



Investment & Financial Services Association Ltd

ABN 82 080 744 163

14 July 2008

Review of State Taxation
Independent Pricing and Regulatory Tribunal
PO Box Q290
QVB Post Office NSW 1230

By email: ipart@ipart.nsw.gov.au

Dear Dr Keating

Re: Review of State Taxation - Report to the Treasurer - Other Industries

The Investment and Financial Services Association Limited (IFSA) welcomes the opportunity to comment on the June 2008 draft report: *Review of State Taxation - Report to the Treasurer - Other Industries* (the Draft Report).

IFSA is a national not-for-profit organisation which represents the retail and wholesale funds management, superannuation and life insurance industries. IFSA has over 140 members who are responsible for investing over \$1 trillion on behalf of more than ten million Australians. Members' compliance with IFSA Standards and Guidance Notes ensures the promotion of industry best practice.

IFSA welcomes the detailed information and analysis of the range of State Taxes levied by the New South Wales (NSW) Government contained within the Draft Report. The Draft Report expands the range of publicly available information on State Taxes, which creates opportunities for participants in the Review to make more detailed and analytical submissions.

IFSA notes the following findings reported by the Independent Pricing and Regulatory Review Tribunal (IPART) in the Draft Review.

- i. NSW's own-source tax revenue represents only 39% of its total State revenue (page 3);
- ii. Insurance duty and purchaser transfer duty (including "land rich" provisions applying to property trusts and other managed funds) rank among the worst of the major State taxes, assessed on the basis of standard taxation principles, including efficiency (page 5);

- iii. IPART proposes that in the longer term NSW moves away from its current heavy reliance on transactions-type taxes (including the purchase of insurance products) towards broader-based annual taxes on asset holdings or economic activity (page 6);
- iv. Stamp duties on insurance are among the State's most inefficient taxes (page 7);
- v. Insurance taxes (\$616m in 2007/08) represent only 3.5% of NSW own-source taxation revenue (page 19);
- vi. Insurance duty and the fire services levy funding contributions are arguably the least efficient State taxes. Both revenue sources penalise those who are prudent enough to take out insurance; and so encourage underinsurance and non-insurance (pages 44 & 46);
- vii. Insurance duty is a highly inefficient tax that creates disincentives for appropriate insurance. The State should seek to reduce its reliance on this duty over the long-term (page 47);
- viii. Insurance taxes were 8.1% of total NSW revenue (including but not limited to own-source revenue) in 2006/07, the third highest proportion among all State and Territories (page 72);
- ix. Taxes on insurance act as an incentive for individuals and businesses to under-insure or not insure. The burden of these taxes falls on those who prudently take out insurance, while the uninsured who do not contribute often receive public assistance (page 92);
- x. IPART considers that on economic efficiency grounds, there is a compelling case for abolishing stamp duty on insurance. However, there are severe constraints on the State's fiscal capacity to do this in the short-term (page 101);
- xi. Stakeholders expressed to IPART the view that purchaser transfer duty, among other things, unfairly taxes a range of "land rich" entities (including unit trusts operated by retail and wholesale funds) (page 106); and
- xii. In response to submissions by stakeholders that "land rich" duty definitions and corporate reconstruction exemptions from stamp duty should be harmonised across the States, the NSW OSR responded that it is currently in communication with other jurisdictions and industry bodies to improve national consistency in this area (page 110).

IFSA Recommendations

1. *Life insurance duty*

IFSA supports the recommendations made in the Draft Report in relation to insurance taxes. IFSA however notes that only limited comments are made specifically in relation to life insurance duty.

As noted in the report, life insurance duty (about \$19.7m for 2007/08) makes up a small component of total insurance duty in NSW (page 215). It is 3.2% of total insurance duty levied by NSW; and only 0.1% of NSW own-source revenue in 2007/08. It is less than 0.05% of NSW's total revenue of \$45 billion in the same year.

IFSA believes that the cost of maintaining the current system for industry and government represents such a large proportion of the revenue collected that stamp duty on life insurance can be considered a nuisance tax.

The different obligations under the various stamp duty legislation across the States impose a huge administrative burden on IFSA members, who operate at a national level. This is overlaid with the need to comply with the varying administrative and interpretative practices of revenue authorities, which further complicates the assessment of stamp duty liabilities. Lastly, the cost of audit activity for government is both unproductive and impacts on revenue to the extent to which the revenue generated is probably negligible.

In addition, IFSA notes and strongly supports the Draft Report's conclusion that taxes on insurance act as an incentive for individuals and businesses to under-insure or not insure. In general, IFSA notes that tax rates for life insurance are lower than for general insurance, because legislatures across Australia have traditionally recognised these arguments as being even stronger for life insurance than for general insurance.

The effect therefore of continuing to tax life insurance (and indeed to tax some forms of life insurance at the higher rates applicable to general insurance duty) is to discourage insurance and encourage under-insurance; as well as penalising those who are prudent enough to make provisions for dependents and invest in superannuation for retirement on their own behalf.

IFSA recommends that in its Final Report, IPART should specifically adopt recommendations that:

- life insurance duty (including duty on life insurance riders (ie additional benefits included in life insurance policies covering events such as trauma and total and permanent disablement, etc.) should be abolished as soon as fiscally/prudently possible;
- life insurance riders and disability income policies which constitute life insurance under the *Life Insurance Act 1995* (Commonwealth) should be taxed in the same way pending the abolition of life insurance duty, namely by making disability income policies dutiable at the greater concessional rate that applies to life insurance riders; and
- if life insurance duty is not abolished immediately, NSW should also seek the agreement of other State/Territory jurisdictions to the harmonisation of life insurance taxes, on the basis that harmonisation is to be pursued continuously by all jurisdictions and not limited to the initial adoption of harmonised laws. In particular, that harmonisation should recognise the public policy intent of encouraging life insurance as adopted by the NSW Duties Act's approach to life riders and that this approach be extended to the treatment of long term disability insurance issued by life insurance companies as recommended above.

Whilst IFSA supports the proposals for abolition of insurance duty generally, the case is most compelling for life insurance. If fiscal necessity imposes limitations on the capacity or timetable to abolish insurance duty, IPART should consider recommending that the first priority amongst insurance taxes is the abolition of life insurance duty.

2. Purchaser Transfer Duty – land rich provisions applying to managed funds

IFSA notes and supports other submissions that the land rich provisions unfairly tax land rich entities including unit trusts which are commonly used as investment vehicles for “mum and dad” investors by retail and wholesale fund managers.

IFSA also notes and supports the OSR's response that it is considering proposals to harmonise “land rich” provisions among all States and Territories.

IFSA's concern is that whilst in NSW and in other jurisdictions, “land rich” provisions were originally intended to be inapplicable to public unit trusts, they have become applicable because of changes in legislation since 2003. In particular, the definition of a widely-held public unit trust scheme, which is traditionally excluded from the application of the land rich provisions, has been dramatically narrowed by requiring a trust, in order to be a public unit trust scheme, to:

- i. have at least 300 unitholders;
- ii. have no holder (including a holder who is the trustee of another widely-held trust) holding 20% or more of the units in the trust.

These changes have caused severe problems for managed funds. As a result of the sub-prime crisis and its effect on property and other trusts in Australia in the current economic environment, many public unit trusts are experiencing serious outflows of investors, resulting in the number of unitholders falling below 300. The trust remains in all other respects a widely-held public trust, but under the amended definition applying since November 2003 such a trust becomes a private unit trust scheme and becomes subject to the land rich rules.

The definition of a widely-held public unit trust scheme should be amended to reduce the requisite number to 50 holders or, alternatively, to enable a “look through” approach to be applied where any holder is holding as trustee of another widely-held trust (so as to include in the number of unitholders those holders in the other trust for whom the trustee unitholder holds units). This is reflective of the approach applying under the Queensland Act, which IFSA members operating public offer trusts have found to be far more consistent with the intended operation of the “land rich ” rules as not being applicable to public offer funds.

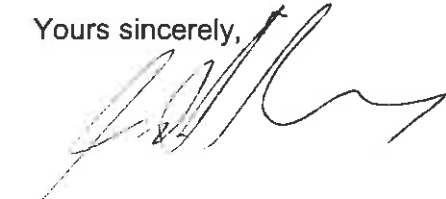
In addition, the 20% threshold on the maximum holding of units by any holder in a widely – held trust should be removed where the holder is the trustee of another unit which is itself a widely-held, public unit trust scheme, superannuation fund or PST etc. Such a holder should be able to have a higher threshold, such as 50%, rather than being treated in the same way as another single holder or closely-held private unit trust/ private company holder

These changes will enable the "land rich" provisions to operate in a way that limits them to governing the operations of private closely held trusts; and so as not to apply to managed funds operated by retail and wholesale fund managers.

IFSA would be happy to provide any further detail required by IPART, or to meet with IPART to discuss any aspect of the above conclusions if that would be of assistance

Should you have any questions regarding the submission, please contact myself or Daniel Caruso on 02 9299 3022.

Yours sincerely,



John O'Shaughnessy
Deputy Chief Executive Officer