Submission to Federal Treasury in response to its Consultation Paper dated September 2017 regarding the Tax Expenditures Statement

We welcome the opportunity to provide a submission to Treasury as part of its consultation process regarding possible improvements to the Tax Expenditures Statement (TES). As you know, we have made a number of submissions on this subject, including providing a submission and giving verbal evidence to the House of Representatives Standing Committee on Tax and Revenue.
(Hansard Report).

That evidence was provided by two of our directors, Duncan Fairweather and Malcolm Clyde. At that time, our organisation was called the SMSF Owners' Alliance. However, early this year SMSFOA merged with the Self-managed Independent Superannuation Funds Association ("SISFA") and we are now known by that name. Both Duncan and Malcolm have remained with the merged organisation which has been greatly strengthened as a result of the merger and now represents considerably more trustees and advisers to SMSFs who bring the benefit of their practical, technical knowledge of how superannuation works in practice.

Summary

We strongly support the objective stated in your "Vision of the Future TES" that improvements can be made to the TES so that it can better inform the public and contribute to ongoing discussions about the future of the Australian tax system.

It is clearly important that public policy debate on the cost of tax concessions, which often leads to policy positions adopted by political parties and policy decisions made by Governments, is well-informed and based on objective analysis.

As a body focussed on the superannuation sector and SMSFs in particular, our comments are generally confined to this sector but broadly apply to the TES as a whole.

Our main issues with the TES have been that:

a. The existing benchmark for measuring superannuation tax concessions is inconsistent with an efficient savings taxation system. The debate regarding tax concessions has been misled by use of the income tax benchmark and would be greatly enhanced if a more suitable benchmark for savings were used;

b. Neither does the TES acknowledge that the concessional treatment of superannuation has been a longstanding "structural feature" of the income tax system (introduced in 1915 at the same time as our income tax system), notwithstanding that this is the explanation given for not including tax expenditures regarding the progressive income tax system;

c. Users of the TES – including some in Government – have ignored the caveat that the two superannuation figures should not be added. Even Treasury in past TES reports have added these figures together; and

d. The TES makes no reference to savings in direct expenditure that flow from the existence of superannuation tax concessions nor attempts to put the quantum of tax expenditures into any contextual framework.

We note that most of these issues are addressed in the Consultation Paper including the possibility of including tax expenditures for savings using a pre-paid expenditure tax benchmark under which investments are purchased from post-tax income but then investment returns are not subject to tax.

Detailed response to questions

A. HOUSE INQUIRY RECOMMENDATION 1

That Treasury devote fewer resources to estimating smaller, technical tax expenditures. This could involve reviewing them less frequently and reporting them as a range.

QUESTIONS

1. What is an appropriate annual threshold below which expenditures could be updated less frequently and reported as ranges?

   We support any efforts that improve the effectiveness of the TES and allow Treasury to use its available resources to provide more focus on the larger figures and the overall scope of the TES. See our response to question 7 below. In principle we believe the annual threshold should be such that about ten of the largest tax expenditures are reported. In the 2017-18 TES, this approach would cover about $150 billion or about 80% of all the TES items.

2. What is an appropriate frequency for updating these small tax expenditures?

   At least once in the four-year budget cycle.

3. What are the appropriate bounds for the ranges?

   Whatever gives a fair indication of the tax cost, which Treasury is best placed to judge.

B. HOUSE INQUIRY RECOMMENDATION 7

That Treasury:

- *Incorporate the capital gains tax exemption for the main residence into the benchmark*
- *Develop a transparent process and criteria to assist consideration of benchmarks which reflect the practical possibility of a tax concession being abolished; and*
- *Consult with stakeholders on the benchmarks used in the Tax Expenditures Statement.*

QUESTIONS

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

   Yes. We have serious concerns regarding the benchmarks presently used as we do not believe they support the purpose of the TES which has been reported by Treasury as being to *"help inform debate on the efficiency and equity of the tax system"*.

5. What broad set of principles should be used to inform the choice of benchmark?

   They should be chosen on 'optimal taxation' grounds. i.e. the benchmark should better reflect that some taxes are more distortionary on economic activity than others and revenue (taxes) should be raised in a way that minimises detrimental impact on economic activity.

   In particular, taxing investment income is more distortionary than taxing labour income and a different benchmark should therefore apply to investment income. This is quite consistent with the principle exposed in the Consultation Paper that the standard taxation treatment should apply to *similar types of activity*.

6. Should standards be developed and published for determining the benchmark tax treatment? If so, who should be responsible for their development?

   Definitely yes. Treasury is best placed to undertake this task with advice from external independent economists. Perhaps a review panel could be set up. It should be on a voluntary basis and not entail any cost.

C. HOUSE ENQUIRY RECOMMENDATION 6

That Treasury retain the comprehensive income tax benchmark for savings in the Tax Expenditures Statement.

QUESTIONS

7. Should the TES report tax expenditures for income from savings against a pre-paid expenditure benchmark in addition to a comprehensive income benchmark?

   We believe that the TES would be greatly enhanced if the pre-paid expenditure benchmark were used for savings income in place of the income tax benchmark. The explanation for not doing this appears to be that it would be more "resource intensive". We support other changes to reduce the cost to Treasury of preparing the TES just so that it can apply such resources to making the important aspects of the TES more relevant in public debate.

   However, if we are only now being given one choice of adding a second set of figures using a better benchmark then we would clearly support this.

   It is widely recognised that taxation of savings at income tax rates creates an inadvisable bias against savings and is not an optimal system. Use of a pre-paid expenditure tax benchmark would remove this bias.

It is also more consistent with the way earnings on superannuation savings has been taxed for many years. Contrary to widely held views, superannuation was NOT introduced in 1988 and has been tax-free since it was first introduced. When the Income Tax Assessment Act was introduced in 1915, the desirability of exempting savings from taxation was recognised. Contributions in superannuation savings vehicle were deductible and earnings on such savings were tax exempt.

Contrary to much commentary, 1988 was NOT the year that superannuation commenced. It was the year in which the Government commenced TAXATION of superannuation contributions which it subsequently made compulsory when the universal superannuation system was introduced in the early 90s.

Treasury comments in its annual reports that the reason it does not report on tax expenditures relating to the progressive income taxation system is that it has been a long-standing component of our taxation system. If one applies the same yardstick, the benchmark for superannuation contributions and earnings should also be deleted from the TES since the taxation treatment of retirement savings was introduced at the same time in 1915.

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?

   One would expect lower tax to apply to superannuation savings compared with other forms of savings to provide additional incentive/compensation for the restrictions on access to superannuation savings and other controls imposed on superannuation funds.

   However, on balance we believe the TES should be consistent in its application of benchmarks and so should apply the same taxation benchmark to all forms of savings; bank, personal, superannuation and property. However, the TES should then point out clearly the reasons that one would expect a greater tax expenditure with regard to superannuation savings than other forms of savings.

   We believe that this so-called "alternative" benchmark is a more appropriate benchmark than the existing one and so should be given equal, if not more, prominence and reported as frequently as the existing report - i.e. annually.

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?

   Yes to the extent the tax expenditure then calculated is more comparable to the treatment of investment property.

D. HOUSE INQUIRY RECOMMENDATION 8

That Treasury consider ways of increasing the visibility of warnings in the Statement to better draw the attention of readers to the Statement's limitations.

10. What options are there to improve the visibility and accessibility of caveats in the TES?

    Treasury, ATO, their officials and politicians should be enjoined to refrain from misquoting figures - in particular the adding together of two superannuation tax expenditures that are not additive.

    This caveat - and others regarding the use of figures - should be

    - **clearly and briefly expressed in plain English;**
    - **in clear type on the same page as figures; and**
    - **in same size font, not as footnotes in smaller type.**

11. What options or strategies are available to mitigate or reduce the misunderstanding of figures published in the TES?

    We briefly debated with the House of Representatives Standing Committee a comparison of the responsibilities of public servants and politicians vs the responsibilities of directors of public companies. (See [Hansard report on Committee Hearings]())

    We recognise that, unlike for directors, there is no legal obligation on public servants and politicians to minimise any misleading statements in the public domain. However, we do believe that there are strong moral imperatives for them to be held to a similar standard of behaviour.

    In this regard, an individual within Treasury - as publisher of the TES - should be assigned the responsibility for drawing the attention of the appropriate senior public servant to any substantial misreporting or misquoting of TES figures. Action - such as a simple explanatory note - should then be taken to correct this. This is no more onerous than the obligation imposed on officers and directors of public companies.

    We suspect that if this happens a few times, journalists may then take more care before quoting figures including, for example, reading and understanding any caveats.

E. HOUSE INQUIRY RECOMMENDATION 9

That Treasury include in the Statement an informative explanation of data and methods for large estimates and when estimates are substantially revised, either in terms of size or reliability?

12. Would adopting a model where technical descriptions of tax expenditures are contained in a separate technical manual be appropriate?

    In the context to endeavouring to make the TES clearer and more focussed, we believe that the idea of including more technical descriptions in a separate manual has merit, provided the TES contains a reference and link to such document.

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 document.)

    If there has been no change in some aspect of the technical descriptions, then it would make sense not to print and repeat such descriptions every year provided the TES contains a reference and link to the standing technical descriptions and that such link remains available until a particular description is replaced.

F. HOUSE INQUIRY RECOMMENDATION 10

That Treasury and the Australian Taxation Office consult with stakeholders on possible data sources and apply a prioritised approach to data improvements.

14. Is there additional data that taxpayers can provide to the ATO to improve the estimates without significantly increasing compliance costs?

    In the public policy discussion on the estimated cost to the revenue of superannuation tax concessions, and the appropriate level of such concessions, it would be helpful for the ATO to publish data on the taxable status of contributions. Such data would distinguish between concessional contributions on which a tax benefit has been received and non-concessional contributions on which the full rate of income tax has been paid. We believe that if this information is published, it would show that a significant proportion of contributions to self-managed funds is non-concessional.

    This information should be readily available from tax returns. We have made this suggestion to the ATO previously.

    In similar vein, when the budget cost of superannuation tax concessions and their distribution by income cohort is published by Government, a comparison should be made with the amount of tax paid. For example, Chart 6 on page 138 of the Financial System Inquiry's Final Report, and the accompanying text, makes the point that the majority of superannuation tax concessions accrue to the top 20% of income earners.

    While this is so, the statement was not balanced by information showing the amount of tax that these top 20% income earners pay. They actually account for a somewhat greater proportion of income tax than the proportion of superannuation tax concessions they receive.

    It is unremarkable that high income earners will receive a benefit from a tax concession that is proportionate to the tax they pay.

    There may be an argument for the progressive scaling of tax concessions. Our point is simply that official publications should give a balanced account to inform policy debate. By leaving out any reference to income tax paid compared to concessions given, the FSI Report allowed commentators, advocates and politicians to run an emotive argument that superannuation tax concessions were unfair.

In a broader context, in the interests of an informed policy debate, it would be helpful for the ATO/Treasury to publish easily accessible information on the distribution of tax paid by income bracket on a net basis, taking into account income tax paid to government offset by benefits received from government. The ATO used to publish a handy '100 persons' summary on its website, however this appears not to have been published since 2012-13. For that year the '100 persons' analysis showed that 3 people out of 100 paid 27% of income tax collected and 6 people paid 20% - so 9% of taxpayers paid nearly half of the income tax collected. 35 people paid 11% of the tax collected and 26 people didn't pay tax.

Though simplistic, the '100 persons' analysis clearly shows the pattern of income tax payment in Australia and could assist a better informed and more reasoned debate on tax policy.

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 are aware of, but not familiar with, the STINMOD (Static Incomes Model) operated by the National Centre for Social and Economic Modelling (NATSEM) at the University of Canberra. We understand the input data for STINMOD is sourced from government statistics. The best source of data is from within government – the ATO statistics and Treasury modelling. This increases the responsibility on Treasury to ensure that the TES numbers are as objective as they can be and appropriately qualified when published.

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?

There are two types of additional information that would improve the value of the TES.

a. <u>Reporting offsetting direct savings as a result of tax expenditure</u>

Some tax expenditures lead to direct savings in the Federal Budget. Others are for social reasons. It would assist an open and informed debate of these issues if the TES more clearly identified which tax expenditures lead to direct savings and provided an "order of magnitude" estimate of such savings.

For example, it is a fact that 100% of the Age Pension is a cost to the Government whereas most of the funds supporting a superannuation pension represents an individual's deferred expenditure and only a small proportion is a cost to Government through tax concessions.

It would therefore be helpful to the debate if the TES mentions this and states that removal or reduction of the superannuation tax incentives would be expected to lead to an increase in the cost to Government of Age Pension. Whilst it is acknowledged that it may not lead to <u>every</u> retiree becoming dependent upon the Age Pension, it would assist debate of the issue if the TES included a report of

- current annual expenditure by the Federal Government on Age Pensions and
- an estimate of the total Age Pension cost if ALL retirees were to draw the full Age Pension

..with a note that removal of the superannuation tax expenditure would increase the Age Pension cost from its current level towards the higher figure.

b. Information that would put the size of the tax expenditure into context

   For example, comparing the size of the superannuation tax expenditure with the total sum of assets in the superannuation system. Or referring to the value of any home ownership tax expenditure in the context of the total value of homes.

This submission was prepared by the Self-managed Independent Superannuation Funds Association (SISFA) - October 2017