Policy costing

Capping deductions for managing tax affairs at $3,000

<table>
<thead>
<tr>
<th>Party:</th>
<th>Australian Labor Party</th>
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Summary of proposal:
The proposal would implement a cap of $3,000 on tax deductions for individual taxpayers related to the cost of managing tax affairs.
The cap would not apply to small businesses with positive business income and annual turnover of less than $2 million.
The deduction cap would not apply to adjusted taxable income for the purposes of calculating eligibility for family and childcare payments.
The proposal would have effect from 1 July 2019.

Costing overview

This proposal would be expected to increase both the fiscal and underlying cash balances by $375 million over the 2019-20 Budget forward estimates period. This impact reflects an increase in revenue of $380 million and an increase in expenses of $5 million over this period. Departmental expenses of around $5 million for the Australian Taxation Office (ATO) in 2019-20 reflect the estimated cost of implementation and administration of the proposal.

A breakdown of the financial implications of this proposal over the 2019-20 Budget forward estimates period is included at Attachment A. The proposal would be expected to have an ongoing impact beyond the 2019-20 Budget forward estimates period.

<table>
<thead>
<tr>
<th>Table 1: Financial implications ($m)(a)(b)</th>
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<tbody>
<tr>
<td>Fiscal balance</td>
</tr>
<tr>
<td>-5</td>
</tr>
<tr>
<td>Underlying cash balance</td>
</tr>
<tr>
<td>-5</td>
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(a) A positive number represents an increase in the relevant budget balance; a negative number represents a decrease.
(b) Figures may not sum to totals due to rounding.
This costing is subject to uncertainty around the representativeness of individuals claiming deductions for the cost of managing tax affairs in the base year of data. In particular, a small number of individuals claiming very large deductions account for a significant proportion of total deductions above the cap, and the magnitude of such deductions can vary significantly across financial years. The costing is also sensitive to assumptions made about the behavioural response of individuals.

**Key assumptions**

The Parliamentary Budget Office has made the following assumptions in costing this proposal.

- **Individuals would not bring forward the costs of managing tax affairs from 2019-20 to 2018-19.**
  - This reflects that individuals have limited control over the timing of their cost-of-managing-tax-affairs expenses.

- **Taxpayers and tax accountants would adjust their behaviour to reduce the impact of the policy proposal by an average of 30 per cent.**
  - Individuals may claim deductions under alternative labels on their tax return.
  - Setting a cap may act as a signal to individuals and tax accountants as to an appropriate amount to spend on managing tax affairs. As such, individuals currently claiming deductions below the $3,000 cap may increase their deductions.

**Methodology**

- The costing was estimated using a 16 per cent sample of de-identified personal income tax and superannuation returns for individuals in 2016-17 provided by the ATO.

- These data were used to estimate the amount by which expenses associated with the cost of managing tax affairs reduced taxable income for affected individuals under the proposal, after accounting for the specified exclusions. This was then adjusted to account for the behavioural response identified above.
  - In 2016-17, all deductions associated with the ‘cost of managing tax affairs’ were captured under a single label on an individual’s tax return. These deductions included litigation costs and interest charges imposed by the ATO. This costing treats all deductions under the ‘cost of managing tax affairs’ label in the same way, consistent with the policy specification.

- The cost of managing tax affairs was projected to grow in line with the 2019 Pre-election Economic and Fiscal Outlook parameters over the period to 2029-30.

- The estimates were benchmarked to the average of the 100 per cent files in the 2015-16 and 2016-17 income years for cost-of-managing-tax-affairs deductions in order to reduce variation in deductions across income years.
  - In some income years there are a small number of very large deductions that can significantly affect the estimated financial implications. This approach reduces the impact of extreme deductions in a given year.

- The modelling takes into account the timing of tax collections.

- Departmental expenses were estimated based on amounts allocated to the ATO for measures with similar administrative complexity.

- Revenue estimates have been rounded to the nearest $10 million.
• Departmental expense estimates have been rounded to the nearest $1 million.

Data sources

The ATO provided:

• de-identified 16 per cent sample of personal income tax and superannuation returns from the 2016-17 tax year

• de-identified 100 per cent files of personal income tax and superannuation returns from the 2015-16 and 2016-17 tax years.


The Treasury provided the 2019 Pre-election Economic and Fiscal Outlook parameters.
Attachment A – Capping deductions for managing tax affairs at $3,000 – financial implications

Table A1: Capping deductions for managing tax affairs at $3,000 – Fiscal and underlying cash balances ($m)\(^{(a)(b)}\)

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<tbody>
<tr>
<td>Revenue</td>
<td>-</td>
<td>120</td>
<td>120</td>
<td>130</td>
<td>380</td>
</tr>
<tr>
<td>Departmental expenses – Australian Taxation Office</td>
<td>-5</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-5</td>
</tr>
<tr>
<td>Total</td>
<td>-5</td>
<td>120</td>
<td>120</td>
<td>130</td>
<td>375</td>
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\(^{(a)}\) A positive number for the fiscal balance indicates an increase in revenue or a decrease in expenses or net capital investment in accrual terms. A negative number for the fiscal balance indicates a decrease in revenue or an increase in expenses or net capital investment in accrual terms. A positive number for the underlying cash balance indicates an increase in receipts or a decrease in payments or net capital investment in cash terms. A negative number for the underlying cash balance indicates a decrease in receipts or an increase in payments or net capital investment in cash terms.

\(^{(b)}\) Figures may not sum to totals due to rounding.
- Indicates nil.