnes**—Compared to what we had in the original legislation, no change. I’m sorry, do you mean in terms of CTP?

**Senator CONROY**—Yes.

**Mr Maguire**—I do not know. We do not have an estimate of that.

**Senator CONROY**—Tax and Treasury may have to take a punt on that one.

**Mr Jack**—We can do a very ballpark estimate using the GST rate, the 10 per cent, on the margin.

**Senator CONROY**—It is tens of millions, if not more, I would have thought.

**Mr Jack**—As Phil indicated when we started, the whole idea is to get a tax on the margin. If you do not have the input tax credit, then you do not get that tax on the margin. That tax on the margin would be 10 per cent on, say, 20 per cent, being the margin. So, it is two per cent of total premium in CTP. I do not know how much CTP we write, probably $2 billion annually, or something like that.

**Mr Maguire**—It is something of that order around the country.

**Mr Jack**—So CTP is in the order of $2 billion, and two per cent of that is $40 million. That is a very broad figure, so your suggestion, Senator Conroy, of tens of millions is—

**Senator CONROY**—Reasonable.

**Mr Jack**—The Commonwealth departmental officers who are here may wish to clarify that.

**Senator CONROY**—The Insurance Council raised some very complex transitional issues in the context of the main GST debate. For the record, could you please outline what the general problem is?

**Mr Maguire**—There have been two significant transitional issues for us. One has been what we refer to as the unearned premium reserve issue, which is effectively contracts that span the introduction date of 1 July 2000 for the GST. In other words, any contract that goes beyond that time attracts a GST for the portion of premium earned after that time. But, because we are selling insurance premiums now that usually run for 12 months, there is some part of that that needs to be collected.

That clock started to tick when the legislation was introduced on 2 December 1998, so any contracts that we entered into from that day through until whatever time companies were able to modify their systems, knowing how the GST would apply, is effectively an impact on the insurance companies' bottom line of not being able to recover those costs.

That is the unearned premium reserve issue, the straddled contracts issue, but the bigger part of the transitional issues for us is, effectively, outstanding claims provisions. In layman's terms, insurance companies set aside a sum of money to pay tomorrow's claims because some claims are paid out in a day or two—motor cars and what have you can be repaired quickly—whereas workers' compensation claims may take several years. It may take that length of time to allow for people with injuries to stabilise the injuries, to understand what their ongoing disability is, and then to go through court systems, as often is the case.

So, the money we set aside for future claims is not going to be sufficient in a new ANTS environment, a new tax system environment, to the extent of probably an estimated $½ billion. Both of these issues together will probably impact the insurance industry to about $600 million. They are, effectively, the two main transitional issues.

**Senator CONROY**—Does the government continue to reject your assertions or proposals?

**Mr Maguire**—We have been seeking some changes to the legislation to try to address those issues.

**Senator CONROY**—For probably a year by now.

**Mr Maguire**—Yes, for quite a while, and I guess we remain hopeful that we can come up with some solutions for that.

**Senator CONROY**—It is almost Christmas. Maybe the spirit of goodwill—

**Mr Maguire**—We will look forward to that.

**Senator CONROY**—Blair in a red hat! That is going to look good.

**Senator WATSON**—Have you put forward any draft solutions?

**Mr Maguire**—What we would have liked to have been able to proffer, particularly in relation to the outstanding claims provision issue, was some sort of an actuarial calculation that resulted in revenue neutrality—in other words, the insurance companies make no windfall, the government has no extra benefits—and that essentially the results of ANTS are neutralised as far as the insurers were concerned. We have put forward propositions of that sort. At this stage the government has not supported those.

**Senator CONROY**—I noticed in this press clipping that HIH Insurance has:

. . . booked a $50 million abnormal related to the introduction of the GST

Presumably, the auditors have signed off on the accounts. I think it was said in its annual statement. The government continues to deny that this should be in there, if they continue with that logic presumably. Is that correct?

**Mr Maguire**—I cannot speak for the government in terms of that. The figures are effectively audited figures for all the publicly listed companies, HIH and others included. The impacts are very much bottom line ones, but the government's response to that is something probably best answered by the government.

**Senator CONROY**—Sure, but it is an offence under the Companies Act to put figures in your annual report that are not correct.

**Mr Maguire**—Yes.

**Senator CONROY**—They would be committing a crime if they were not putting this figure in.

**Mr Maguire**—The figures are accurate. They are independently audited figures. Certainly, all the publicly listed companies, and many other non-publicly listed companies, have also had their figures audited. Our survey of the industry indicates this $600 million plus impact.

**Senator CONROY**—And it is all signed off by independent auditors. There is no dispute from them that this liability is there?

**Mr Maguire**—No, it is accepted.

**Senator CONROY**—Will you be looking forward to the government prosecuting a few companies for false advertising?

**Mr Maguire**—I guess that will be judgments for the government to make. The companies certainly have had the figures audited. They have done all the right things as far as company law is concerned.

**Senator WATSON**—How has it been explained in the balance sheet and accounts? Has it been put in as a contingent liability?

**Senator CONROY**—No, it is an abnormal. It says here HIH booked an abnormal.

**Mr Jack**—That has been the standard approach—to book it as an abnormal and not as an extraordinary, and certainly not as a contingent liability but a real liability.

**Senator CONROY**—There is nothing contingent about it.

**Senator WATSON**—I am just asking how it has been explained. Some companies have put it as an abnormal item and some as an extraordinary item.

**Mr Barnes**—That's correct.

**Senator WATSON**—Are there any other classifications that you have seen, or just those two headings?

**Mr Jack**—I imagine in some cases it may be neither because of the nature of the business that companies write, that it might be small for particular types of companies. But for most companies with any sort of long tail exposure, by which I mean claims which have paid significantly after the date of incurrence—

**Senator WATSON**—Why is there an inconsistency in the way it is treated between an extraordinary or an abnormal?

**Mr Barnes**—Companies are required to comply with the accounting standards.

**Senator WATSON**—That's right. If they comply with the accounting standard, it would be one or the other.

**Mr Barnes**—The accounting standards are written in such a way that they do leave certain discretions and certain interpretations, depending on the individual facts.

**Senator WATSON**—As far as audit is concerned, it would either be an abnormal or an extraordinary.

**Senator CONROY**—I think in the HIH case, there was an extraordinary on top of the abnormal, so they were possibly wanting to just set it out separately. They had to book a $50.1 million extraordinary, as well, relating to the loss on the sale of FIA's former asset Oceanic Coal so maybe, just in terms of clarification, they did not want to lump them in together.

**Senator WATSON**—Yes. The sale of that probably had nothing to do with the transition.

**Senator CONROY**—No.

**Senator WATSON**—I am just talking about how they are dealing with the transitional in their profit and loss account.

**Mr Jack**—As Peter said, if it is being treated as extraordinary in some circumstances and abnormal in others. I was not aware that it was being treated as extraordinary and I am not an accountant so I would not presume to know why one goes for one or the other. But I know, in particular cases of the company I am employed by, the view was that the treatment consistent with accounting standards was to treat it as abnormal.

It might help, perhaps, if we explain why that figure is there. There are a couple of significant components. One has nothing to do with GST and is only to do with the marginal income tax rates. So for CTP, which we underwrite substantially in Queensland—

**Mr Barnes**—But that is to do with Ralph and the reform package.

**Mr Jack**—It is to do with tax changes and is abnormal to that extent.

**Mr Barnes**—It has nothing to do with these particular bills we are looking at today.

**Senator WATSON**—That is what our focus is on today. Again, I come back to my other question: in terms of the GST, how are you treating the item: as an extraordinary or as an abnormal?

**Mr Barnes**—My company is treating it as an extraordinary item and Trevor's company is treating is as an abnormal.

**Senator WATSON**—But you just told us you are dealing with two different issues: one dealing with the Ralph issue and the other with a GST issue. You have got to clarify that for the committee. We are focussing in this committee on the GST. We are saying: how are you treating your difficulties associated with the transitional provisions? Are you treating them as an extraordinary, or are you treating them as an abnormal, ignoring Ralph?

**Mr Jack**—This bill does not address any issues which give rise to any abnormal or extraordinary charge to the profit and loss. The net impact of this bill is zero in financial terms, except that it saves us administrative costs which we are pleased about.

**Senator WATSON**—What have you been talking about for the last 10 minutes then?

**Mr Anderson**—We are talking about the transitional effect to the whole GST package rather than the amendments—

**Mr Barnes**—The whole tax reform package?

**Senator WATSON**—Yes. We have to focus on just this bill at the moment.

**CHAIRMAN**—Are there any further questions of relevance on these bills?

**Senator CONROY**—As you know, the Treasurer announced in parliament that you guys had all had a chat with Alan Fels, the good bloke that he is. You are not profiteering, are you?

**CHAIRMAN**—Senator, what is the relevance to this bill?

**Senator CONROY**—It is about GST.

**CHAIRMAN**—No, it is not.

**Senator CONROY**—Yes, it is. The guys have got $50 million abnormals and extraordinaries and these are GST-related amendments.

**Senator WATSON**—We have had this argument previously and it has nothing to do with this bill.

**Senator CONROY**—I am sorry, these are amendments to the ANTS package the last time I checked—A New Tax System (Indirect Tax and Consequential Amendments) Bill. The Treasurer has referred you off to the—

**Senator WATSON**—You will have to have a go at another occasion.

**Senator CONROY**—No, it is all right, you know me.

**Senator WATSON**—We just had that argument.

**CHAIRMAN**—Senator, that issue which we have just talked about has no relevance for these two particular bills.

**Senator CONROY**—You are not using tax changes for recovering losses or raising premiums, are you? These are the Treasury statements.

**Mr Maguire**—I guess what the insurance companies have basically been doing is calculating the net effects of all the ANTS package and effectively putting those into pricing adjustment mechanisms. As I indicated at the outset, that has probably been the more difficult discussion for us because we are at the leading edge of introducing many of these things. Some of the amendments are still going through, such as the DAM proposition we are talking about today, but I can certainly assure members of the committee that the insurance industry has been doing all in its power in terms of resources and what-have-you to properly reflect those net effects of ANTS in terms of pricing.

**Senator CONROY**—Dr David Cousins from ACCC says that he is determined that insurance companies not take advantage of the tax changes to increase margins. You are not doing that, are you?

**Mr Maguire**—No, that is not the intention of any insurance company that I am aware of at all.

**Senator CONROY**—Could you give the committee some idea of the size of the operating margins we are talking about across the various insurance sectors for one year? I am happy for you to take this on notice and supply it later if you cannot do it now, and I would not think that you would necessarily be able to.

**Mr Maguire**—Off the top of my head, Senator—

**Senator CONROY**—I could give three categories—home insurance, home contents insurances and compulsory third party. If you have got any figures, I am happy to take them now but if you would like to take it on notice I am happy for that as well.

**Mr Maguire**—Are you asking about the margins in terms of what the effects of ANTS and the GST are all together on those classes of business?

**Senator CONROY**—Just GST.

**Mr Maguire**—I do not think that that is a valid question, with all due respect.

**Senator CONROY**—Feel free. Help me out as much as you can.

**Mr Maguire**—If we could take CTP as an example, one of the reasons that our costs will go up is that we pay claims in respect of loss of earnings on a net of tax basis. If we are paying the net of tax and marginal personal tax rates come down, then our claims costs will go up. That has nothing to do with the GST per se.

**Mr Maguire**—That is right. It is part of the ANTS package because it is not—

**Senator CONROY**—If it is not relevant to this, please feel free to tell me.

**CHAIRMAN**—Senator Conroy, do you have any further questions on these bills? Otherwise, we are wasting time.

**Senator CONROY**—We are after the basic GST purposes—we are after what the base is on which GST is charged. I think you have jumped ahead of where we were. We were just looking to try and work out what the base figures are that they then levy you on.

**Mr Jack**—We do not get levied on a base premium. We charge a premium and one-eleventh of that—

**Senator CONROY**—What is the margin for each of these categories?

**Mr Barnes**—The margin will vary—

**Mr Jack**—The value-added margin?

**Senator CONROY**—I am a ventriloquist so read that as my question.

**Mr Barnes**—The Sydney hailstones will say that the home and contents margins were very low—negative.

**Mr Jack**—Negative, quite large, in fact.

**Mr Barnes**—So it varies from year to year and month to month.

**Mr Maguire**—Senator, I wonder if maybe just one overall observation in terms of the results of this might help. In the year 1998 the insurance industry made a net after-tax profit of $485 million if that gives an indication of the kinds of levels that you might be looking for. That is across all classes of the private sector.

**Mr Jack**—The value-add of course should be the internal expenses as well as the profit margin, so that is a relevant factor as well. But all of these figures are available from the APRA statistics.

**CHAIRMAN**—Any further questions on these particular bills? Thank you very much for appearing before us this morning.

[9.43 a.m.]

**BAMBRICK, Mr Matthew Peter, Manager, GST Insurance Team, Australian Taxation Office**

**COMLEY, Mr Blair Robert, Manager (Specialist), Indirect Tax and Payment Design Division, Treasury**

**McCULLOUGH, Mr Paul Andrew, General Manager, Indirect tax Division, Treasury**

**QUIGLEY, Mr Bruce William, Senior Assistant Deputy Commissioner, Australian Taxation Office**

**CHAIRMAN**—I welcome officers from Treasury and the tax office. Do you wish to make any comments on the evidence we have had before us this morning?

**Mr McCullough**—There is just one point that I thought Mr Comley could clear up. By and large we did not disagree with much of what we heard, but there was just one point that I think might assist in understanding some of the issues.

**Mr Comley**—I think there is a key issue and it is the question Senator Conroy was trying to get at. I think it needs clarification. It comes back to really the basis on which the GST is charged and the margins of the insurance industry.

The comment was made right at the end there that, for some types of insurance, there is effectively a negative margin and that this is an issue when you have an underwriting loss. The point is that that is true in a nominal sense, but when you look at the way should view GST on insurance, looking at the industry on a nominal basis is not really the correct or the most useful way of looking at it. As someone from the industry said to me once, 'Insurance is all about timing.' The whole point is that you take in premiums at the start of a period, and you only make payouts or claims later in that period or, for example, in the outstanding claims case, you might not make a payout for five years. It is the use of that money for the period between the time of the premium and the time of the claim that really drives a lot of the profitability in the insurance industry. So when you are thinking about the margin for the insurance industry, you should think about it in terms of the present value of the payouts compared with the present value of the premiums, not of those in nominal terms.

When we have talked to the industry about this in the past and asked for an indication of what is the margin of insurance when thought of in present value terms—that is, take the total amount of money payouts you are making or the amount of goods or services you have to buy to put someone back in the same position and discount that back to the point in time at which the premium was collected—what is the margin of the insurance industry there, we have been given the answer of somewhere between 10 and 20 per cent. We have not sought to verify that one way or the other, but that is essentially, in a sense, the true margin of the insurance industry—that is, in present value terms, the difference between the premiums you collect and the total payouts you must make on the insurance policies.

When you ask the question, 'What revenue would the GST be raising from insurance?' not only do insurance companies have to think of this in a present value sense; the government also has to think of it in a present value sense, because we obviously have funding requirements and there is an interest rate on the funds we use. So the margin is really that 10 or 20 per cent expressed in present value terms.

There is a related point to this. When Mr Maguire was explaining the tax on the value added, I think he made it sound like we total up all the premiums and deduct all the payouts in working out the amount of GST for an insurance company in a particular period. In a sense that is correct and that is how a return would be done, but another way of looking at it is that we are not really trying to tax the value added directly in that way. If we were taxing the value added directly in that way, the insurance provisions would look quite different. They would look like—and I hesitate to use the example—the gambling provisions. What the gambling provisions do—which is not part of these amendments—is to literally total up the wages in a particular period, take off the payouts and directly estimate the margin. The reason that is appropriate for gambling and is not appropriate for insurance is that essentially the bets and the payouts are pretty well simultaneous, that there is no timing issue there.

We do not actually do that in insurance. We levy on the premium; we make a credit on the payout. When you are thinking of taxing the value add, you are really thinking of a link between the premium and the payout for the same policy, not necessarily all the premiums in one period and all the payouts in one period. That is not really the correct way of viewing it when you are really trying to calculate the margin in present value terms. I suppose that is the clarification I wanted to add. I think some of the confusion comes from this: there is an underwriting loss there; where is the real revenue? It really is because of the timing of the insurance industry more than anything else.

**CHAIRMAN**—Thank you, Mr Comley, that was useful.

**Senator CONROY**—If I could just follow up on that. I was with you up until you started talking! You describe this present value question, if you like, in terms of the gains. I think that is the way you described it: they collect their premiums and then when they pay them out down the track they have made a gain by holding the premiums, fundamentally?

**Mr Comley**—Yes.

**Senator CONROY**—Why do you think the GST should be applied on the gains they make?

**Mr Comley**—Let me clarify that. It is not made on the gains in the sense that we do not levy GST on the returns from their investment income. We do not do that. That is input tax. But if we were to ask the question, 'What should the GST be levied on?' it should be levied, essentially, on the consumption value to the consumer. Fundamentally, that is what a GST should do.

What is the value entering final consumption? It is the value the person essentially puts on it when they purchase the premium. What is the value a person puts on an insurance policy? We normally think it gives them security. In a sense, what they are doing is they are prepared to pay a difference between the amount they get paid out to them and the amount they pay in a premium, at least in an expected sense, because they are prepared to pay for that certainty. For example, if you pay $100 on a premium—and you ultimately expect that, on average, you are going to get paid out $90—you have effectively paid $10 for the security of having an insurance policy, for having no variation in your economic position. So both the consumer and insurer are looking at it in terms of, 'What is the real cost to me of taking this insurance policy?' It is the difference between the premium and the expected value of what I will receive as a payout should a loss occur, and that difference is essentially the consumption value entering final consumption.

**Senator CONROY**—I think I am with you in the economic theory sense. I am just not sure how that then translates into the real world and the problem that they have got in terms of accounting. I recently accused you, as you would remember, of having been captured by the accountants, but you seem to have struck a blow back for economic theory there.

**Mr Comley**—Sorry, I do not understand.

**Senator CONROY**—I understand the economic theory of the way you have described it. I think you said 'true margins' and those sorts of things in the tax value of the consumption, which are economic theory and consistent. I am just not sure how that translates into bookkeeping. Most of this exercise has been about bookkeeping.

**Mr Comley**—In the bookkeeping, you will just record in each period every time you receive a premium—the insurer will remit one-eleventh. Every time they make a payout, they may or may not be entitled to a decreasing adjustment according to the person they are paying out. That would essentially be the bookkeeping. I am just saying that, in terms of working out what the net revenue which generated from the insurance industry is, you should really be thinking of it as a present value sense, which is a calculation you could do, but is not what an accounting measure would traditionally do.

**Senator CONROY**—Should HIH have $50 million in here as abnormals as a cost to business?

**Mr Comley**—I think that is a different question, and that relates to the issue of what is HIH's assessment of the transitional impact of tax reform. I do not really think it is appropriate for me to comment whether HIH have correctly done their sums or not.

**Senator CONROY**—But you are saying that the economic theory says that they have not done the sums the way that you think they should have done the sums?

**Mr McCullough**—I do not think Mr Comley's comments were going to the HIH issue at all, or not directly.

**CHAIRMAN**—Senator Conroy, we will not discuss that issue, if you do not mind.

**Senator CONROY**—I think they are. I am sorry, you might not want to, but I think they are.

**Senator CHAPMAN**—Mr Comley, distilling what you have said, is my understanding, therefore, correct that, to the consumer or the customer, GST should be charged on this calculated margin rather than on the full premium they pay?

**Mr Comley**—Effectively, that is what an insurance company will be doing. They will be allowing for any allowable credit to them on the payout, which means effectively the GST only applies to the margin viewed in a present value sense, which would be the 10 per cent or 20 per cent. So you would expect the GST impact of charging on the premium itself for the margin component would be one per cent or two per cent.

The actual change in insurance policies really has two components to it. One is directly taxing the value add of the insurer. The second is, what is the change in the underlying price of what you are insuring? As we all know, if you insure something for $200,000, you are going to have a different premium to insure something for $100,000. So it is really the combination of those two. But, yes, the actual tax on the insurance itself is just on the margin, so it would be one per cent or two per cent.

**Mr Quigley**—From a practical perspective, as far as filling out the GST return is concerned, or as part of the business activity statement, it would be pretty much akin to the way Mr Maguire explained it in a practical sense of each month, or each quarter, whatever the particular company has. That is what would actually translate in—

**Senator MURPHY**—A company would submit to the tax office a claim that would consist of duties that it collected on business insurance, for private insurance—being home insurance, contents insurance, and whatever else. And it would pay an assessed one-eleventh on premiums, less the claims paid out?

**Mr Comley**—Less the credits or the degrees and adjustments allowed.

**Senator MURPHY**—So instead of paying one-eleventh on all of the premiums—the total quantity of the premiums—it would be a percentage of the premiums?

**Mr Quigley**—That is correct. That is the way it would work in practice.

**Senator MURPHY**—But the insured, in the case of business, only claims the premium as an input tax credit?

**Mr Comley**—Business always claims the input tax credit on the premium.

**Senator MURPHY**—And nobody else does.

**Mr Comley**—That is right, in the same way that, for any other good or service, consumers do not get a credit or banks, for example, do not get a credit.

**Mr Quigley**—This is to get one-eleventh of that premium.

**Mr Comley**—In an insurer to business that is registered transaction, there is no net GST because the same amount of tax that is returned by the insurance company for that premium is allowed as a credit for the business. There is no net GST on that transaction.

**Senator MURPHY**—What about in a business that operates from a house?

**Mr Bambrick**—If that is the case, they will be able to claim the credit on the premium to the extent that it relates to their business operations. So it is just the same as they will be able to claim the credit on their electricity to the extent that it relates to the business operations.

**Senator CONROY**—I am just going back to the issue we were talking about before. In practice, the GST collections would be based on the annual performance of the industry—that is, money in that year and money out that year, irrespective of the liabilities that the payments relate to. Is that a fair way to describe it?

**Mr Comley**—Yes, except for the transitional period, because, in the transitional period, the link between the premium and the payout is made to say that, essentially, if GST was not collected on the premium, you are not entitled to any credit on the payout. It is really the transitional period that illustrates the importance of viewing this as a policy basis that you levy on the premium and you get a credit on the payout and the contemporaneous view does not really capture underlying what is happening in the industry.

**Senator CHAPMAN**—Senator Gibson and I have just been having a discussion about your last answer to my question, about whether you were clear about what I was asking. I was asking from the perspective of the consumer who pays the premium.

**Mr Comley**—Right.

**Senator CHAPMAN**—Should the GST be charged on that full premium or only on the 20 per cent of it?

**Mr Comley**—The answer is twofold, and I do not want to overcomplicate it. The net change in the price to the consumer will only be the one or two per cent. They will actually see, if it is displayed, that one-eleventh of the full price is GST. But the base on which that one-eleventh, that 10 per cent, is added will fall because the insurance company will take account of the credit on the payout. For example, if you had a premium that was currently $108, then the premium might rise to, say, $110—it will only rise $2. The consumer might get a bill that says the premium is now $110 including $10 GST, but the price impact has only been the one or two per cent.

**Senator CHAPMAN**—Okay, that is good.

**Senator MURPHY**—In the case of business that can claim current insurance premiums as a cost to the business, why would you lump business insurance in with general insurance for the purposes of doing the calculation, when business insurance is going to be able to claim an input tax credit for the full premium as they currently are now?

**Mr Comley**—Are you talking about income tax?

**Senator MURPHY**—No. If I pay $108 for, say, house insurance, I cannot claim anything. Is that correct?

**Mr Quigley**—From an income tax perspective, or GST, that is correct.

**Senator MURPHY**—Yes.

**Mr Quigley—**But GST doesn't exist.

**Senator MURPHY—**It will, and when it does, if you look at the diagram that was put up there, you have got one-eleventh paid on a nominated 20 per cent, or thereabouts, by the insurer for the whole collection of premiums acquired, including general insurance premiums and business insurance premiums, all lumped in together, to make an assessment about what is paid out across all of that spectrum, and you have the business people able to claim a full input tax credit.

**Mr Quigley—**Of the GST component of the premium.

**Senator MURPHY**—Of just the GST component?

**Mr Quigley—**Yes, that's right, it is one-eleventh of the premium, and then for income tax purposes they would be entitled to a deduction of that net amount.

**Senator MURPHY**—Okay. I am just trying to understand that and the effect on the general insurers.

**CHAIRMAN**—Any further questions?

**Senator CONROY**—The way you describe it, the GST implications for revenue should net each other out. Is that about right?

**Mr Quigley**—No.

**Mr McCullough**—I think Mr Comley was explaining that if you look at it in present value terms there is a revenue gain.

**Senator CONROY**—So what does this amendment do to the revenue?

**Mr Comley**—There is no change. What the decreasing adjustment method does is essentially replicate the original design, but in a way that shifts the compliance burden away from businesses that take out insurance policies and requires the insurance companies to essentially account for the total GST implications of a payout.

**Senator MURPHY**—You have the insurer paying you the two per cent, or whatever the figure is, their claim to two per cent as an input tax credit, and then they still make the general claim.

**Mr Comley—**In the previous case you would have had a tax credit for the insurer on a payout.

**Senator MURPHY**—Which again comes from the punters?

**Mr Comley**—In the whole GST system, the only place revenue ever sticks is with the consumers. But there is no change here.

**Senator CONROY**—What are the revenue estimates for the next three years?

**Mr Comley**—We have not published disaggregated revenue estimates down to industry level.

**Senator CONROY**—Can we have them? Are they secret?

**Mr Comley**—I would have to take that on notice.

**Senator CONROY**—Take it on notice. Go and ask the Treasurer who will, of course, say no, but I appreciate that you have taken it on notice. Mr Quigley, I understand that you have two handouts? Could you table them?

**Mr Quigley**—We are certainly prepared to table the one from the Taxation Office. It just gives a comparison and a number of scenarios between the current division 78 and the amendments that are being proposed.

**Senator CONROY**—I hesitate to ask you to go through them, so I will not.

**Mr Comley**—We are happy to table the other one in your hand, which is part of a set of slides that I gave at an Insurance Council of Australia presentation.

**Senator CONROY**—And lived to tell the story. Well done!

**Mr Comley**—They are very friendly.

**CHAIRMAN**—Is it the wish of the committee that the documents be incorporated in the transcript of evidence? There being no objection, it is so ordered.

*As reproduction of the documents would have unreasonably delayed production, they were not incorporated. Copies may be obtained from the committee secretariat.*

**Mr Quigley**—That one is from the Australian Taxation Office and shows a comparison between the current legislation and the amendments, and it goes through a number of scenarios, which helps to explain it.

**Mr Comley**—This is a set of slides which came out of a conference presentation I made to the Insurance Council of Australia a few months back.

**Senator CONROY**—They were making effigies of you the last time I was with them!

**Mr Comley**—That is pre the decreasing adjustment method, but it fairly clearly explains the underlying idea before the decreasing adjustment method.

**Senator CONROY**—Can you give a diagrammatic representation of how the GST contributes to the revenue stream, just in terms of a simple diagram. Any volunteers? And apologies to Hansard again.

**Mr McCullough**—We are not talking in relation to the particular, we are just talking generally.

**Senator CONROY**—I am just trying to get my head around it. A diagrammatic version of what Blair said is probably what I am hoping for.

**Mr Comley**—Forget the business sector, because ultimately the business sector gets credits, all the GST washes out, so you are only ever talking about consumers as to where the net contribution to revenue comes. Essentially, the revenue comes from the fact that the premiums are larger than the payouts in present value terms. My handout there goes through it.

If you think about a pre-GST world, in a pre-GST world I might have a premium of $108. What the premium is going to entitle me to is a payout. For an individual you are going to look at the figure that actually covers you against the loss of. For the sake of argument, let us say that payout in present value terms is $880. So you might have an insured a TV, or whatever, that is worth $880.

From an insurance company's perspective, they look at that payout and say, 'Okay, I do not expect to pay out on every policy. What is my probability that I am going to pay out?' If you had a probability of 10 per cent, you expect to pay out on 10 per cent of your claims.

**Senator CONROY**—Not 'claims,' 10 per cent of your policies.

**Mr Comley**—Yes, 10 per cent of your policies you expect to make a payout on.

**Senator CONROY**—They only really pay on 10 per cent of claims! Just teasing.

**CHAIRMAN**—Keep going. Don't take any notice of Senator Conroy's comments.

**Mr Comley**—Therefore, the expected value of their payout—which is calculated as how often you expect to pay out times what you have to pay out if you do—is $88. So, in present value terms what the insurance company is doing is making money from the difference between the payouts and the premiums. In nominal terms, that $88 is probably higher because it occurs later than the initial premium. That is the present value. I have collapsed it back in time to the $108, but it could in fact be $100. When you think of that, the margin of that whole operation for the insurer is $20.

What happens in a post-GST world? In a post-GST world let us say the prices of things do not change and the—

**Senator CONROY**—That's optimistic. You are from Treasury, aren't you?

**Mr Comley**—You can build in the case if prices change.

**Senator CONROY**—No, let's not.

**Mr Comley**—For example, if this was the TV, which was at 32 per cent, now at 10 per cent—

**Senator CONROY**—There's a headline: Treasury admit that prices are not falling, again. That's cars and airfares, and now TVs.

**CHAIRMAN**—Senator Conroy!

**Mr Comley**—If this is pre-GST and this is post-GST, post-GST the insurance company is going to have the same expected payout of $88. But now they know that effectively they are going to be charged GST on their margin. So rather than try to recover a margin of $20, they have actually got to get a margin of $22.

The margin is now $22, and so the total premium that they are going to charge is $110, because they have to effectively add on the $22 to their expected payout of $88. The way that works in practice is that they collect a premium of $110 and the GST on that is remitted as $10. When they make the payout of $88 they get a credit of one-eleventh. So, effectively, they have a negative GST liability of $8. So the net GST liability comes down to this plus two, which is effectively one-eleventh of the GST inclusive margin.

So the way the revenue gets money is effectively because of this difference in present value terms between the premium and the payout, which is the margin that insurers have to earn because they have got to make a profit. We collect effectively one-eleventh of a GST inclusive margin of that. So that is where the money comes from.

**Senator CONROY**—I think we will use you in our GST advertising in the next election, Blair.

**CHAIRMAN**—That was a good illustration.

**Senator CONROY**—Could you please explain how the GST applies to workers compensation?

**Mr Bambrick**—With workers compensation, it is the same as for all other insurance under the current treatment in division 78 and under the amendments. It is also the same as for all other insurance. Under the current division 78 we have workers compensation insurance policy taken out; tax is charged on the premium; business takes the credit and has a GST liability on any payouts. So if you have an injured worker who receives income of placement payments every fortnight for five years then the business will have a GST liability on those payments. Under the amendments for workers compensation, as for all other insurance such as public liability, the insurance company will sell the policy. The business will buy the policy, take a premium and get a credit on the premium. Payment will be made to the worker and that is the end of the story as far as the business is concerned. It has no GST liability. Payments just get made straight to the worker and that is it.

**CHAIRMAN**—So it is the same structure as that which we were just talking about.

**Senator CONROY**—There is no difference in how settlements are treated under the new proposals?

**Mr Bambrick**—No. Under the amendment bill No. 2, as first introduced to parliament, there are amendments in relation to workers compensation only. That was the decreasing adjustment mechanism in its first form. Originally it was only for the workers compensation in the CTP. Once those amendments were introduced, the rest of the industry was consulted about applying it to all insurance.

**CHAIRMAN**—That wraps it up?

**Senator CONROY**—I would hate to waste the opportunity of having the Insurance Council representatives here, as well. I was just wondering whether they would like to make any response to what Treasury has said, without wanting to prolong this—I have to be out by 10.30 a.m. Is there anybody who would like to make a response? I would hate to waste the collective heads of those who are more around the issue than, certainly, me.

**Mr Maguire**—Thank you for the opportunity but I think that, unless there are specific questions, we would be quite content to leave it at that.

**Senator CONROY**—Okay.

**CHAIRMAN**—Thank you very much, Mr Maguire and your colleagues, for coming before us this morning.

**Committee adjourned at 10.12 a.m.**