

## SENATE FINANCE AND PUBLIC ADMINISTRATION COMMITTEE

### **Inquiry into Transparency and Accountability of Commonwealth Public Funding and Expenditure**

#### **Submission by Dr Mark Burton, Law School, University of Canberra**

##### **Introduction**

For the purposes of this submission I wish to focus upon the transparency of tax expenditure reporting in the Commonwealth budget.

The key items of this submission are:

1. In framing its report upon the matters identified in the terms of reference, the Committee must identify what concept of ‘transparency’ it is applying. There are at least two concepts of transparency. One is restricted to providing sufficient information regarding the national economy and public finances as to enable private markets to operate efficiently. Although there are some limitations of the current practice, the current Australian practice of tax expenditure reporting broadly complies with this standard. A second concept of transparency holds that the provision of information by government to the public should enable the active, informed participation of the general public in the scrutiny of the budget;
2. If this ‘participatory’ concept of transparency is adopted, I suggest that the current approach to tax expenditure reporting is inadequate because:
  - a. it does not comprehensively inform interested parties of tax expenditures provided under Commonwealth legislation and under the administration of that legislation;
  - b. it does not provide sufficient information as to enable critical consideration of tax expenditures included within the budget; and
  - c. there are grounds for questioning the independence of the Australian Treasury and this threatens the perceived legitimacy of the tax expenditure reporting process. The nature of the agency responsible for preparing the tax expenditure statement should be reconsidered if the tax expenditure statement is to embody a credible, critical report upon the government’s tax expenditure program.

I have attached two research papers which I have published in the past year with respect to the subject of the Committee’s inquiry:

1. the first paper, ‘Is participatory tax transparency in Australia achievable?’ (2006) 4(3) *Tax Notes International* 333-357, outlines different approaches to the definition of transparency; and
2. the second, ‘Making the Australian Tax Expenditures Statement an Effective Policy Instrument – From Fiscal Record to Transparent Report’ (2005) 8 *Journal of Australian Taxation* 1-68, describes the shortcomings of the Australian tax expenditures statement if it is considered to be a tool for enhancing the critical consideration of the government’s tax expenditure program by the body politic.

In the following pages I outline the key points of these papers as they apply to the subject of the Committee's inquiry – enhancing Parliamentary scrutiny of the Commonwealth budget. The points outlined below are developed more fully in these research papers.

### **What is a tax expenditure?**

A tax expenditure is a departure from a defined benchmark or normative taxation system. Such departures might be positive (ie a tax concession) or negative (ie 'overtaxation'). Definitions of the benchmark may vary. The Australian Treasury applies a modified Schanz-Haig-Simons definition of economic income as the basis for the benchmark.<sup>1</sup>

Although the concept of tax expenditure reporting has its critics, it was promoted by Stanley Surrey in an effort to bring greater transparency to budget deliberations in the United States of America. In particular, Surrey was frustrated with a perverse budgetary process which saw tax concessions escape budgetary review while expenditure programs were subjected to intense scrutiny. Surrey hoped that, by exposing tax expenditures as another part of the government's spending program, such 'spending' would be subjected to the same scrutiny as 'normal' spending programs.

### **The concept of transparency**

It is clear that Surrey had in mind the close scrutiny of tax expenditures, but in the context of his era he envisaged that such tax expenditure analysis would be undertaken behind closed doors by an independent Treasury Department and/or Congressional committee. Surrey's legacy has therefore been a limited concept of tax expenditure reporting which focuses upon the mere identification and quantification of tax expenditures – he considered that this would be enough to trigger close, independent scrutiny of each tax expenditure by independent Treasury experts. However, the Australian experience suggests that the mere listing and quantification of tax expenditures has done little to prompt such critical scrutiny.

The question, then, is whether the mere listing and quantification of tax expenditures, as is currently undertaken by the Australian Treasury, meets a concept of transparency which is sufficient to enable the scrutiny of the Commonwealth budget by Parliament and also by the general public. It is therefore necessary to elaborate upon the concept of transparency.

The concept of budget transparency has been interpreted in various ways and it is necessary to consider two of the more important interpretations in framing this submission.

One interpretation of transparency dictates that the provision of budget information be sufficient to enable private markets to efficiently allocate resources. This market oriented concept of transparency requires the provision of relatively minimal information detailing budgeted expenditure and revenue items sufficient to enable investors to ascertain the nature and extent of public intervention in private investment decisions. Thus, for example, provision of information regarding the

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<sup>1</sup> Commonwealth of Australia, *Tax Expenditures Statement 2005*, Treasury, Canberra, 2005, 19ff.

nature and quantum of tax expenditures is sufficient under this market oriented concept of transparency. This market oriented approach is emphasised in the literature upon budget transparency published by the International Monetary Fund and the Organisation for Economic Cooperation and Development. In such literature, one finds only fleeting reference to a second, participatory concept of transparency.<sup>2</sup>

This second concept of transparency holds that a budget will be 'transparent' if it enables members of the body politic to play an active, informed role in public policy making. This concept of transparency entails the provision of information sufficient to satisfy the market oriented concept of transparency outlined above, but moreover necessitates the provision of credible descriptive and critical commentary upon the nature and effectiveness of budget programs. Only when armed with such information can a member of the general public assess whether the provision of public funds to a particular societal group produces wider benefits for the community.

More specifically, the participatory concept of transparency entails adherence to the following principles:

1. that there be a commitment to active engagement on the part of those ultimately responsible for public policy;
2. there be broad rights of the citizenry to access information, provide feedback, be consulted and actively participate in policy making;
3. that information provided to the citizenry should be objective, complete and accessible;
4. that mechanisms for promoting active engagement on the part of the citizenry should be adequately resourced;
5. there must be appropriate feedback provided to those engaged in the consultation process; and
6. governments should adopt measures which build the capacity of citizens to actively engage in the process of shaping public policy. (OECD, *Citizens as Partners*, OECD, Paris, 2001, 15).

This 'participatory' concept of transparency is better adapted to the policy making realm because it enables critical consideration of public policy decisions, and therefore draws the public focus to the substantive quality of the policy measure. By contrast, the market oriented concept of transparency merely focuses upon the reporting of substantive decisions and is not directed towards critical consideration of public policy decisions by the general public.

### **Why the participatory standard of transparency should be preferred**

I submit that the second, participatory, concept of transparency should be adopted for the purposes of this inquiry. The inquiry's terms of reference include improvement to Parliamentary oversight of the Commonwealth budget. As Parliament is the form in which public policy is, at least theoretically, determined, the participatory concept of transparency is more appropriate than the market oriented concept of transparency.

Moreover, the adoption of the participatory concept of transparency is consistent with the promotion of greater public engagement in the political process (see, for example,

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<sup>2</sup> Aside from my attached paper, see also Mary Condon and Lisa Philipps, 'Transnational Market Governance and Economic Citizenship: New Frontiers for Feminist Theory' (2006) 28 *Hastings Law Journal* 101.

OECD, *Citizens as Partners*, OECD, Paris, 2001). Such wider public engagement is thought to have a number of benefits, including:

1. enhanced perceived legitimacy of government, and hence less social unrest/voluntary compliance with law; and
2. better policy, informed by the viewpoints and expertise of the wider community.

Indeed, in the taxation context, there is some evidence of a need to restore public confidence in the taxation system and one step in this direction would be to adopt the participatory standard of transparency in the context of oversight of the Australian taxation system.

### **The current official approach to the transparency norm, as evidenced by the practice of tax expenditure reporting**

Current Australian practice with respect to tax expenditure reporting evidences the official view that a market oriented concept of transparency is sufficient. As such, the Commonwealth *Tax Expenditures Statement* comprises an itemised list of many Commonwealth tax expenditures with a brief description of each item. Most importantly for present purposes, there is no critical commentary regarding the operation of the identified tax expenditures.

It might be suggested that such critical commentary is to be found in the Regulation Impact Statement accompanying the legislation which introduced any particular tax expenditure. Unfortunately, this is not the case. Ideally, a tax expenditure analysis would be undertaken prior to the introduction of a proposed tax expenditure measure, and should be updated annually with the update included in the tax expenditure statement accompanying the budget papers. However, this ideal process of tax expenditure review is precluded by the Government's policy regarding Regulation Impact Statements. Those requirements are less onerous with respect to taxation legislation, and so such comprehensive critical analysis of the policy underlying the taxation measure and its effectiveness is not required. Moreover, there is no systematic process by which such measures are subject to transparent, open and critical review. Even where some measures are reviewed by the Board of Taxation, the Board's interpretation of its terms of reference means that it restricts its post implementation reviews to technical issues rather than the broader tax expenditure analysis.

Thus, for example, consider the legislative process adopted with respect to the recently introduced entrepreneurs' tax offset. These measures were not subjected to broad community input, the Explanatory Memorandum noting that 'the Department of Prime Minister and Cabinet and the ATO have been consulted on this issue. In view of the requirement to introduce legislation on 9 December 2004, there is not sufficient time to consult more widely.'<sup>3</sup> On the basis of vague claims, untested in the public arena, the government expected to provide another \$125 million per annum to small business.<sup>4</sup> In fact the *Tax Expenditures Statement 2005* put this figure at \$380 million for the 2006/07 income year (Commonwealth, 2005: 82 Item B23).

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<sup>3</sup> Explanatory memorandum accompanying *Tax Laws Amendment (2004 Measures No. 7) Act 2005*, para 1.63.

<sup>4</sup> Id.

To date, no tax expenditure analysis of this measure has been made public. Further, in the absence of any ongoing and systematic review function, such measures escape scrutiny. The same might be said about the other components of the government's \$1.5 billion per annum small business tax expenditure program. Despite the scale of this spending program, there is no accountability as to its effectiveness.

### **The Agency responsible for preparing the Tax Expenditures Statement**

At present the tax expenditures statement is prepared by the Australian Treasury. Sadly, there is good reason to doubt the capacity of Australian Treasury to deliver an independent critical appraisal of the government's tax expenditures. Thus, for example, the current Secretary to the Treasury, Dr Ken Henry provided a surprisingly frank interview to *The Canberra Times* in which he detailed what he considers to be his Department's responsibility for eliminating/minimising the release of information which is damaging to the government (*The Canberra Times*, 2006). For the sake of accuracy, I have extracted the relevant part of the report of the interview in its entirety:

Another issue he nominates for the department is freedom of information requests about the development of government policy. "The way this is going, there are only two possible consequences I can see for this department," he says. "I'm satisfied, having reviewed a number of them, that by and large they have been motivated by a desire to either embarrass the Government and Treasurer, or the department. "Now it is not my role to help people embarrass the Government. So how am I going to respond? There are two likely responses. The first is that you will see Conclusive Certificates, stating conclusively that it is not in the public interest for the information to be released, issued on every one of them. That's very likely." The second response, which he says is already happening, is that documents will not be produced. Communication on sensitive policy issues will be verbal. "Communication with the Treasurer is obviously vital. But, because of FOI, records are not always kept." Yet Henry says he thinks it is "very important that records are kept of oral communication with ministers and ministers' offices and that there is an accurate recording of not just the decision, but the considerations underlying the decision". FOI requests cannot be made for Cabinet documents but Henry says he can't just stamp Cabinet-In-Confidence on a document to keep private. "It has to be a document of the Cabinet which seems to mean that at least it has been noted in the Cabinet decision. "Well, I can't remember a Treasury briefing to a treasurer for a Cabinet meeting that's ever been noted in a Cabinet decision. "So somebody needs to think through the implications of the increasingly aggressive use of FOI for record keeping in departments like this one. "And I can tell you it is having an adverse impact on record keeping."

Aside from such statements, there is enough objective evidence to indicate that at least some within the Australian Treasury reject the proposition that the general community, and presumably the Australian Parliament, have a right to be informed about the operation of the Australian taxation system. Such objective evidence includes:

1. the circumstances surrounding the *McKinnon* litigation (currently on appeal to the High Court); and

2. my personal experience in having my informal request to the secretariat of the Board of Taxation (Treasury) for a copy of a KPMG report with respect to community consultation upon tax reform, prepared at the request of the Board of Taxation, rejected by anonymous email.

Unless the independence of those responsible for the preparation of tax expenditures statements can be assured, the value and legitimacy of such statements will be jeopardised. For this reason, in the United States of America different branches of government prepare separate tax expenditures statements, and there is much to be learnt from the differing statements in terms of their conceptual framework, methodology and breadth.

### **What does participatory transparency entail in the context of tax expenditures reporting?**

In the context of tax expenditure reporting, participatory transparency would entail:

1. A clear statement of the benchmark taxation principles against which 'tax expenditures' might be ascertained and quantified. This benchmark would most profitably take the form of a charter of taxation principles against which the Australian taxation law might be measured. Such a Charter was recommended by the Review of Business Taxation but has not been adopted;
2. Identification of *all* tax expenditures. At present, the Australian tax expenditures statement is defective for a number of reasons, including:
  - a. the exclusion of the Goods and Services Tax upon the basis that the revenue from this taxing measure is transmitted to the States and Territories. This ignores the fact that the Goods and Services Tax is Commonwealth legislation and therefore should be included within the scope of the Commonwealth's tax expenditures reporting; and
  - b. at present the tax expenditures statement only refers to express legislative measures – it does not refer to other departures from the Schanz-Haig-Simons definition of income such as tax evasion (it being generally accepted that small business is a significant perpetrator of criminal tax evasion)<sup>5</sup> and administrative tax concessions such as the Commissioner of Taxation's lenience with respect to small business debt.<sup>6</sup> Such information would be of benefit with respect to consideration of the efficacy of other small business tax expenditures or of the tax system more generally. For example, the recognising the level of small business tax evasion/tax planning may induce consideration of small business presumptive taxation;
3. Gathering sufficient 'raw' data as to enable informed critical assessment of the operation of the tax expenditure. Such data would include:
  - a. the number and characteristics of taxpayers who benefit from the tax expenditure;

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<sup>5</sup> Australian National Audit Office, *The ATO's Strategies to Address the Cash Economy*, Report No 30, 2005-06, ANAO, Canberra, 2006, para 1.15; David E.A. Giles and Lindsay M Tedds, *Taxes and the Canadian Underground Economy*, Canadian Tax Foundation, Toronto, 2002, 36; see also James Alm, Jorge Martinez-Vazquez and Friedrich Schneider, '“Sizing” the Problem of the Hard to Tax', in James Alm, Jorge Martinez-Vazquez and Sally Wallace (eds), *Taxing the Hard to Tax*, Elsevier, London, 2004, 11 at 13.

<sup>6</sup> Inspector-General of Taxation, *Review into the Tax Office's Small Business Debt Collection Practices*, Commonwealth of Australia, Canberra, 2005

- b. the deadweight tax compliance costs associated with the particular measure (in order to assess whether government assistance might be rendered by a less expensive means and also whether a legislative purpose of reducing compliance costs<sup>7</sup> has been achieved); and
  - c. the use to which the benefit of the tax expenditure is put (for example, do small business taxation expenditures promote small business growth and investment, or is the benefit of such expenditures applied to private consumption? If the latter, there would be a good case for considering whether the particular tax expenditure should continue in its current form);
4. Publication of a critical appraisal of the merits of each tax expenditure which explains why the particular tax expenditure has been adopted and also why the tax expenditure has assumed the legislated form; and
  5. that the preparation of the tax expenditures report be undertaken by an independent government agency.

I urge you to consider the adoption of these measures in order to enhance Parliamentary, and public, scrutiny of the Commonwealth budget papers.

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<sup>7</sup> Commonwealth of Australia, *A Post-implementation Review of the Quality and Effectiveness of the Small Business Capital Gains Concessions in Division 152 of the Income Tax Assessment Act 1997*, The Board of Taxation, Canberra, 2005, 8.