3 November 2017

Tax Expenditure Statement Consultation
Tax Analysis Division
The Treasury
Langton Crescent
PARKES ACT 2600

Email: taxexpenditures@treasury.gov.au

Dear Madam/Sir,

SMSF ASSOCIATION SUBMISSION ON THE TAX EXPENDITURES STATEMENT CONSULTATION PAPER

The SMSF Association welcomes the opportunity to make a submission to Treasury's consultation on the Tax Expenditures Statement (TES). The SMSF Association has been a critic of the TES measurement of the superannuation tax concessions due to the distortionary effect it has on the public debate regarding superannuation policy. We understand that the annual TES is an important exercise in the ongoing evaluation of the Australian tax system. However, due to the shortcomings of the TES measurements, we believe that the TES estimates of the superannuation tax concessions inappropriately influence the view of superannuation tax concessions in policy debates.

Given the distortionary effect and its consequence for superannuation policy we are pleased that Treasury is reviewing the annual TES publication to improve its presentation and its role in public discourse around tax concessions and their policy efficacy.

We believe that a significant improvement to the TES can be made through the following:

- Estimating alternative benchmark measurements regularly for large tax expenditures and ones that generate significant public debate.
- Reducing the focus and effort to estimate smaller tax expenditures to place greater effort on more accurate measurement of large tax expenditures.
- Improving the visibility and wording of caveats regarding the accuracy and use of the TES.

Our detailed responses to the consultation questions are in the attachment.

ABOUT THE SMSF ASSOCIATION

The SMSF Association is the peak professional body representing SMSF sector which is comprised of over 1.1 million SMSF members who have $696 billion of funds under management and a diverse range of financial professionals servicing SMSFs. The SMSF Association continues to build integrity through professional and education standards for advisors and education standards for trustees. The SMSF Association consists of professional members, principally accountants, auditors, lawyers, financial planners and other professionals such as tax professionals and actuaries. Additionally, the SMSF Association represents SMSF trustee members and provides them access to independent education materials to assist them in the running of their SMSF.

If you have any questions about our submission please do not hesitate in contacting us.

Yours sincerely,

John Maroney
Chief Executive Officer
SMSF Association

ATTACHMENT

Consultation Questions

1.	What is an appropriate annual threshold below which expenditures could be updated less frequently and reported as ranges?
2.	What is an appropriate frequency for updating these small tax expenditures?
3.	What are appropriate bounds for the ranges?

The SMSF Association supports less frequent updating of smaller, less significant tax expenditures with a greater focus on larger tax expenditures that are the focus of greater public scrutiny. We believe that updating smaller tax expenditures every four years would be sensible and align with Budget revenue forward estimates timing.

We do not have a view on appropriate bounds for ranges.

4.	Do you have any concerns about the benchmarks currently used in the TES? How can they be improved?

We believe that a key problem with the TES estimates is the comprehensive income tax benchmark that is used in measuring the magnitude of all tax concessions. The comprehensive income tax benchmark assumes that all income derived by a taxpayer is taxed at their marginal tax rate and any deviation from this tax treatment for tax purposes is regarded as a tax expenditure. We believe that this can be misleading for superannuation tax concessions and that alternative estimates should be published to highlight the effect of choosing the comprehensive income tax benchmark to measure tax expenditures.

The comprehensive income tax benchmark views the tax settings for superannuation as highly concessional because pre-tax contributions to superannuation and superannuation earnings are taxed at a rate lower than most taxpayers' marginal tax rates. Superannuation benefits are exempt from tax under a comprehensive income tax benchmark as contributions and earnings are assumed to be fully taxed under the benchmark.

Accordingly, the comprehensive income tax benchmark embodies a "TTE" model of superannuation where the first two phases of superannuation are fully taxed under the ideal benchmark and benefits paid out of superannuation are exempt from tax. The Australian superannuation system embodies a "ttE" system where the first two phases are concessionally taxed rather than fully taxed. The difference between the TTE and ttE system is the amount that the TES statements measure as the revenue forgone to Government by having superannuation tax concessions.

The choice of using a comprehensive income tax benchmark that embodies a TTE taxation of superannuation results in superannuation tax concessions having a large TES estimate of superannuation tax concessions. Choosing this methodology to estimate the cost of superannuation tax concessions results in the relevant TES measurements indicating that significant amounts of revenue will be forgone by Government. These large revenue forgone estimates are used by various special interest groups to assert that superannuation tax concessions are too generous or inappropriately reduce Government revenue which could be used for other outlays. However, these large revenue forgone estimates, which can influence retirement income policy debate, are largely a consequence of the Treasury's choice to use a comprehensive income tax benchmark in estimating the cost of superannuation tax concessions.

As explained above, Australia's existing superannuation system does not have a complete tax exemption for returns on savings (as envisaged in a TEE benchmark), but instead both contributions and earnings are taxed at concessional rates (i.e. a ttE system). Accordingly, we believe that instead of using a comprehensive income tax benchmark, alternative tax benchmarks that better embody our superannuation system should be considered for the TES measurements of superannuation tax concessions.

An unrealistic benchmark?

Further, the use of the comprehensive income tax benchmark is unrealistic in maintaining an assumption that all income will be taxed at a taxpayer's marginal tax rate. It is widely accepted that the tax system is not purely in place to derive revenue to fund Government expenditure. Instead, taxation policy is often used to promote certain Government objectives such as encouraging business activity or incentivising particular behaviour. For instance, the superannuation tax concessions are in place to encourage people to save for retirement by forgoing current consumption for future income in retirement. However, the comprehensive income tax benchmark is not designed to account for using the tax system to achieve economic or social policy objectives and views a deviation from the ideal benchmark as a loss to Government. This is plainly inconsistent with modern tax policy.[1]

On this note, it is a common feature of retirement income systems across the world to have Government support through concessional tax arrangements. However, under the comprehensive income tax benchmark, the use of a tax incentive results in a large short-term loss of revenue to Government. In our view, while this may be theoretically correct under the chosen benchmark, it does not reflect the broader and longer-term policy goals of Government, the taxation system or the retirement income system, and disproportionately skews superannuation policy debates.

Therefore, in our view it would be prudent to consider the use of an alternative benchmark or publishing alternative estimates of the superannuation tax concessions that have a longer-term perspective.

[1] The comprehensive income tax benchmark is based on the Schanz-Haig-Simons income definition which was established between the late 1890s and 1938. This raises the question as to whether the modern Australian tax system should be judged against an idealised tax benchmark created over 70 years ago. That is, is an income tax benchmark created in the late 19th and early 20th centuries an appropriate benchmark to measure the current income tax system against?

5.	What broad set of principles should be used to inform the choice of benchmark?
6.	Should standards be developed and published for determining the benchmark tax treatment? If so, who should be responsible for their development?

We do not have a set of principles that we would recommend to use to select a benchmark. However, we do believe the following factors may be useful in helping Treasury determine when an alternative benchmark should be estimated as well as the existing benchmark (generally the comprehensive income tax benchmark):

- The tax expenditure is a high profile and well-known feature of the tax system.
- The estimate of the tax expenditure is sensitive to the benchmark being chosen.
- The tax expenditure is large in size or the number of taxpayers that are affected by it.
- The TES estimate has an influence on public policy debates regarding the tax expenditure.
- Any benchmark used should not distort the incentives for current consumption versus saving for future consumption.

7.	Should the TES report tax expenditures for income from savings against a pre-paid expenditure benchmark in addition to a comprehensive income benchmark?
8.	If so, should this apply to all forms of savings, or only a subset? Should reporting against this alternative benchmark be done annually, or periodically?

The SMSF Association strongly supports reporting tax expenditures for income from savings against a pre-paid expenditure.

Under a pre-paid expenditure tax benchmark, labour income is taxed and returns to savings are exempt (as income contributed to savings has already been fully taxed under this benchmark). It can be argued that this is a more appropriate benchmark to measure superannuation against as superannuation is a concessionally taxed savings vehicle which encourages savings for use in retirement where benefits are drawn down tax free.

A pre-paid expenditure tax benchmark resembles a TEE benchmark. Accordingly, the revenue forgone to Government is estimated as the difference between a TEE benchmark and our ttE system. This would result in the only revenue forgone against this benchmark being the concessional taxation of contributions. However, tax on superannuation earnings would be a gain for the Government.

Another alternative may be to use a post-paid expenditure tax where taxation is levied on final expenditure on goods and services. This embodies an EET tax benchmark. If this was used to estimate superannuation tax concessions the taxes on contributions and earnings would be a revenue gain to Government while the tax exemption on superannuation benefits over the age of 60 would result in revenue forgone to Government.

In the 2013 TES, Treasury undertook an experimental estimate of the cost of the tax concessions superannuation using an expenditure tax benchmark.[2] The 2013 TES states that this was undertaken "to facilitate discussion and understanding of the impact of utilising different benchmarks." Under the expenditure tax benchmark, the benchmark treatment is for contributions to be taxed at marginal rates, while earnings and benefits are exempt from tax.

Using an expenditure tax benchmark, the cost of the superannuation tax concessions fell from $32 billion to $11.24 billion. The effects of choosing a different benchmark can be seen in the following table:

Superannuation Tax Concession Measurements 2013-14 ($m)		
	Expenditure Tax Benchmark	*Comprehensive Income Tax Benchmark*
Taxation of employer contributions	$16,000	$16,000
Taxation of personal/self-employed contributions	$670	$670
Taxation of unfunded superannuation	$490	$490
15% tax on earnings in accumulation phase	-$4,700	$16,100
0% tax on earnings (including capital gain)	$0	
10% tax on capital gains in accumulation phase	-$1,100	
Measures for low-income earners	$130	$130
Tax on funded lump sums	-$250	-$250

The use of the expenditure tax benchmark changes the current tax treatment of superannuation fund earnings from a $16.1 billion cost to the Government to a $5.8 billion revenue gain. This is because under the expenditure tax benchmark returns to savings are exempt from tax, so the 15% tax on superannuation earnings is a gain to Government revenue. This is in contrast to the comprehensive income tax benchmark where the difference between a taxpayer's marginal tax rate and the 15% superannuation earnings tax is recorded as a loss of revenue to the Government. This is illustrative of how the choice of tax benchmark influences the outcomes of the TES estimates for superannuation tax concessions.

While the separate tax concession measurements are not to be used in an additive fashion, the total superannuation tax concessions in the above table shrink from $33.35 billion to $11.24 billion under the expenditure tax benchmark. Again, this illustrates the effect of setting an arbitrary benchmark for costing tax concessions.

This is illustrative of how the choice of benchmark for estimating a tax expenditure can have a dramatic impact on the outcome of the measurement exercise and consequently perceptions of the effectiveness of the superannuation tax concessions.

[2] http://www.treasury.gov.au/~/media/Treasury/Publications%20and%20Media/Publications/2014/TES%202013/Documents/PDF/04_Appendix_A.ashx

9.	Should the current benchmark treatment of owner-occupied housing be altered to allow deductibility of mortgage interest and capital works deductions against the CGT cost base?

The SMSF Association does not have a view on this issue.

10.	What options are there to improve the visibility and accessibility of caveats in the TES?
11.	What options or strategies are available to mitigate or reduce the misunderstanding of figures published in the TES?

The SMSF Association makes the following recommendation on improving the visibility of caveats in the TES and reducing misunderstanding of the figures of the TES:

- Caveats regarding the construction and accuracy of the TES should be given primacy at the front of the TES document, similar to the summary figures on large tax expenditures.
- Caveats should be drafted in plain English as much as possible.
- The Treasury webpage hosting the TES document should also explain the nature of the TES and the caveats as to their usage.

In addition to these recommendations, we believe a more significant effect will be had by publishing additional/alternative estimates of significant tax expenditures as this will highlight the effects of choosing tax benchmarks on the TES.

12.	Would adopting a model where technical descriptions of tax expenditures are contained in a separate technical manual be appropriate?
13.	Would it be reasonable to update the technical manual with lower frequency? (Noting that a description of new and changed expenditures would still be included in the annual.)

The SMSF Association is supportive of publishing a technical manual to accompany the TES which is updated with lower frequency than the TES document. We acknowledge that for many users of the TES, the technical explanation of tax expenditures is not relevant or of interest to them. However, this should not abrogate the need for more careful explanation of the limitations of the TES and its estimates in the main document.

14.	Is there additional data that taxpayers can provide to the ATO to improve the estimates without significantly increasing compliance costs?
15.	Are there existing data sources external to Government that can be used to improve the reliability of existing estimates or allow estimates currently presented as unquantifiable to be reliably quantified?

We would encourage the ATO and Treasury to seek out industry and academic research that attempts to quantify behavioural effects of changes in policy settings that are relevant to the tax estimates (for example, changes to superannuation tax settings). This could assist in informing more accurate estimates of tax estimates, especially revenue gain estimates that attempt to model the impact of behavioural change.

16.	Would the value of the TES be enhanced by including appendices that focus in more detail on particular topics (varying each year) relevant to tax expenditures? What topics should be prioritised?

We support the TES including appendices that have a more detailed focus on high profile and large tax expenditures. This would allow interested parties to have more information to build a better understanding of how the TES estimates for high profile expenditures are created. We would give priority to superannuation tax expenditures, large CGT expenditures such as the exemption for the family home and general CGT discount, and, GST exemptions.