

Chapter 4

Tax expenditures, AFM, GST and ordinary annual services

4.1 In this chapter the Committee considers sources of funding not dealt with in Chapter 3 – tax expenditures, the Advance to the Finance Minister and the Goods and Services Tax. It also examines the question of funds appropriated for ordinary annual services.

Tax Expenditures

4.2 The Australian Treasury (Treasury) defines a tax expenditure as 'a tax concession that provides a benefit to a specified activity or class of taxpayer ... A tax expenditure can be provided in many forms, including a tax exemption, tax deduction, tax offset, concessional tax rate or deferral of a tax liability'.¹

4.3 Treasury produces an annual Tax Expenditures Statement (TES) in December. The TES is tabled in the Senate, usually on the first sitting day of the following calendar year and, under a Procedural Order of the Senate, is referred to the legislative and general purpose committees for consideration by the committees during their examination of the additional estimates.

4.4 Treasury has stated in the TES that:

Concessional arrangements that give rise to tax expenditures often only receive consideration from Parliament at the time they are introduced. Furthermore, the cost of tax expenditures is generally not directly observable as it does not arise from a direct transaction with government. The publication of information on tax expenditures contributes to the review and assessment of tax expenditures, especially whether their objectives are being met at a reasonable cost and in the interest of the community in general.²

4.5 In the 2006 TES Treasury estimated that tax expenditures in 2006-2007 would amount to approximately \$41 billion.³

4.6 Treasury considers that the publication of the TES is an integral component of the government's budget reporting and that publication serves three key functions:

1 Australian Department of the Treasury, *2006 Tax Expenditures Statement*, Dec 2006, p. 1.

2 Australian Department of the Treasury, *2005 Tax Expenditures Statement*, Dec 2005, p. 2.

3 Additional quantitative information on tax expenditures may be found in the annual publication of the Productivity Commission, *Trade and Assistance Review*, which assesses assistance provided to industry by tax concessions.

- to allow tax expenditures to receive a similar degree of scrutiny to direct expenditures;
- to allow for a more comprehensive assessment of government activity; and
- to contribute to the design of the tax system, by promoting and informing public debate on all elements of the tax system.⁴

4.7 Dr Mark Burton, Law School, University of Canberra, submitted that while the TES may meet the OECD rules for reporting tax expenditures it does not contain any critical commentary regarding the operation of the identified tax expenditures.⁵ Dr Burton made a number of suggestions for greater transparency for reporting tax expenditures. In brief, they are:

- A clear statement of the benchmark taxation principles against which 'tax expenditures' might be ascertained and quantified.
- Identification of all tax expenditures, including reporting on goods and services tax expenditures and matters such as tax evasion, and Commissioner of Taxation lenience for classes of taxpayers.
- Gathering sufficient 'raw' data as to enable informed critical assessment of the operation of tax expenditure, such as the number and characteristics of taxpayers who benefit; the deadweight tax compliance associated with a particular measure; and the use to which the benefit of the tax expenditure is put.
- Publication of a critical appraisal of the merits of each case which explains why the particular tax expenditure has been adopted and also why the tax expenditure has assumed the legislated form.
- The preparation of the tax expenditures report be undertaken by an independent agency.⁶

4.8 Professor Bartos submitted that:

Inclusion of detailed tax expenditure in the budget papers, preferably broken down by function in the same way as other expenditure, would be a highly desirable step forward in transparency.⁷

4.9 Treasury responded to the suggestion that detailed tax expenditures should be included in the budget papers as follows:

... publication of the TES shortly after the publication of the MYEFO [Mid Year Economic and Fiscal Outlook] means that it provides the Government with more timely input regarding tax expenditures for use in formulating the Budget. If the TES were to be published with the Budget papers it

4 Australian Department of the Treasury, *2006 Tax Expenditures Statement*, Dec 2006, p. 2.

5 Dr Mark Burton, *Submission 3*, p.4.

6 Dr Burton, *Submission 3*, pp 6-7.

7 Professor Bartos, *Submission 5*, p. 12.

would not be available in time to provide an input into the Budget planning, which commences some months before the Budget is presented, and this would detract from its use in policy formulation.⁸

4.10 Treasury also noted that the publication of a detailed TES is required by the *Charter of Honesty Act 1998* with the MYEFO and that any change would require an amendment to the Act. The suggested change, if implemented, would also have significant resource implications for Treasury.⁹

4.11 ANAO informed the Committee that its Planned Audit Work Plan 2006-2007 includes a potential performance audit examining the preparation of the TES.¹⁰

Committee's conclusions

4.12 Tax expenditures provide what is in effect a subsidy through income foregone for certain activities or categories of persons. Subsidies generally are provided by means of special appropriations and the Committee considers that the reporting of tax expenditures should be no less transparent than the reporting of special appropriations. The Committee supports the publication of the TES; it is an essential accountability mechanism.

4.13 In view of the arguments put by Treasury the Committee does not consider that there is any compelling need for a change to the timing of the publication of the TES. The Committee suggests that ANAO and Treasury examine Dr Burton's submission (see paragraph 4.7 above) to ascertain in what respects the TES could be further improved.

4.14 The Committee considers that Dr Burton's suggestions require further consideration with greater attention to be given to what is expected to be achieved from tax expenditures, processes for periodic review and exploration of notional allocation of such expenditures to other budget expenditures that fall within economic functions and sub functions.

Advance to the Finance Minister

4.15 The Advance to the Finance Minister (AFM) is an appropriation authorised by the annual Appropriation Acts which is made available to the Minister for Finance and Administration as a central contingency fund to provide urgent funding to agencies, through the year, where the appropriated funds prove to be insufficient or a new appropriation is required.

8 Mr Paul McCulloch, Acting Executive Director, Revenue Group, The Treasury, *Correspondence*, 9 January 2007.

9 Mr Paul McCulloch, Acting Executive Director, Revenue Group, The Treasury, *Correspondence*, 9 January 2007.

10 ANAO *Supplementary Submission 4b*, [p. 14.]

4.16 AFM funding should only be made available if agencies are able to meet two essential tests:

- The need for funding must be urgent; and
- The need for funding was unforeseen, or has arisen because of erroneous omission or understatement.

4.17 All applications must satisfy both legislative criteria. An advance from the AFM is only issued if it is the last available legal source of funding.

4.18 Provisions relating to the AFM are set out in Section 12 of Appropriation Acts Nos. 1 and 3 and Section 13 of appropriation Acts 2 and 4. Under Appropriation Acts Nos. 1 and 3, AFM has remained at \$175 million for a number of years and under Appropriation Acts Nos. 2 and 4, has remained at \$215 million.

4.19 Since 1 January 2005, determinations made under these provisions are registered on the Federal Register of Legislative Instruments and are tabled monthly in Parliament together with explanatory statements relating to the determinations. The determinations set down the purpose of the Advance, the agency receiving the funds, and the amount and the outcome against which the funding is appropriated. Additional information may be found in the explanatory statement, including how the determination meets the tests outlined in the legislation.

4.20 Funds from the AFM may be advanced pending the passage of the Additional Estimates or may remain as a Final Charge for the financial year. Funds provided pending the Additional Estimates may be recovered from agencies when the additional Appropriation Bills are passed. Determinations that are made as a Final Charge are not recovered from agencies during the year. Those Issues are documented in an annual report to Parliament, *Advance to the Finance Minister as a Final Charge*.

4.21 That report discloses amounts issued from the AFM that remained as a final charge to the AFM as at 30 June, including details of expenditure against each item. The reports can be found on Finance's website.

4.22 The *Advance to the Finance Minister as a Final Charge* is referred each year with the particulars of proposed expenditure to the relevant Senate (estimates) Committee for inquiry and report. After the Senate votes on the third reading of the additional appropriations bills, the Issues document is considered in the Committee of the Whole. According to *Australian Senate Practice*:

The Senate considers [statements of expenditure from advances] in committee of the whole on a motion that the statements be approved. This does not have the effect of authorising the expenditure, which is authorised

in the original appropriation. Rejection of such a motion would signify dissatisfaction with a statement as an accountability document.¹¹

4.23 Appropriations for the AMF have not increased for several years and are now much less significant as a source of funds than in the past. This may be because the additional financial flexibility provided to government agencies by the outcomes/output framework and especially the ability of agencies to carry over surpluses has alleviated their need to access the AFM.

Committee's conclusions

4.24 The Committee considers that the AFM provides a necessary level of flexibility to enable a government to meet contingencies. It considers that the means of accounting to Parliament for the use of the AFM are sufficient to enable the Parliament to scrutinise expenditure from the Advance.

Goods and Services Tax

4.25 The Government does not classify the GST as a Commonwealth Government tax, and receipts and expenditure from the GST therefore are not reported in the Commonwealth's accounts. For the same reason, as discussed earlier, tax expenditures relating to the GST are not reported in the Tax Expenditure Statement.

4.26 The Government's policy regarding the treatment of the GST in its accounts may be found in the Finance Minister's *Statement of Compliance* to the CFS.

... Australian Accounting Standard AAS31 and other relevant accounting standards would suggest the gross amount of GST and associated payments to the States and Territories be included in the Australian Government's consolidated financial statements. However, the clear policy intent of the *Intergovernmental Agreement on the Reform of Commonwealth-State financial Relations* is that the GST is a State tax collected by the Australian Government in an agency capacity. Therefore, accrued GST revenues and associated payments to the States and Territories have not been brought to account in these statements. Full disclosure of the GST collected for the States and Territories is provided in Note 46 of these statements ...¹²

11 Harry Evans, ed., *Odgers' Australian Senate Practice*, 11th edition, Department of the Senate, 2004, p. 273.

12 *Consolidated Financial Statements for the year ended 30 June 2005*, Circulated by Senator Nick Minchin, Minister for Finance and Administration, December 2005, Commonwealth of Australia, 2005, p. 33.

4.27 ANAO does not agree with the Government's treatment of the GST and has qualified its audit of the CFS on a number of occasions.¹³ ALP and Australian Democrats members of the Committee agree with the ANAO that the GST is a Commonwealth tax and should be counted as such.

Committee's conclusions

4.28 The Government publishes the gross amounts of revenue and expenses, assets and liabilities relating to the GST in a note to the CFS. Additionally, the Government, in view of the fact that all GST revenue goes to the States and is the subject of an intergovernmental agreement, provides details of the GST in Budget Paper No. 3 (Federal Financial Relations). In view of the Government's rationale for its accounting of the GST the Committee agrees that Budget Paper No.3 is the appropriate reporting vehicle for additional detail in relation to the GST.

4.29 The Committee does not consider that there is adequate detail in the data published in Budget Paper No. 3 in relation to the expenditures and purposes to which the States and Territories put the GST. The Committee considers that the level of reporting would be greatly enhanced if the States and Territories were to provide to the Commonwealth comprehensive statements of the purposes and expenditure of GST revenue that could be included in the budget documents.

Recommendation 7

4.30 The Committee recommends that the State and Territory jurisdictions provide to the Commonwealth comprehensive annual statements of the purposes and expenditures of GST revenues to enable their incorporation into Budget Paper No. 3.

Recoverable GST

4.31 Section 30A of the FMA Act provides that agencies' appropriations are increased to the extent of the recoverable GST they pay on acquisitions and importations. Finance informed the Committee that:

Annual appropriation Acts do not include allowance for GST. This approach is in line with the accepted accounting practice for GST, which specifies that revenues, expenses and assets are to be recognised net of the amount of recoverable GST.¹⁴

13 In his Independent Audit Report on the *Consolidated Financial Statements for the year ended 30 June 2005* the Auditor-General stated that the non recognition of GST revenue and expenses 'does not accord with Australian Accounting Standard AAS 31 *Financial Reporting by Governments* which requires that all of the Government's assets, liabilities revenues and expenses be recognised in its financial statements'.

14 Department of Finance and Administration, *Submission 6*, p. 16.

4.32 Finance also submitted that because agencies can only recover the amount of the payment as an input credit under the GST law, the net impact on the CRF of the GST supplement is zero, once the recoverable GST paid by agencies has been refunded by the Australian Taxation Office.¹⁵

4.33 Agencies are required to disclose in the notes to their financial statements the amount each appropriation was increased by Section 30A during the relevant reporting period.¹⁶

4.34 ANAO submitted that Section 30A of the FMA Act is a 'recycling' provision, that is, it does not provide an effective net increase in the appropriation otherwise available for expenditure on approved outcomes.¹⁷ However, ANAO emphasised that agencies should report clearly and accurately on the exercise of this and other authorities under the FMA Act, because:

Inaccuracies in reporting can provide the Government and the Parliament with a misleading impression of the extent to which an agency has actually generated additional appropriation authority through its transactions with other entities.¹⁸

4.35 The Committee considers that the treatment of recoverable GST is reasonable and that disclosure in an agency's financial statements probably provides sufficient transparency and accountability.

Funds appropriated for ordinary annual services

4.36 Any consideration of how funds intended for the ordinary annual services of the government are appropriated must begin with the relevant Constitutional provisions – Sections 53 and 54.

Constitutional provisions

4.37 Sections 53 and 54 of the Constitution read as follows:

53. Proposed laws appropriating revenue or moneys, or imposing taxation, shall not originate in the Senate. But a proposed law shall not be taken to appropriate revenue or moneys, or to impose taxation, by reason only of its containing provisions for the imposition or appropriation of fines or other pecuniary penalties, or for the demand or payment or appropriation of fees for licences, or fees for services under the proposed law.

The Senate may not amend proposed laws imposing taxation, or proposed laws appropriating revenue or moneys for the ordinary annual services of the Government.

15 Department of Finance and Administration, *Submission 6*, p. 16.

16 Department of Finance and Administration, *Submission 6*, p. 17.

17 ANAO, *Submission 4*, p. 29.

18 ANAO, *Submission 4*, p. 30.

The Senate may not amend any proposed law so as to increase any proposed charge or burden on the people.

The Senate may at any stage return to the House of Representatives any proposed law which the Senate may not amend, requesting, by message, the omission or amendment of any items or provisions therein. And the House of Representatives may, if it thinks fit, make any of such omissions or amendments, with or without modifications.

Except as provided in this section, the Senate shall have equal power with the House of Representatives in respect of all proposed laws.

54. The proposed law which appropriates revenue or moneys for the ordinary annual services of the Government shall deal only with such appropriation.

4.38 The Clerk submitted that, while the purpose of the distinction in section 54 is to identify bills that the Senate may amend directly under section 53 of the Constitution and those to which it must request amendments, the distinction is a useful tool for parliamentary scrutiny and control of expenditure in that it separates normal ongoing expenditure from other projects.¹⁹

Ordinary annual services

4.39 Professor Bartos described ordinary annual services in his publication, *Public Sector Governance Australia*, as follows:

But just what are ordinary annual services? What sorts of proposed spending can the Senate amend and what does it have to leave alone? This was the subject of much debate and disagreement for the first half of the twentieth century. The matter was finally resolved in what is known as the "Compact of 1965", an agreement between the Senate and the Executive that saw some items such as new buildings, grants to the States and new policies put into their own appropriation bill (Bill 2) that the Senate had power to amend. An amendment to the Compact was agreed with the introduction of accrual budgeting in 1999, whereby appropriations for depreciation (to allow replacement of capital equipment) were classed as "ordinary annual services".²⁰

New policies

4.40 The Clerk informed the Committee that new policies are regarded as not part of the ordinary annual services under the Compact and submitted that this part of the Compact has been violated in recent times. He submitted that:

19 Clerk of the Senate, *Submission 1*, p. 4.

20 Professor Bartos, *Submission 5*, p. 10.

Taking advantage of the nebulous nature of departmental outcomes, departments have been able to start up new policies by using ordinary annual services money.²¹

4.41 As an example, the Clerk reported that funds provided by the Government for the relief of victims of the 2004 Asian Tsunami had come from agencies' appropriations for ordinary annual services. Providing relief for this natural disaster, in the Clerk's words, could 'not possibly be an ordinary annual service of the government'.²²

Continuing activities

4.42 The Clerk's submission is based on the premise that the Senate and the executive have different views regarding whether 'continuing activities for which appropriations have been made in the past' should be classified as ordinary annual services. The Clerk submitted that the Senate's agreement with the executive on this matter:

... seems to have been taken to mean that anything falling within the statements of outcomes is an ordinary annual service, an assumption quite contrary to section 54 of the Constitution and the Compact of 1965.²³

4.43 Finance submitted that:

Under the Compact, Bill 1 contains appropriations for departmental *items and outcomes* that have previously been the subject of appropriations approved by the Parliament, excluding payments to other Australian governments and major replacement and new capital items. Bill 2 incorporates items not classified to Bill 1, including payments to other Australian governments, *administered appropriations for new outcomes* and replacement and new capital, including construction or acquisition of land, public works and buildings and major plant and equipment.²⁴ (Committee's italics)

4.44 The Clerk informed the Committee, however, that:

What the Appropriations and Staffing Committee agreed to, and what the Senate agreed to, was 'continuing activities'. The department of finance, as I understand it, is saying that what was really agreed to was 'existing outcomes', which is something quite different. 'Continuing activities' is considerably more objective and more in keeping with the original Compact of 1965 than 'existing outcomes'.²⁵

21 Clerk of the Senate, *Submission 1*, p. 4.

22 Clerk of the Senate, *Submission 1*, p. 4.

23 Clerk of the Senate, *Submission 1*, p. 4.

24 Department of Finance and Administration, *Submission 6*, p. 8.

25 Clerk of the Senate, *Committee Hansard*, 8 September 2006, p. 14.

4.45 With regard to Finance's interpretation that the Compact applies only to administered items the Clerk stated that:

... regardless of whether things are administered expenses or departmental expenses, the principle which the senate and its committees set down in earlier decisions was that all appropriations for new policies would be in bill No. 2.²⁶

Suggested remedy

4.46 Professor Bartos submitted that a diminution in the number of appropriation items for non-annual services has been underway for many years. He submitted that:

One of the problems for the scrutiny of the budget by the Senate is that adherence by the executive to the 1965 Compact is difficult to monitor. It depends on a number of factors including:

Knowledge by departments/agencies of the significance of the distinction between ordinary annual services and non-annual services

Willingness of the executive to ensure that they comply (including through promulgation of regulations or Finance department orders)

Senate committees themselves being aware of the significance of the issue and raising it in their estimates hearings at budget time.²⁷

4.47 Professor Bartos elaborated on these factors as follows:

The high rate of staff turnover, especially in budgeting/finance areas of government agencies, gives rise to the possibility that awareness is low...The second question, Department of Finance and Administration monitoring and enforcement of the split, is an area the committee should probably explore with that department in due course.

4.48 He suggested that:

Audit coverage of the budget documents would be one way of strengthening monitoring of not only this but many other aspects of the accuracy and reliability of budget reporting, but it would have huge resource implications for the ANAO and in any case is unlikely to be adopted by the executive government.²⁸

4.49 ANAO referred to the differing views in relation to the Compact and quoted from a submission made to the High Court in *Combet v Commonwealth of Australia* which was to the effect that the Compact is a political agreement and that it is non-justiciable. ANAO concluded that:

26 Clerk of the Senate, *Committee Hansard*, 8 September 2006, p. 7.

27 Professor Bartos, *Submission 5*, p. 10.

28 Professor Bartos, *Submission 5*, pp. 10-11.

In this light, and consistent with long-standing practice, the Compact, and its interpretation, are properly matters for the Parliament to resolve.²⁹

4.50 The Senate Standing Committee on Appropriations and Staffing has been considering this matter for some time, since late 2005,³⁰ but apparently agreement has not been reached with the Government because a report has not been presented to the Senate.

4.51 A member of the Committee queried whether, in view of the tension between the Senate and Finance, the Senate and the government and the Senate and the House of Representatives with respect to money bills, a statement by the President should not accompany appropriation bills which would declare how the Senate views the bills:

I am very sympathetic to the idea that ordinary annual services bills should be swept through ... But the real issue is new programs and changes to programs and it tends to be very grey in [those] areas. That is another one [recommendation] we could suggest which would sharpen the focus for the consideration of appropriation bills.³¹

4.52 Professor Lindell suggested that the Senate might wish to consider whether the wording of the Compact of 1965 should be altered to strengthen the restriction which seeks to ensure that capital expenditure and expenditure for new services are not dealt with in the Appropriation Acts No. 1.³²

Committee's conclusions

4.53 The suggestions that have been discussed above are worthy of consideration. However, given the potential for disagreement (or misunderstanding) that exists in relation to this issue, the Committee suggests that the Senate continue to work to clarify those matters that should be included in the annual appropriation bills.

Recommendation 8

4.54 The Committee recommends that the Senate continue to seek clarification from the Government as to which items the Government believes should be included in the different appropriation bills. The Senate should then form a view as to the appropriateness of the split. When any differences are resolved to the satisfaction of the Senate, the Department of Finance and Administration should be required to monitor and enforce the split.

29 ANAO, *Submission 4*, p. 40.

30 Clerk of the Senate, *Submission 1*, p. 8.

31 Senator Murray, *Committee Hansard*, 12 October 2006, p. 14.

32 Professor Lindell, *Submission No. 10*, p. 10.

Recommendation 9

4.55 The Committee recommends that the Standing Committee on Appropriations and Staffing should report expeditiously on its negotiations with Government in relation to the appropriate split of items of expenditure in the different appropriation bills so that the issue may be considered by the Senate.

Recommendation 10

4.56 The Committee recommends that the Clerk advise the President of the Senate with respect to concerns about the matters included in periodic Appropriation bills and that the President table a statement accompanying the bills or return the bills to the House of Representatives or to the minister for clarification, elucidation or adjustment.