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The Tax Expenditures Statement – Consultation Paper

The MCA supports making improvements to the Tax Expenditures Statement (TES) to improve transparency and public debate on Australia's tax system. The provision of meaningful information on the tax system helps promote debate on the tax system based on accurate information.

The TES plays an important role in budget transparency and Australia's tax system by facilitating scrutiny of tax features, tax concessions, offsets and exemptions. It adds to the suite of tax information published by Government including the ATO's annual Tax Statistics publication (detailed data at industry wide level). The TES also adds to the Productivity Commission's annual trade and assistance review which estimates Commonwealth assistance to industry.

The TES uses appropriate benchmarks to estimate tax expenditures. However, the content and presentation of the TES should be improved. The TES currently does not provide sufficient information to encourage an informed and meaningful public debate of the broader tax system and individual tax expenditures.

There is a balance to be struck between providing sufficient information to the public and the need to ensure the TES is a useful, readable document. Similarly, the TES needs to balance the need for simple explanations with technical information.

The MCA considers the TES would benefit from the following changes:

- Clearly set out the principles underpinning the benchmarks
- Simpler information on the appropriate use of tax expenditures and their limitations through the publication of a separate short supplementary document
- More detailed descriptions of tax expenditures including the policy rationale of large tax expenditures, their beneficiaries and a brief analysis of second round impacts.

Treasury should remain the body charged with responsibility for determining the benchmark and publishing the TES. The benchmark is appropriate and Treasury has access to the data and revenue costings expertise.

The benchmark

The benchmarks used in the TES are broadly appropriate. Income taxes are based on the Schanz-Haig-Simons definition, the generally accepted international benchmark. Importantly, benchmarks for indirect taxes including excise and for commodity taxes and GST benchmarks are based on structural features encompassing standard practices in the tax bases for these taxes and long standing treatment of these taxes.

The consultation paper points out that because there is an element of subjectivity associated with defining benchmarks, a clearly identified set of principles should state the basis upon which a benchmarks are set. This would also ensure the process of choosing benchmarks is transparent. This is partly covered in the TES already with a description of the Schanz-Haig-Simons definition of income and indirect tax explanations. The principles for excise, commodity taxes, GST and customs duties should also be explained clearly. In the case of excise for example, the inclusion of contextual and historical tax information would be useful. This might include long standing tax arrangements for various taxes and explanations of tax policy principles which inform the benchmark choice.

Small Tax expenditures

All tax expenditures, including expenditures with small revenue impacts, should continue to be reported in a comprehensive TES to maximise transparency in the tax system.

The MCA supports the House Inquiry's and Treasury's suggestion to review small, technical expenditures less frequently – on a three year basis – to reduce the administrative costs of producing the TES. Given that a large number of tax expenditures are unquantifiable (almost half), and given that most of the unquantifiable expenditures are at the smaller end (less than \$10 million or less than \$100 million), even a low threshold would result in potentially a significant number of tax expenditures being exempt from annual estimates. If a threshold is to be pursued, it should therefore be set very low to ensure public transparency of tax expenditures. An appropriate threshold would be tax expenditures that are estimated as 'nil or as 'not zero, but rounded to zero'.

Content and Presentation

The MCA supports the House of Representatives Standing Committee on Tax and Revenue's recommendation to improve explanations on the limitations of tax expenditure estimates in its inquiry into the TES.

The TES is relied on by the public, media and others on a reported cost of a tax expenditure to estimate the revenue gain of removing a tax expenditure. The current approach in the TES of using only a 'revenue forgone' approach and not a 'revenue gain' approach in estimates of expenditures (other than for certain expenditures in Chapter 3 of the TES) can lead to inaccurate conclusions being drawn on the revenue impacts of various tax expenditures. The difference between the TES estimate and any actual revenue gain that might flow from the removal of the tax expenditure can lead to incorrect conclusions being drawn.

Treasury has attempted to address the issue by including a section in the TES (Chapter 3) estimating the 'revenue gain' (not just the 'revenue forgone') that may result from the removal of some of the more prominent and larger tax expenditures including treatment of superannuation and GST exemptions. However, this 'revenue gain' figure will stay have has its own limitations as it does not account for behavioural changes.

While the introduction to the TES attempts to explain how to interpret tax expenditures and issues caution on interpreting revenue gains and the reliability of estimates. These explanations could be made more prominent and explained in simple terms.

The behavioural changes or second round impacts should be noted to provide a more complete analysis. This need not be costed given behavioural impacts are not estimated by Treasury for any budget or reporting purposes. Further, accounting for such impacts would reduce comparability of various tax expenditures since these impacts can be uncertain. The inclusion of some basic analysis on second round effects in the TES is elaborated on below.

Treasury's recent attempts at better explanations on the limitations of tax expenditure estimates are welcome and go some way to reducing the likelihood of misleading conclusions being made from estimates, but the information could be provided in a more simple format. Treasury should give consideration to a short factsheet being published with the TES. The ATO published contextual

information with the recent 'tax gap' estimate and with the annual 'Report of entity tax information'. These formats could be used as a model to explain tax expenditures.

Descriptions of tax expenditures

Because the TES is used by the public and media to scrutinise the tax policy and to identify changes to the tax system, it is an important source of information for public debate on the tax system. TES expenditure descriptions should provide more information to help improve scrutiny and transparency.

The TES currently provides very basic information. The current expenditure descriptions essentially only identify a tax expenditure and attempt to quantify it. This minimalist approach to descriptions can lead to misunderstanding of individual measures and costs. It does not arm readers with information to take a deeper analysis on why the expenditure exists, its policy aim, and its beneficiaries.

The TES could be considerably improved through more detailed, less technical descriptions of individual tax expenditures. This will increase the transparency and information on individual expenditures. More information in descriptions will help lead to more meaningful scrutiny and analysis of the tax system and help address the concern that TES estimates can be easily misunderstood in public debate on tax policy.

More detailed descriptions should include simple analysis of the original policy rationale of the measure and its beneficiaries. Canada's descriptions could provide a basis for measure descriptions. The Canadian Report on Federal Tax Expenditures provides a simple description of the expenditure, refers to the beneficiaries (including the number of beneficiaries where possible) and its policy objective.

A basic assessment of the expected behavioural or second round impacts should also be considered. The inclusion of brief analysis of second round impacts would make the TES more useful to the public by providing pointers to the economic impacts of the measure to help inform public policy debate. It is acknowledged that there will be varying views on the on second round impacts and there will be administrative costs. To minimise these costs, such analysis may only need to apply to the largest tax expenditures and need not be an appraisal of the tax expenditure but simply an informative piece in recognition of the reality that expenditures will be used to identify reform options. In future, distributional impacts of personal income tax expenditures could be included building on the second round analysis. This information might be particularly useful in judging equity in tax expenditures – key criteria for tax measures.

A 'streamlined' document

The consultation paper suggests the creation of a 'streamlined' document listing the measures with a brief description and the quantified estimate with the publication of a separate technical document. It is not clear that this would make the TES more user friendly or useful if the descriptions were curtailed to such an extent that explanations of each measure are inadequate. Smaller documents would impact on transparency and risk increasing the likelihood that misleading conclusions being made on the removal of any measure.

To improve readability of the TES, detailed technical information can be dealt with in appendices. A simple 'explainer' document should be published, as set out above, issuing caution on interpreting revenue gains and providing context around the TES.

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Yours sincerely



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