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STATEMENT OF REFORM PRIORITIES

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STATEMENT OF PRIORITIES

Thank you for the opportunity to provide a position statement to the upcoming Tax Forum. This statement is based on ongoing research being conducted with Associate Professor Mark Burton, Melbourne University, on the use of tax expenditures as part of the Australian tax regime and their impact on fiscal management. This position statement has been written in consultation with Associate Professor Burton. We hold the view that a priority for reform of our tax and transfer system should be the tax expenditures management framework.

Tax Expenditures, or benefits provided to a specified activity or class of taxpayer that are concessional when compared to the 'normal' tax treatment that would apply, are provided in many forms, including tax exemptions, tax deductions, tax offsets, concessional tax rates or deferrals of tax liability. Tax expenditures play an important role in the tax and transfer system. The cost is significant, with an incomplete estimate upwards of $113 billion per year, or around 8.8 per cent of GDP. This potential revenue forgone through tax expenditures shifts the burden from one group of taxpayers to another. As such, a robust tax expenditures management regime is integral to fiscal responsibility and the integrity of the tax system. We hold the view that an integral part of the government's 'strict fiscal rules' policy and the need to maintain strong fiscal management is a robust management framework for tax expenditures.

Successive tax system reviews have called for the need for a comprehensive and systematic analysis of the tax expenditure concept and of the framework for managing Australian tax expenditures. Most recently, the Henry Review recommended changes to the monitoring and reporting of tax expenditures (see Recommendations 135-138). We strongly support these recommendations and urge the Federal Government to consider a reform of Australia's tax expenditure management framework. We consider that there are two aspects to a review of tax expenditures. First, a robust tax expenditure management framework should be designed to apply prior to the introduction of any new tax expenditures, and second, this framework should apply as part of an ongoing evaluation of existing tax expenditures.

An assessment of both potential and existing tax expenditures requires, as a minimum, an evaluation of whether the tax expenditure serves a valid government objective and whether it is the best mechanism for achieving a government spending priority. Assuming the proposed or existing expenditure serves a valid government purpose, we suggest that it is essential to determine whether: the benefits are distributed fairly; the tax concession is accurately targeted (for example, does it reach intended beneficiaries); the program avoids causing any unintended distorting effects; the administrative and compliance costs of the program are reasonable; there is control and accountability over the spending program; and the program is or will be appropriately implemented. This process will require the purpose of the tax expenditure to be stated, and its expected fiscal cost over the budget cycle determined, having regard to the accuracy of costing, and the reliability of the information relied upon.

An assessment of the type we propose will result in questions as to the efficacy of delivery through the taxation system. For example, the use of the tax regime for the delivery of the spending program may result in its underachievement where there is non-lodgement of a tax return by eligible taxpayers, or difficulties surrounding its delivery such as we have seen previously with tax expenditures such as the childcare rebate. Second order effects also need to be considered as part of the management process.

We commend the Federal Government for addressing several tax expenditure programs which compromise the integrity of the tax regime because they have created unintended incentives, have only been accessible to a small group of people or have an 'upside down' effect of providing benefits to higher rather than lower income earners. The phasing out of the Dependent Spouse Tax Offset, the replacement of the Entrepreneurs' Tax Offset and changes to the superannuation regime are three such examples.

We do however believe that there is a lot more work to be done to consider other inefficient tax expenditures. Below we provide two examples of the types of considerations that would occur through our proposed reform of the tax expenditures management framework, one in relation to personal income and the other in relation to business income.

The newly introduced Research and Development Tax Incentive is one such example of where the tax regime is merely a mechanism by which to deliver over one billion dollars of public money to entities engaged in R&D activities. Much of the debate prior to its introduction centred on taxation issues. Yet, the incentives are part of Australia's broader innovation agenda, which arguably means that the R&D Tax Incentives should be evaluated as a government spending program in the same way as any direct spending on innovation. When this is done, the tax regime is arguably only the administrative policy instrument by which the subsidy is delivered. A consideration within this framework may result in the conclusion that using the tax regime may not be best practice to distribute those funds fairly, efficiently, and without distortion, while at the same time maintaining adequate government control and accountability.

The private health insurance rebate, reported to cost over $4 billion annually, is another tax expenditure which is arguably inefficient. Statistical trends in private hospital treatment coverage published by the Private Health Insurance Administration Council indicate that the rebate, whilst halting the decline in private health insurance has done little to increase its uptake. We note the Bills currently before Parliament proposing the introduction of the private health insurance incentives tiers go some way towards addressing the problems associated with this tax expenditure. However, we suggest that a more robust tax expenditures management framework may offer further insight into the soundness of the private health insurance rebate.

In addition to a robust tax expenditure management regime, we would urge the Federal Government to consider whether the current definition of tax expenditures, used as the basis for the annual Tax Expenditures Statement, is sufficiently broad enough to accurately represent the full list of tax expenditures. We note that some tax expenditures arise without an express legislative rule, for example income splitting through family trusts which is commonly undertaken by those with higher incomes as a means to reduce a family's overall tax liability.

We propose that reforming Australia's tax expenditures management framework has several significant benefits. There would be a significant improvement in the prevention of the erosion of our most robust and efficient broad based taxes. Improved transparency and accountability will lead to greater stakeholder confidence in Australia's tax institutions and hence voluntary compliance with the taxation system would increase. Finally, an optimal tax expenditures management model ensures that tax expenditures are only adopted and/or retained after rigorous appraisal of alternate mechanisms for delivering government policy.

LIST OF ATTACHMENTS