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Submission to Tax Expenditure Statement Consultation

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We welcome the opportunity to comment on the Tax Expenditure Statement (TES) Consultation Paper.

Tax expenditures are government revenues foregone because certain activities or classes of taxpayers receive preferential tax treatment. Tax expenditures can take many forms including exemptions, deductions, concessional rates or deferral of tax liabilities.[1]

Estimates of tax expenditures inform public discussion of the cost of tax concessions. Because tax expenditures are inherently more difficult to measure and observe than government spending, they do not attract the same scrutiny, despite their often large budget impact. The annual TES provides a regular assessment of the size and scope of these expenditures. Ultimately, this improves the transparency and accountability of government.

This submission addresses three particular issues raised in the consultation paper and presents our views on whether and how the TES can be improved.

1.1 Choice of benchmark

We commend the Government for retaining the income tax benchmark for estimating expenditures for savings tax concessions. Some argue that concessional tax treatment of savings, relative to other income, is a desirable structural feature of the tax system so tax expenditures should be measured from an expenditure rather than an income tax benchmark. But the income benchmark remains the best measure of the revenue costs of providing these concessions. Policy arguments in favour of the concessional tax treatment of savings should be kept separate from the question of how the costs of these concessions are measured.[2]

Treasury's existing approach of separately publishing "revenue gain" estimates for major tax expenditures addresses criticisms that that the standard "revenue foregone" approach to estimating tax expenditures ignores behaviour change. But requiring all tax expenditures be reported net of behavioural changes would substantially increase the complexity and cost of the calculations.

1.2 Priority topics for more detailed analysis in the TES

We also endorse the proposal to periodically publish more detailed analyses of selected issues relating to the TES. More detailed analysis would help the public evaluate the cost, effectiveness and distributional implications of large tax expenditures.

Topics that should be prioritised for more detailed analysis include:

1. **Estimating the net fiscal impact of superannuation tax concessions, including fiscal savings from reduced Age Pension outlays.** We endorse the Government's primary objective for superannuation, first proposed by the Financial System Inquiry[3], for the superannuation system to "provide income in retirement to supplement or substitute for the Age Pension". Understanding how superannuation tax expenditures reduce future pension liabilities is central to evaluating the effectiveness of these tax breaks in supporting this objective. Treasury already has the modelling capability to do this: it previously prepared estimates of the long run fiscal

[1] Treasury (2015), p.3; Brixi, *et al.* (2004), p.3.

[2] Daley, *et al.* (2015)

[3] Financial System Inquiry (2015), p.4.

impact of increasing the Super Guarantee rate to 12 per cent as part of the Cooper Review.[4]

2. **Projecting the long-term costs of superannuation tax breaks over the same time scale as the *Intergenerational Report*.** Superannuation tax breaks are a large and growing cost to the budget bottom line at a time when the Commonwealth Budget faces substantial long-term challenges.[5] The annual revenue lost in superannuation tax breaks -- after accounting for potential behaviour change and the interaction between contributions and earnings tax breaks -- is over $25 billion.[6] Population ageing will only add to the budgetary cost of superannuation tax breaks over time as a larger share of Australians become eligible for tax-free super earnings in retirement.[7]

3. **Projecting the lifetime benefits of superannuation tax breaks vis-à-vis Age Pension payments among taxpayers across the income distribution.** Treasury has previously published projections of the lifetime distribution of super tax breaks, including in the 2016-17 Budget.[8] Future estimates would ideally account for post-tax contributions, and allow for people to move up and down the income distribution through their working life.[9] Estimates should also be accompanied by sensitivity analysis around life expectancy and draw-down rates that can significantly affect the distribution of the lifetime benefits of superannuation tax breaks estimates, especially for high-income earners.[10]

4. **Estimating the net benefits received by different age cohorts from superannuation tax breaks and other large tax expenditures each year, and projecting forward the average lifetime benefits received from major tax expenditures for each generation.** Tax expenditures, particularly for superannuation, have become increasingly generous over time[11], despite recent changes announced in the 2016-17 Budget.[12] Yet there is little analysis of the impact of tax expenditures on different generations, and for intergenerational equity. Grattan Institute's report, *The Wealth of Generations*, showed that households aged 65 and over pay less income tax in real terms today than did households of the same age 20 years ago, even though both their workforce participation rates and their incomes have jumped.[13] Decisions by the former Coalition Government to abolish taxes on superannuation withdrawals for those aged over 60 years in 2007, together with generous tax offsets only available to

[4] Cooper Review (2013), p.11.
[5] Daley, *et al.* (2013); Hockey (2015); Daley and Wood (2015).
[6] Daley, *et al.* (2015), Section 2.8.
[7] Rice Warner (2015), p.23 projects that the share of superannuation assets held in (tax-free) retirement pensions will rise from 32 per cent in 2014 to 38 per cent in 2029.
[8] Treasury (2016), p.4; Treasury (2012).
[9] Although as Daley, *et al.* (2015) (p.35) notes, incorporating income mobility won't completely change the outcomes. For example analysis of HILDA suggests that people of prime working age who are in the top income decile in any single year spent 85 per cent of the 13 years in which data was collected among the top 30 per cent of income earners. Overseas studies confirm the finding that most high-income earners in a given year tend to stay towards the top of the income distribution for most of their working lives
[10] For example, Industry Super calculates that superannuation tax breaks for the top 5 per cent of income earners are worth more than $2 million for men over their lifetimes The projected lifetime cost of super tax breaks for single women in the top 5 per cent of income earners is $1.6 million.
[11] Parliamentary Library (2014)
[12] Parliament of Australia (2017); Daley, *et al.* (2016b)
[13] Daley, *et al.* (2014), p.27.

older Australians – such as the Seniors and Pensioners Tax Offset – have reduced the income tax bills of older Australians.[14] These budgetary decisions have been funded by deficits. The accumulating debt burden will disproportionately fall on younger households who are unlikely to be able to access the same benefits from these tax expenditures due to their unsustainable budgetary costs.[15]

5. **Estimating the value of the CGT exemption for the family home allowing for deductibility of mortgage interest and capital works deductions against the CGT cost base.** Grattan Institute and others have canvassed making owner-occupied housing liable for capital gains tax in order to help fix the Commonwealth Budget and improve housing affordability.[16] Yet it is difficult to estimate the budgetary impact of doing so, especially if mortgage interest payments were made tax deductible (given taxation of the gains), which could wipe out most of the benefit to the budget.

1.3 More detailed explanation of the data and methodologies for estimating large tax expenditures

Finally, we support the Treasury publishing more detail on the benchmark, methodologies and data employed to produce estimates of selected large tax expenditures. The methodologies for estimating of tax expenditures are often opaque. Providing more detail on how these tax expenditures are estimated would build public confidence in the accuracy of the estimates. Further detail would also counter often spurious criticism of tax expenditure estimates by special interests.[17]

To reduce demand on Treasury resources, more detailed technical descriptions of how particular tax expenditures are estimated could be published periodically as part of the selected issues series discussed at Section 1.2 above.

[14] Daley, *et al.* (2016a), p.10.
[15] Daley, *et al.* (2014), p.29.
[16] Daley, *et al.* (2013), pp.40-41; Kelly, *et al.* (2013); Yates (2016)
[17] For example, see Clare (2015); ASFA (2015).

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