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Tax Working Group Secretariat
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Emailed to: submissions@taxworkinggroup.govt.nz

Dear Tax Working Group Members,

ICNZ Submission: Future of Tax – Interim Report

ICNZ welcomes the opportunity to submit on Future of Tax – Interim Report ("Interim Report"), released by the Tax Working Group in September 2018. ICNZ represents general insurers that insure about 95 percent of the New Zealand general insurance market, including over half a trillion dollars' worth of New Zealand property and liabilities.

We are writing to you in regard to two specific issues:

A. the distortions and unfairness created by the continuing imposition of the Fire and Emergency New Zealand (FENZ) levy on insurance, and why FENZ should be funded through general taxation; and
B. the tax treatment of earthquake strengthening of buildings.

Funding FENZ through general taxation

The earliest fire brigades were formed in the 18th century by insurance companies in order to reduce their companies' losses from fire. Brigades were owned by each fire insurer who responded only to their customer's fires. This practise was confined to large urban areas where it was practical to respond.

Over time, however, the insurance industry role was phased out as local government (initially) and then central government (in 1976) took over responsibility for the provision and funding of urban fire services. A levy on fire insurance in its current form to fund the then Fire Service, now FENZ, was introduced as a "temporary fix" in 1993.

A number of factors have contributed to the breakdown of the historical link between fire insurance and fire services, including the change in scope of fire services to include a full range of non-fire emergency services and the increased focus of fire-fighters on preservation of life rather than preservation of property. We have identified twelve reports produced since 1993 and almost all recommend moving away from the current insurance-based levy to at least partial use of alternative bases, including greater use of general tax revenue funding.

There is no public policy rationale for continuing to involve the insurance industry in collecting money through levies on policy-holders to fund fire and emergency services. The insurance industry does not benefit directly from the provision of fire services to its clients, although it is acknowledged those services reduce costs that clients would face without the intervention of FENZ. That cost reduction is reflected in reduced insurance premiums.

On equity grounds, a leading consideration of the Tax Working Group, we submit that the funding of FENZ is fundamentally unfair. It imposes the cost of funding FENZ on those who insure themselves when FENZ provides a public good by responding to all those who call for assistance. The insurance-based regime imposes unjustified collection, administration and compliance costs on insurers and on FENZ, which must administer and audit the levy collection scheme.

Levying insurance makes insurance more expensive due to the imposition of the levy itself and the costs of collection. The impacts of this are regressive for households as the levy rate for residential property is capped. Reducing the affordability of insurance potentially contributes to under-insurance, exposing households, their communities and ultimately the government to greater costs in the event of major disasters.

Inland Revenue on the other hand already provides a very efficient revenue gathering service. Utilising this to fund FENZ would drastically reduce the direct and deadweight costs associated with the current approach of funding it by a levy collected on a complex product like insurance.

Using established public finance principles to evaluate the current insurance-based levy, analysis undertaken by NZIER[1] (**enclosed** with this submission) identified that the current insurance-based levy is the worst option for funding FENZ, and the first best option would be having it funded entirely from general taxation. This was the preferred option because the general tax system with its broad base and low rates provides the fairest and most efficient means to raise the revenue required and would recognise the wider public benefits associated with much of FENZ's activities. These reasons have led most relevant jurisdictions internationally to fund their fire and emergencies services through direct taxation and/or some form of property levy.

We draw this issue to the attention of the Working Group and recommend that in the interests of improving efficiency and fairness it considers the benefits that would result from funding FENZ through general taxation rather than through the current levy on insurance.

Earthquake strengthening

We note the Tax Working Group has identified the issue of the tax treatment of the seismic strengthening of buildings and that no deductions are allowed for this.[2] We agree the current approach results in a counterintuitive outcome: deductions may be claimed if a building collapses in an earthquake, but no deductions may be claimed on expenditure that will prevent the building from collapsing.

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[1] Better ways of funding fire services in New Zealand Alternatives to the present insurance levy, NZIER report to the Insurance Council of New Zealand, April 2013.

[2] Refer to Box 14.1 on page 108 of the Interim Report.

Given the seismic risks prevailing in much of New Zealand it is important for buildings to be strengthened to reduce the potential loss of life from a major earthquake. Such strengthening can also contribute to improving the resilience of such buildings to earthquakes and therefore the communities they sit within. More resilient buildings will also generally be easier to insure.

The tax system should not disincentivise building owners from conducting earthquake strengthening and so we support the Working Group giving further consideration to how to ensure tax policy is supporting the Government's disaster risk management agenda, rather than working against it.

Conclusion

Thank you again for the opportunity to submit on the Interim Report. If you have any questions, please contact our Regulatory Affairs Manager on (04) 914 2224 or by emailing andrew@icnz.org.nz.

Yours sincerely,

Tim Grafton
Chief Executive

Andrew Saunders
Regulatory Affairs Manager