Submission No: .... 3.

Joint Committee of Public Accounts and Audit

ANSWERS TO QUESTIONS

Treasury Portfolio

Audit Report No. 32 2007-08, Preparation of the Tax Expenditures Statement

1. Why was a zero rate benchmark adopted as the customs duty tax benchmark? Doesn't this merely conceal tax concessions?

Under the consumption tax benchmark, the relevant activity for measuring tax expenditures is the consumption of particular goods. The consumption of imported goods and consumption of similar domestically produced goods are treated as the same activity. Accordingly, the decision to be made under the Customs Duty benchmark was whether to set the benchmark at the prevailing customs duty rates applying to imports and apply that benchmark to all goods (domestically produced and imported) or to set the benchmark rate at the equivalent tax rate applying to domestically produced goods (zero).

Accordingly, under the consumption tax benchmark, the benchmark tax rate for goods imported into Australia is set at the same rate as similar domestically produced goods (i.e. zero). Under this benchmark, goods imported into Australia are free from Customs duty, except to the extent that the customs duty imposed is equivalent to taxes imposed on domestically produced goods, such as excise equivalent customs duties and the goods and services tax levied on imports.

The zero benchmark is also appropriate from the perspective of the purpose of tariffs and measuring the benefit they provide the taxpayer. The taxpayer on whom the Customs Duty tariff is imposed is the importer. The tariff is a tax that is imposed on importers in order to provide an economic benefit to <u>another</u> group. The impact of the tariff on the taxpayer that pays the tariff is an economic detriment, in the form of increased taxation relative to the tax paid by an Australian producer. This detriment is reflected in the tariff being shown as a negative tax expenditure.

2. The audit report notes the presence of contradictory tax expenditures such as benefits to encourage older workers to both leave, and join the workforce. Would the regular reviews proposed in 1997 have identified and addressed this anomaly, and what steps are being taken to address this issue?

As noted in the ANAO report, Treasury has accepted the ANAO recommendation 1(a), that it "develop an approach for the conduct of an ongoing prioritised review of the existing program of tax expenditures." This process will examine, inter alia, the purpose of particular tax expenditures and whether or they are still relevant.

Treasury cannot comment on whether regular reviews of tax expenditures (such as recommended in 1997) would have addressed any policy issues as such decisions would have been policy matters for government to decide.

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3. **The reporting model currently in place in Canada allows the quantum of concessions to be viewed by Parliament and the public, and improves the transparency of reporting of tax relief. What steps is Treasury taking to improve to best practice currently on display in Canada?**

Treasury does not believe that the Canadian practice of reporting "all measures that deviate from a narrow definition of the tax structure—measures that are unarguably tax expenditures along with a range of others that may or may not be so categorised" is necessarily all that different to the approach employed in Australia.

The Australian TES includes a detailed discussion of the tax expenditure benchmarks (Chapter 4 of the 2007 TES) which outlines the benchmarks and any structural features of the tax system that are incorporated into those benchmarks. Those structural features of the tax system are very similar to the 'memorandum items' listed under the Canadian approach.

The Treasury continues to monitor international developments in the area of tax expenditure reporting.

4. **Senator MARK BISHOP — I refer you to page 19 of Budget Paper No. 2, part 1, revenue measures, and the table attached to crude oil excise and condensate and in particular to row 4 of the figures. The current year 2007-08 shows a revenue figure of $80 million. There is a discussion in paragraphs 4 and 5 of it being revenue foregone to the Western Australian government being reimbursed by the Commonwealth. The tax measure comes into effect from 13 May 08 towards the end of the financial year. Could I have an explanation of why the figure is $80 million for effectively six weeks in the financial year towards the end of 2008, compared to the other four figures in the out years which are roughly between $72 and $85 million? Why is the figure of $80 million so high when it appears to be only for six weeks of the financial year? Is there another reason as to why the figure is so high in terms of reimbursement to the Western Australian government?**

The measure referred to was a decision of the Government. The measure is an expense measure, not taxation revenue and does not give rise to any tax expenditure.

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5. **Additionally, the Committee is interested in Treasury's modelling. It would like to know how Treasury goes about costing a revenue measure that is also a tax expenditure measure, and is especially interested in the modelling of the private health insurance rebate. Please see pages 11-12 of the transcript for more information.**

The Treasury models tax expenditures as the difference in taxation revenue that is actually collected in the presence of particular tax concessions from that which would be collected in the absence of that tax concession, assuming no change in taxpayer behaviour. This "revenue forgone" approach measures tax expenditures as the benefit that the taxpayer derives from the provisions concerned, relative to the tax that would be paid under a fully non-concessional tax system (the benchmark).

Budget costings on the other hand, seek to measure the impact on the budget forward estimates of a budget measure. They take account of factors such as the level of revenue (and tax concessions) already included in the revenue estimates and the behavioural responses of taxpayers to any change. This means that tax expenditure estimates may differ substantially from budget revenue estimates. Tax expenditure estimates are calculated separately from budget revenue estimates using different benchmark assumptions, but generally utilise the same base data.

In the case of the Medicare levy surcharge, the surcharge is already reported in the Tax Expenditures Statement as a negative tax expenditure, meaning that the surcharge results in tax higher than under the benchmark tax system. The tax expenditure estimates do not include any estimates of the impact on tax (or Government expenditures) that would arise from the behavioural responses to the removal of particular provisions.

The 2008-09 Budget changes to the Medicare levy surcharge threshold would be reflected in the TES as the change in surcharge payable due to fewer people being in the surcharge income range. There would also be some variation in the estimate of the tax expenditure from the non-taxation of the private health insurance tax offset (an expense item) in the hands of recipients arising from any estimated change in take up as a result of the Budget measure.

An example of the difference that can arise between tax expenditure estimates and budget revenue estimates can be seen from the costing of the 2008-09 Budget measure *Depreciation of computer software* where the increase in the period over which capital expenditure on in-house computer software was increased from 2.5 years to 4 years. This measure reduced the level of tax concession and tax expenditure by aligning the write off period more closely with the effective life of software. The revenue gain from this measure was estimated to be:

2007-08	2008-09	2009-10	2010-11	2011-12

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-	15.0	300.0	681.0	318.0

The tax expenditure for accelerated depreciation of software in the 2007 TES is estimated to be:

2007-08	2008-09	2009-10	2010-11	2011-12
35	60	75	85	na

The difference in these estimates arises because the TES estimates represent an estimate of the revenue forgone from the *ongoing* operation of the provisions, where the estimate represents the balance of larger up front deductions for taxpayers, offset by no deductions being available in the latter years of the effective life of the software assets involved. By contrast, the Budget estimates show the *transitional* impact of the measure which applies the new tax arrangements only to software purchased after 7.30pm (AEST) on 13 May 2008. After a transitional period, the revenue gain from the Budget measure will decline to a level consistent with the TES estimates, once the smaller up front deductions are balanced by deductions being claimed in the latter years of the effective life of the assets affected by the measure.