Senate Finance and Public Administration Legislation Committee
ANSWERS TO QUESTIONS ON NOTICE
BUDGET ESTIMATES 2013-2014

Prime Minister and Cabinet Portfolio

Department/Agency: Australian National Audit Office
Outcome/Program: Performance Audit Services
Topic: Treasury Tax Reporting Procedures
Senator: Corman
Question reference number: 56
Type of question: Hansard – Page 29 - 30, Tuesday, 28 May 2013
Date set by the committee for the return of answer: 12 July 2013

Number of pages: 3
Question:

1. What did your audit cover in terms of reviewing the methodologies used by Treasury and ATO to estimate tax expenditures.
2. You include in your summary of findings a conclusion that there has been no measureable improvement of the reliability and quantification of the Treasury's tax expenditure estimates over time. Does that finding cover your assessment of how Treasury and the ATO are treating tax concessions for superannuation?
3. In coming to that conclusion, you would have looked behind the methodology used by Treasury for various items given that the so-called tax concessions on superannuation are the biggest item. Does that come under your finding that there has been no measurable improvement to the reliability and quantification?

Answer:

Q1. The audit did not review the methodologies used by the Treasury and ATO to estimate tax expenditure items.

The objective of the audit was to assess the extent to which the Treasury and the ATO have improved the management of tax expenditure estimates by implementing the six recommendations in the 2008 ANAO audit and the three recommendations made by the JCPAA following its inquiry.[1]

Accordingly, when examining particular tax expenditure items, the ANAO's focus was on assessing the implementation of the relevant recommendations of the 2008 ANAO audit and the 2009 JCPAA report. In this regard, we examined the Treasury's:

- processes and results in assessing (rating) the reliability of the estimates of the value of tax expenditure items contained in TES 2011 (Recommendation No. 6 from the 2008 ANAO audit);

[1] Joint Committee of Public Accounts and Audit, Report 414, *Review of Auditor-General's Reports tabled between August 2007 and August 2008,* June 2009.

- reviews of tax expenditure items (Recommendation No.1. from the 2008 ANAO audit); and
- application of the revenue gain method (Recommendation No.5 from the 2008 ANAO audit and Recommendation No. 7 from the 2009 JCPAA report).

The ANAO did not systematically consider the appropriateness of the models underpinning the calculation of the 364 tax expenditure items reported in TES 2011. The 2008 audit emphasised the fine judgements that had to be made in modelling individual tax expenditure items, particularly relating to the determination of the 'benchmark' or normative taxation system to which each tax measure must be compared. These benchmarks were critical to the quantification of tax expenditure items but can be arbitrary. In this context, the 2008 audit recommended the Treasury develop standards relating to the reporting of tax expenditures (Recommendation No.3) which we followed up in the 2013 ANAO audit (paragraphs 2.22 – 2.28). In assessing the accuracy and completeness of tax expenditure estimates, the 2008 audit, therefore, focused on the reliability of the data used in the modelling of each item, and the extent of unquantified items. Consequently, this was an area of focus for the 2013 ANAO audit (and discussed in Chapter 4 – Quality of Tax Expenditure Estimates).

Q2. Yes, it covers: a lack of improvement in the reliability of superannuation estimates; a lack of review of the main superannuation items; and problems with the revenue gain estimates for superannuation. With respect to the two largest superannuation estimates (concessional taxation of employer contributions (C5) and concessional taxation of entity earnings (C6)):

- the reliability of C5 was rated *medium* in TES 2011, unchanged since TES 2008. C6 was rated *low* in TES 2011 (also unchanged since TES 2008) due to the unverifiable data assumptions associated with the pension phase, which typically comprised around 20 per cent of the total tax expenditure. However, unverifiable assumptions in relation to tax expenditure items were treated inconsistently (as outlined in paragraph 4.46 of the 2013 ANAO report).
- items C5 and C6 were reviewed by the ATO in late 2009 but not substantively. As explained in paragraphs 3.11 and 3.12 of the 2013 ANAO report the reviews used 'a simplified assessment that contained no analysis'. The reviews referred to the work conducted as part of the *Australia's Future Tax System* review or (in one case) amendments before Parliament relating to the tax expenditure.
- the ANAO queried the behavioural assumptions for the revenue gain estimate of C5 (as outlined in paragraphs 4.30 and 4.31 of the 2013 ANAO report). For example, in respect of C5, total employer contributions are assumed to fall by 20 per cent, and the average marginal tax rate is reduced by one per cent. In October 2012, ANAO queried the bases on which these assumptions were made, as there was no documentation available to support the assumptions.

Q3. The primary evidence was the examination of Treasury's own reliability estimates over time, as discussed in paragraphs 4.41 and 4.42 and Table 4.3 of the 2013 ANAO report.

The 2008 ANAO audit estimated the reliability of each of the quantifiable estimates reported in 2006. In undertaking this assessment, ANAO developed a table containing six categories (ranging from very low to high), and a description of models that may fit within each of the categories. Since 2008 (and the introduction of reliability ratings), this table has been published in the annual TES, and been used as an assessment tool by both the ATO and the Treasury. This table is set out in Appendix 4 (page 99) of the 2013 ANAO report.

To assess these reliability estimates, the ANAO examined the 20 largest items in TES 2011 using the revenue foregone method (covering 77 per cent of the total value of tax expenditures in that year) and all 10 revenue gain estimates. The testing examined the methodologies for the ratings and processes for their improvement. This analysis identified inconsistencies in the approach taken by analysts within the Treasury and the ATO to assigning reliability ratings to estimates and found that the Treasury had not developed a formal, documented approach to prioritise improvements to reliability.