

MAKING THE AUSTRALIAN TAX EXPENDITURES STATEMENT AN EFFECTIVE POLICY INSTRUMENT – FROM FISCAL RECORD TO TRANSPARENT REPORT

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Tax expenditures reporting has attracted a good deal of attention following upon the seminal work of Stanley Surrey, who developed the tax expenditures statement (“TES”) as a fiscal management tool. Although Australia has adopted some form of tax expenditures reporting for some time, the nature and efficacy of the Australian tax expenditures statement has attracted little critical attention. This article argues that a TES which meets Surrey’s fiscal management imperative by merely identifying tax expenditures and quantifying their extent, fails to provide the information necessary for a transparent tax expenditure analysis. This article therefore argues that the TES should be reconceived in terms of an annual critical appraisal of the operation of the tax system. Whilst retaining the benefits of tax expenditures reporting as originally conceived by Surrey, this approach to tax expenditures reporting would enhance fiscal transparency in the sense of promoting participatory democracy and, hopefully, promote taxation legislation with stronger and clearly stated policy foundations.

1. INTRODUCTION

Sound public administration is, in part, founded upon publicly accessible information regarding the distribution of government moneys within the community.¹ The Federal Government of the

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¹ For recent international consideration of the transparency imperative see: International Monetary Fund, *Manual of Fiscal Transparency* (2001) (“IMF Report”); available at: <http://www.imf.org/external/np/fad/trans/manual/sec02a.htm#h2.1.3>. OECD,

United States and the Republic of Germany² were the first to formally recognise that the concessional treatment of taxpayers under the tax system was effectively another form of government expenditure.³ These countries adopted the practice of issuing an annual statement of tax concessions for the purpose of enhancing the annual budget deliberations⁴ and annual tax expenditure statements are now prepared in a number of Organisation of Economic Cooperation and Development (“OECD”) countries.⁵ Tax concessions were recognised as a part of the Australian Government’s spending program in the 1968-1969 budget papers, but it was not until the mid-1970s that tax expenditure reporting was routinely adopted. Since the early 1980s the Australian Treasury has prepared a Tax Expenditure Statement (“TES”) detailing the revenue

OECD Best Practices for Budget Transparency (2001) (“OECD Practices”) sets out some general principles with respect to tax expenditure reporting. These principles were elaborated more recently in OECD, *Best Practice Guidelines – Off Budget and Tax Expenditures* (2004) (“OECD Guidelines”).

² H Ault, “Steuervergünstigungen in der Bundesrepublik Deutschland und den USA” (1974) 5 *Steuer und Wirtschaft* 335, cited in S Surrey and P McDaniel, “The Tax Expenditure Concept and the ‘Budget Reform Act of 1974’” (1976) 17 *Boston College Industrial and Commercial Law Review* 679, 679 n3. See also H Shannon III, “The Tax Expenditure Concept in the United States and Germany: A Comparison” (1986) 33 *Tax Notes* 201.

³ For elaboration of the development of the tax expenditure concept in the United States of America, see S Surrey, *Pathways to Tax Reform* (1973) (“Surrey, Pathways”).

⁴ At best, in the United States these tax concessions have merely been considered when determining budgetary allocations for each function of government. For discussion of this see: V Thuronyi, “Tax Expenditures: A Reassessment” [1988] *Duke Law Journal* 1155.

⁵ For reviews of tax expenditure accounting practices in a range of OECD countries see: OECD, *Tax Expenditures: A Review of the Issues and Country Practice* (1984); OECD, *Tax Expenditures: Recent Experiences* (1996) (“OECD Experiences”); OECD, *Revenue Statistics* (2003); and H Polackova Brixí, C Valencuc and Z Swift (eds), *Tax Expenditures – Shedding Light on Government Spending Through the Tax System: Lessons From Developed and Transition Economies* (2004).

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forgone as a result of a variety of concessions under the Commonwealth tax system.⁶

At present, Treasury figures suggest⁷ that the amount of measured tax expenditures⁸ has declined and will continue to decline as a percentage of GDP – down from 4.5% in 1999-2000 to 3.8% in 2007-2008.⁹ Further, *measured* tax expenditures as a percentage of total government expenditures are declining.¹⁰ Although apparently in decline, the Treasury figures suggest that tax expenditures are a substantial component of the Commonwealth fiscal framework, amounting to approximately \$32.6 billion in the 2004-2005 income year.¹¹ Clearly, with this much at stake, there is good reason for the Government and members of the public alike to query whether it is receiving value for money from this massive “spending” program. Further, it must be recognised that self-seeking taxpayers will weigh the relative costs (in the broadest sense) of tax compliance, tax flight, tax avoidance, obtaining tax concessions through political channels and obtaining administrative concessions.¹² It is reasonable to expect that an effective tax administration willing to enforce tax compliance

⁶ For a brief account of the development and use of the tax expenditure concept in the Australian context see Economic Planning and Advisory Committee, *Tax Expenditures in Australia* (1986).

⁷ Note the substantial caveats set out by Treasury with respect to the quantification of tax expenditures: Commonwealth, *Tax Expenditures Statement 2004* (2005) 16-17 (“Tax Expenditures”).

⁸ Note that not all tax expenditures are measured by Australian Treasury, and so the tax expenditure budget is possibly larger than the Treasury figures suggest. This is one of several weaknesses of the Tax Expenditures Statement 2004.

⁹ Tax Expenditures, above n 7, 8; cf R Krever, “Taming Tax Complexity” (2003) 25 *Sydney Law Review* 367, 488 (text accompanying n60). Given that Treasury has not quantified all of the tax expenditures it reports on, Krever may be right but he does not refer to any objective data in support of his claim.

¹⁰ Tax Expenditures, above n 7, 8.

¹¹ *Ibid.*

¹² See, eg, J Witte, *The Politics and Development of the Federal Income Tax* (1985) 323-324; and D Roberts, “GE Surges as Tax Breaks Cut in”, *The Australian*, 24 January 2005, 28.

and minimise tax avoidance¹³ will compel some taxpayers to place pressure on the political arm of government to lessen their tax burden. A comprehensive and transparent tax expenditure statement can play a crucial role in disseminating information in the public arena regarding such discriminatory access to tax concessions.¹⁴ From the perspective of transparent government, the sheer size of the *measured* tax expenditures as well as the ongoing pressure of lobbyists to allow more concessions suggests that some form of TES has a critical function in an open democracy.

Given the longevity of Australian tax expenditures reporting and the pragmatic rationale for such reports, it is somewhat surprising that there is remarkably little secondary literature which deals at any length with tax expenditures in the Australian context. Of the Australian literature that does exist, little critical analysis is directed towards the tax expenditure concept itself.¹⁵ As a result, the storms which have raged upon this particular aspect of tax expenditure

¹³ Here I use “compliance” and “avoidance” with McBarnet’s concept of “creative compliance” in mind: D McBarnet, “When Tax Compliance is not the Solution but the Problem: From Changes in Law to Changes in Attitude” in V Braithwaite (ed), *Taxing Democracy Understanding Tax Avoidance and Tax Evasion* (2003) ch 11.

¹⁴ For a consideration of public choice theory in the context of US tax expenditures see D Shaviro, “Beyond Public Choice and Public Interest: A Study of the Legislative Process as Illustrated by Tax Legislation in the 1980s” (1990) 139 *University of Pa Law Review* 1.

¹⁵ See, eg, R Krever, *Australian Taxation: Principles and Practice* (1987) 23. Given the nature of Krever’s book, the brevity with which he deals with the tax expenditure concept is understandable. Nevertheless, it is fair to say that the Australian literature has not subjected the tax expenditure concept to intense scrutiny.

To some extent the tax expenditure issue was addressed in Commonwealth, *A Tax System Redesigned* (1999) (“Ralph Review”). Although the Ralph Review recommended that “tax preferences” (used interchangeably with “tax incentives” and “tax concessions”) be reviewed periodically and systematically, the meaning of “tax preferences” was not considered expressly (ibid 275-276, recommendation 6.24). However, the proposed Charter of Business Taxation stated that the taxation of business income was to be based upon “comprehensive income” (Charter Item P5, at 112).

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reporting in the United States¹⁶ appear largely to have passed Australia by. More generally, the Australian literature is often descriptive and, in any case, is somewhat dated in light of recent developments in the Australian reporting of tax expenditures.¹⁷

The purpose of this article is to rejuvenate Australian consideration of tax expenditures reporting with particular emphasis upon the Commonwealth TES.¹⁸ The principal argument of this article is that the approach to tax expenditure reporting should be governed by the primary functional purpose of a tax expenditures report. In part, this is because the purpose of a TES is central to the determination of such critical matters as the appropriate institution to undertake the tax expenditures reporting function, the definition of the tax expenditure concept and the nature and extent of the information which a TES must contain. At the heart of this consideration of the operative aspects of tax expenditures reporting lies the value judgement of what we mean by transparent government, and in particular how far one wishes to pursue the ideal of participatory government. If participatory government is not a priority, then a minimalist tax expenditure list with “expenditure” estimates for each item would be “transparent” because it would meet the needs of budget analysts, financiers and the like.¹⁹ However, if the ideal of participatory democracy is taken more seriously, a more broadly framed TES will be necessary to inform

¹⁶ For an overview of the debate regarding the tax expenditure concept in the United States literature, see Thuronyi, above n 4.

¹⁷ R Hamilton, “The Concept of a Tax Expenditure Budget” (1982) 17 *Taxation in Australia* 30; J Grbich and Y Grbich, “Tax Expenditures as a Regulatory Tool: Targeting Superannuation Dollars” (1984) 1 *Australian Tax Forum* 96; R Krever, “Tax Expenditures: the Other Spending Program” (1985) 10 *Legal Service Bulletin* 63; and J Smith, “Finding the Civilised Society” (1996) 42 *Australian Rationalist* 26.

¹⁸ Tax Expenditures, above n 7.

¹⁹ Curiously, while many people refer to “transparency” when discussing governance, there appears to be little consideration of what transparency entails in terms of how much information and critical commentary upon the information provided, is necessary and sufficient to meet the transparency norm.

the public in a meaningful way about the consequences of their collective action in the tax domain. This article argues that, although considerable advances have been made in terms of the quality and scope of the information supplied in TES over the years, there is considerable room for improvement if tax expenditures are to be reported in such a way as to foster meaningful public scrutiny of, and participation in the reform of, the Australian taxation system.

2. BACKGROUND TO AUSTRALIAN TAX EXPENDITURES REPORTING

2.1 International Norms and Domestic Statutory Requirements

Although there appears to be a developing consensus upon an international norm requiring the publication of a TES, the literature also accepts that developing a norm regarding the content of a TES is problematic.²⁰ The International Monetary Fund (“IMF”) has released guidelines calling for the full disclosure of public financial information including the provision of information regarding tax expenditures.²¹ The IMF guidelines state:

The inclusion of a statement of the main central government tax expenditures as part of the budget documentation is a basic requirement of fiscal transparency. Such statements should indicate the public policy purpose of each provision, its duration, and the

²⁰ For an early review of international practice, and a suggested normative tax expenditure concept, see P McDaniel and S Surrey, *International Aspects of Tax Expenditures: A Comparative Study* (1985). Even here, McDaniel and Surrey recognised that there was not one correct definition of the benchmark income taxation system as their discussion of a normative benchmark accepted that there were many valid alternative treatments of issues such as loss carry forward/carry back, income averaging, etc. For other reviews of international practice regarding the publication of tax expenditure statements see the material referred to in note 5 above.

²¹ IMF Report, above n 1, paras 67-69.

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intended beneficiaries. Where possible, major tax expenditures should be quantified.²²

Most significantly, for present purposes, the IMF does not elaborate upon the definition of the relevant taxation benchmark.

At the domestic level the *Charter of Budget Honesty Act 1998* (Cth) requires the presentation of an economic and fiscal outlook report as part of the Commonwealth budget papers, including “an overview of the estimated tax expenditures for the budget year and the following 3 financial years”.²³ Further, the *Charter of Budget Honesty Act 1998* (Cth) requires the Treasurer to present a mid year economic and fiscal outlook report which must “contain a detailed statement of tax expenditures, presenting disaggregated information on tax expenditures”.²⁴ The difference in the wording of ss 12(1)(d) and 16(1)(b) is arguably significant – the budget papers need only provide aggregated information while the mid-year economic and fiscal outlook must provide more detailed information. This interpretation is supported by cl 38 of the *Explanatory Memorandum* to the Charter of Budget Honesty Bill 1996:

Subclause 16(1)(b) requires that the mid-year economic and fiscal outlook report include a detailed statement of tax expenditures. This would be similar in content to the *TES November 1995* produced by the Treasury (Australian Government Publishing Service catalogue no: 95 5759 8).²⁵

As the expression “tax expenditures” is not defined for the purposes of the Act,²⁶ it would be reasonable to expect a court to

²² Ibid para 68.

²³ *Charter of Budget Honesty Act 1998* (Cth), s 12(1)(d).

²⁴ *Charter of Budget Honesty Act 1998* (Cth), s 16(1)(b).

²⁵ *Explanatory Memorandum* to the Charter of Budget Honesty Bill 1996; available at: <http://139.134.5.123/kapala/freelegal/scaleplus.html>.

²⁶ Although s 3(1) of the *Charter of Budget Honesty Act 1998* (Cth) incorporates meaning of terms defined in the Commonwealth publication, *Government Finance Statistics: Concepts, Sources and Methods*, as updated from time to time; available at:

examine whether there is a widely accepted technical understanding of this expression.²⁷ However, it is now generally accepted that the tax expenditure concept is not determinate.²⁸

The extent of the Treasurer's obligation to disclose "tax expenditures" therefore remains unclear under both international norms and domestic legal requirements. Aside from the question of compliance with international and domestic legal and quasi-legal norms, the nature and extent of TES might also be addressed from a pragmatic perspective. A pragmatic approach would examine what form of tax expenditure reporting would best serve the interests of stakeholders. In this context, the Australian community at large, the tax profession, taxpayers, the national and international finance communities and government could all be included in the list of stakeholders.

3. WHERE ARE WE WITH TAX EXPENDITURES REPORTING?

3.1 The Current Treatment of Tax Expenditures in Australia

3.1.1 Commonwealth Tax Expenditures Reporting

In Australia, the information provided in the TES is relatively limited. Specific tax expenditures are identified, a brief description of each tax expenditure provided, relevant legislative provisions are noted and the estimated quantum of the tax expenditures may or may

<http://www.abs.gov.au/Ausstats/abs@.nsf/66f306f503e529a5ca25697e0017661f/20c4847d4e94cc7bca256dba00815923!OpenDocument>. This document does not contain a definition of "tax expenditure".

²⁷ If the expression has acquired a technical legal meaning the rule expressed by O'Connor J in *Attorney-General NSW v Brewery Employees' Union of New South Wales* (1908) 6 CLR 469, 531 would apply. Alternatively, if the expression has acquired a particular meaning within a particular societal subgroup evidence of that understanding of the expression may be persuasive: *FC of T v James Flood* (1953) 88 CLR 492, 506-507 (per ...).

²⁸ See, eg, OECD Guidelines, above n 1, 12.

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not be provided. In general, no further information regarding the purpose of the tax expenditure, the actual characteristics of the beneficiaries of the tax expenditure (ie publicly owned primary production entities or family farming entities?), relevant official literature (government reports, extrinsic materials) or the systemic impacts of individual tax expenditures or of the tax expenditures program as a whole is provided.

The publication of the TES by the Australian Government has been officially described as consistent with the minimum international standard applicable to the publication of financial information.²⁹ Regardless of whether the minimum international standard is adequate for the expectations of government held by the Australian public, Australia's compliance with the minimum international standard established by the IMF is open to question. True, the Commonwealth Treasury publishes aggregated information regarding tax expenditures with the budget papers,³⁰ the most recent budget noting that this information is consistent with the information provided in the *Tax Expenditures Statement 2003*.³¹ However, although the *Tax Expenditures Statement 2004*³² quantifies the more significant tax expenditures, it can hardly be said to publish information with respect to the public policy purpose, duration and intended beneficiaries of each expenditure item. Furthermore, it is

²⁹ Commonwealth of Australia, *Making Transparency Transparent – An Australian Assessment* (1999) 68.

³⁰ Commonwealth of Australia, *2004/2005 Budget Paper No 1*, Statement Five, Appendix E (“Budget Paper”). However, this list excludes many tax expenditures which, by international standards, ought be both included and quantified. For example, the main residence exemption and the deferral of taxation upon assets transmitted under deceased estates are noted as tax expenditures but are not measured.

³¹ Commonwealth of Australia, *Tax Expenditures Statement 2003* (2004).

³² Tax Expenditures, above n 7.

notable that the *Tax Expenditures Statement 2004* does not deal with tax expenditures under the Goods and Services Tax.³³

3.1.2 State Tax Expenditures Reporting

The States are obliged to publish core financial data in their budget papers in accordance with the terms of the Uniform Presentation Framework, an agreement between the Commonwealth and the States and Territories.³⁴ The reporting of State tax expenditures is relatively rudimentary, consisting primarily of a listing of tax expenditures with only limited critical discussion of the tax expenditure concept in its application to State taxes and only limited elaboration of the chosen tax expenditure baselines.³⁵

3.1.3 Ralph Review Recommendations Regarding Tax Expenditures

The Commonwealth Review of Business Taxation (“Ralph Review”) recommended that “tax preferences” be reviewed periodically and systematically, but the institution to be responsible for the identification and reporting of such preferences was not specified.³⁶ Presumably, it was expected that this role would fall to the proposed Board of Taxation, as the “guardian” of the proposed Charter of Business Taxation charged with the responsibility of monitoring and reporting “on the performance of the business taxation system ... against the objectives and principles set out in the Charter”.³⁷ Although the Charter of the Board of Taxation³⁸ could

³³ This exclusion is apparently founded upon the rather flimsy justification that the GST is a tax imposed under Commonwealth legislation, but collected on behalf of the States and Territories: Tax Expenditures, above n 7, 5. The GST is clearly a Commonwealth tax and so any GST tax expenditures should be recorded in the Commonwealth budget papers.

³⁴ Commonwealth, *Making Transparency Transparent* (1999) 66.

³⁵ See, eg, New South Wales, *Budget Statement 2004-2005 – Budget Paper Number 2* (2004) ch 6; Queensland, *Budget 2004-2005 – Budget Paper No 2* (2004) Appendix A; Victoria, *Budget Statement 2004-2005, Statement of Finances, 2004-2005* (2004) ch 4; and Tasmania, *2004 Budget Paper No 1* (2004) ch 11.

³⁶ Ralph Review, above n 15, 275-276 (recommendation 6.24).

³⁷ *Ibid* 119 (recommendation 1.4).

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conceivably be construed as allowing it to perform this function, the limited inquiries conducted by the Board to date suggest that it is unlikely to assume the role of reviewing the operation of the tax system as a whole on a regular basis. As a result, no identifiable difference in the institutional aspects of tax expenditures reporting, in the nature of the tax expenditures report or in the consideration of tax expenditures emerged from the Ralph Review report. If the annual TES is considered at all, presumably it is in the context of budget preparation under a “veil of secrecy” and undertaken within tight timeframes.³⁹

The current Australian approach to tax expenditure reporting is therefore of a minimalist nature. The *Tax Expenditure Statement 2004* lists, and for approximately two in three, quantifies tax expenditures. No tax expenditure analysis of the tax expenditures is undertaken in the report. Even if it is true that this minimalist tax expenditures reporting meets the minimum standard of international reporting, the question is whether the TES should provide more information if the interests of all stakeholders are to be met. This is the question addressed by the remainder of this article.

³⁸ The Charter states that:

The Board will provide advice to the Treasurer on:

- the quality and effectiveness of tax legislation and the processes for its development, including the processes of community consultation and other aspects of tax design;
- improvements to the general integrity and functioning of the taxation system;
- research and other studies commissioned by the Board on topics approved or referred by the Treasurer; and
- other taxation matters referred to the Board by the Treasurer.

³⁹ Ralph Review, above n 15, 123.

4. TOWARDS A PRAGMATIC APPROACH TO TAX EXPENDITURE REPORTING – THE PURPOSES OF TAX EXPENDITURES STATEMENTS

4.1 Rhetorical Discourses and the Vexed Issue of Tax Expenditures Reporting

One needs only a brief acquaintance with the relevant literature to come to the conclusion that many have tried and all have failed in the attempt to identify a universally accepted tax expenditure concept.⁴⁰ It is apparent from a review of the literature in this field, and particularly the United States literature, that discussion of the tax expenditure concept forces several conflicting political discourses to the surface of tax policy discussion.⁴¹

For example, the definition of the normative tax base resurrects the conflict between the state's "right" to impose taxation with the individual's "right" to private property. This conflict is played out in various ways, however there can be little doubt that Surrey considered the tax expenditure concept to be a critical weapon in

⁴⁰ The seminal work upon the nature of the tax expenditure concept is that of Stanley Surrey. His later thinking upon this matter may be found in S Surrey and P McDaniel, *Tax Expenditures* (1985). Many of the key issues regarding the problematic nature of the tax expenditure concept are addressed in B Bittker, "A 'Comprehensive Tax Base' as a Goal of Income Tax Reform" (1967) 80 *Harvard Law Review* 925 ("Bittker, Tax Base"); B Bittker, "Accounting for Federal Tax Subsidies in the National Budget" (1969) 22 *National Tax Journal* 244 ("Bittker, Subsidies"); S Helmuth and W Helmuth, "The Tax Expenditure Budget – Response to Professor Bittker" (1971) 22 *National Tax Journal* 528; B Bittker, "The Tax Expenditure Budget – A Reply to Professors Surrey and Hellmuth" (1971) 22 *National Tax Journal* 538; W Blum, "Book Review" (1975) 1 *Journal of Corporate Taxation* 486; W Andrews, "Personal Deductions Under an Ideal Income Tax" (1972) 86 *Harvard Law Review* 309, for a response to which see S Surrey, *Pathways*, above n 3, 19-21.

⁴¹ For an entertaining discussion of rhetorical discourses within the tax arena, see L Eisenstein, *The Ideologies of Taxation* (1961).

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asserting the state's right to impose income tax. Surrey appears to have favoured the income tax because of his commitment to its redistributive potential – a potential which was threatened by what Surrey perceived to be the burgeoning list of tax concessions.⁴² To others less committed to this redistributive ideal, the identification of tax loopholes by reference to a comprehensive normative income tax base amounts to the claim that “the total income of the country constitutes the tax base. A deduction or exemption can only be defined as a “loophole” with this presupposition”.⁴³ Surrey rejected this outlandish proposition, but his rejection of Williams' proposal for the exclusion of medical expenses from the “consumption” element of comprehensive income, framed in terms of the upside down effect,⁴⁴ no doubt lent some credence to the view that Surrey would deny all deductions from gross income. Nevertheless, the fact that the statement is made and repeated⁴⁵ indicates the politically charged nature of the debate regarding the tax expenditure concept.

An associated conflict of discourses may be seen in the debate as to which is the preferred normative tax base – the income tax or the consumption tax. Many argue that the income tax distorts market decisions by disadvantaging savings and should be replaced with a consumption tax.⁴⁶ From Surrey's perspective, it was the ability to pay principle and the perceived redistributive capacity of a progressive income tax which justified its adoption.⁴⁷ In this debate we can see the confrontation between the redistributive ideal founded in an appeal to “equity” and economic liberalism which holds that an

⁴² Surrey, *Pathways*, above n 3, ch 3.

⁴³ J Hall, *Tax Expenditures: A Review and Analysis* (United States Congress, Joint Economic Committee; 1999) 9.

⁴⁴ Surrey, *Pathways*, above n 3, 22.

⁴⁵ Thuronyi, above n 4, 1178, n3.

⁴⁶ Hall, above n 43, 6.

⁴⁷ This is not to say that redistribution can only be achieved with an income tax – as optimal tax theory shows, redistribution can be achieved with flat taxes combined with transfer payments: J Bankman and T Griffith, “Social Welfare and the Rate Structure: A New Look at Progressive Taxation” (1987) 75 *California Law Review* 1905.

optimal tax is one which interferes the least with investment decisions.

Another pressure point focuses upon governance issues which are expressed in calls for transparent decision making. Free public access to information regarding government activity, such as the imposition of taxes and their economic and social effects, entails a balancing of several competing interests. The costs (in terms of both expenditure and opportunity cost) of providing comprehensive information must be weighed against the perceived benefits which flow from “open government” in terms of voluntary compliance, better tax policy⁴⁸ and more predictable legal outcomes.⁴⁹ Debate about whether we should have TES, and what information they should convey, necessitates a decision upon whether transparent government is a universal good and, if so, what constitutes transparent government in the context of tax policy. Different commentators seem to unconsciously adopt standpoints along the continuum from no or minimal provision of government information to endorsement of the public’s absolute right of access to information held by its government.

In light of such intense politically charged debate along several rhetorical fault lines, some have recommended that the tax expenditure concept be rejected.⁵⁰ Such criticism is founded upon the denial of any coherent policy underlying the tax legislation⁵¹ and/or

⁴⁸ IMF Report, above n 1, para 1; although open government will not necessarily produce better policy outcomes: LE Burman, “Is the Tax Expenditure Concept Still Relevant?” (2003) 56 *National Tax Journal* 613.

⁴⁹ For some discussion of the benefits which might flow from conceptualising tax administration in terms of a partnership between taxpayers and government see J Braithwaite and A Wirth, *Towards a Framework for Large Business Tax Compliance* (Working Paper No 24; Centre for Tax System Integrity; 2001).

⁵⁰ Hall, above n 43, 8.

⁵¹ This view holds that the government only intends to tax that which falls within the scope of the legislation and so the construction of a normative taxation system against which to measure the actual taxation system is founded upon arbitrary predilections of the author: Bittker, *Subsidies*, above n 40, 248; cf JA Pechman,

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upon the proposition that only absolute truth should underpin social action.⁵² Although such nihilist arguments can be framed in a rhetorically appealing manner, they should be rejected for two reasons.

First rejecting the nihilistic opposition to tax expenditure reporting is that such an approach amounts to an argument for maintaining the status quo because it denies the validity of any critical perspective from which to assess the existing tax system. This nihilist argument can be turned on its head – what objective truth warrants maintaining the status quo?⁵³ Here the nihilist argument can be likened to the childlike assertion of priority – “I was here first”. The nihilist denial of any normative standpoint amounts to a normative claim in itself – that the tax system should remain bereft of any principled foundation. Indeed, one could take this approach one step further and argue that all laws and principles which were not framed upon objectively verifiable data should be jettisoned. If Simons’ recognition of the vagaries of the income concept are any guide, it is doubtful that many laws and principles would survive this sceptical scrutiny. If taken to its logical conclusion, nihilism would threaten many of the rules and values which these “nihilists” seem to espouse.

The second reason for rejecting the critics is that they ignore the fact that many commentators share common ground, such as the benefits of a TES in terms of government transparency. I would not

“Comprehensive Income Taxation: A Comment” (1967) 81 *Harvard Law Review* 637. See also Thuronyi, above n 4, 1164-1168.

⁵² This nihilistic conclusion is founded upon the essentially postmodern view that absolute truth, and hence some critical standpoint from which the merits of existing institutions and practices can be assessed, is beyond the capacity of the human mind. However, the absence of one universal meaning of the tax expenditure concept need not warrant its rejection. To require absolute truth in any of the social sciences, let alone the physical sciences, would restrict social behaviour to an unduly circumscribed realm.

⁵³ C Norris, *Reclaiming Truth: Contribution to a Critique of Cultural Relativism* (1996).

go as far as Surrey and McDaniel who suggested that shared understandings regarding some aspects of the tax expenditure concept “gives the dialogue rationality and vitality”.⁵⁴ However, it is true to say that few argue for the release of less information regarding the actions of government. Thus, although he argued that the tax expenditure concept will always be somewhat imprecise and that the measurement of tax expenditures will be problematic, Bittker reluctantly agreed that the tax expenditure concept has some practical use.⁵⁵ Others more supportive of the tax expenditure “project” have accepted its shortcomings and have more glowingly proposed that the tax expenditure concept should be retained in one form or another.⁵⁶ Some have even noted that there is little difference between imposing a tax and then subsidising particular activity, and imposing a regulatory requirement upon particular legal subjects. These commentators have therefore suggested that the principle of neutrality dictates that the tax expenditure concept be extended to a regulatory concession report.⁵⁷

4.2 Why Does the Purpose of Tax Expenditures Reporting Matter?

If it is accepted that developing some form of TES complies with an accepted norm of good governance and is therefore in the public interest,⁵⁸ it is necessary to determine how we should proceed given the absence of a normative standpoint which can claim absolute truth. For the purposes of this article I am happy to accept the essentially postmodernist proposition that any normative standpoint

⁵⁴ Surrey and McDaniel, above n 2, 688. Rationalist discourse holds that the rational standpoint is not necessarily consonant with a shared community understanding.

⁵⁵ Bittker, Subsidies, above n 40, 260-261.

⁵⁶ D Shaviro, “Rethinking Tax Expenditures and Fiscal Language” (2004) 57 *Tax Law Review* 187.

⁵⁷ J Roin, “Truth in Government: Beyond the Tax Expenditure Budget” (2003) 54 *Hastings Law Journal* 603.

⁵⁸ This is the thrust of relevant international normative statements, albeit cursory, on this topic: see the material referred to in note 1 above.

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will suffer from some destabilising element. But this is not to say that normative claims about social constructs such as a taxation system ought be denied. Rather, it means that a tax system should be assessed from alternative normative standpoints and an admittedly contingent vision of a tax system adopted. In the context of TES, I have already noted that proponents of alternative visions of tax expenditures reporting agree that the governance norm of transparency underpins the need for such reporting. However, the literature also suggests that alternative visions of the nature and contents of TES have been framed according to what the author considers to be the primary purpose of tax expenditures reporting.

In the discussion below I will introduce the perceived purposes of TES recognised in the official and secondary literature. This review of the alternative purposes for tax expenditures reporting is necessary because any, admittedly contingent, normative vision for tax expenditures reporting must take account of those purposes and arrive at the best reconciliation of what may be competing objectives. Alternatively, it may be possible to construct a normative vision of tax expenditures reporting which accommodates all perceived purposes if those purposes are not conflicting.

4.3 Alternative Concepts of Transparency - The Purposes of Tax Expenditures Statements

Three purposes for the production of TES are commonly identified in the literature and share, as I have noted above, the common theme of transparent government.

4.3.1 Measuring the Size of Government

The first reason for developing TES is the least significant and is included here merely for the sake of completeness. Some argue that tax expenditures reporting enables appraisal of the “size of government” – the true scale of fiscal activity enables one to

determine whether the government is “small” or “big”.⁵⁹ On one view, incorporating tax expenditures into this calculus, and assuming that the quantum of tax expenditures can be accurately measured,⁶⁰ the true scale of government can be recognised as there is no difference between raising taxes and then spending the tax revenue and simply foregoing tax revenue in order to subsidise some particular activity/group of taxpayers.⁶¹ On the other hand, proponents of “small government” favour a substantial tax expenditures program as they consider tax expenditures to equate to a tax cut.⁶²

Although noted as a purpose for preparing TES, the vast majority of the literature dealing with TES focuses upon their budgetary and tax reform roles.

4.3.2 Fiscal Discipline – Transparent Reporting for Budget Preparation

The second purpose is to enhance fiscal transparency by identifying tax “spending” programs – the TES is characterised as a document prepared for the purposes of constructing an annual budget. In Australia, for example, the *Tax Expenditures Statement 2004* states that the first purpose of the statement is for “tax expenditures to receive a similar degree of scrutiny as direct expenditures”.⁶³ This is the primary purpose of TES identified by Surrey. By identifying the core tax rules which were necessary for the income tax to operate, Surrey hoped to flush the “tax spending”

⁵⁹ See, eg, Tax Expenditures, above n 7, 2; C Brown, “Tax Expenditures in Australia” in Brixi et al, above n 5, 45, 47.

⁶⁰ This is a very large assumption. Consider the caveats expressed in Tax Expenditures, above, n 7, 16-17.

⁶¹ Tax Expenditures, above n 7, 4.

⁶² This view is noted in Economic Planning and Advisory Council, above n 6, 1.

⁶³ Tax Expenditures, above n 7, 2. In the 1996-1997 Commonwealth Budget it was announced that tax expenditures would be subject to periodic review as a part of the normal budgetary process: Commonwealth, *Budget Speech 1996-97* (1996) 8. See also Canada, *Tax Expenditures: Notes to the Estimates/Projections* (2004) 7 (“Canada Projections”).

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rules out into the open by expressly reporting them. Once exposed, he expected that they would be subjected to a level of scrutiny equivalent to direct expenditures,⁶⁴ with most failing this scrutiny and being repealed.⁶⁵

In defining the tax expenditure concept Surrey was mindful of the need to present a rhetorically appealing tax expenditure concept in order to win executive and parliamentary support.⁶⁶ Accordingly, while he adopted the comprehensive income tax base as his starting point, he was compelled to make significant concessions from this norm in shaping his benchmark US income taxation system.⁶⁷ For example, the postulated normative taxation system had to comprise rules which were “realistic” candidates for inclusion on the statute book. The nomenclature of “tax expenditures” and his repeated observation that tax expenditures were equivalent to direct spending rules reflected Surrey’s focus upon departures from the comprehensive tax base which could readily be perceived as the legislative decision to “spend” by not imposing tax. Thus, for example, the taxation of capital gains upon a realisation basis was considered a part of the normative taxation system because the administrative obstacles associated with taxing such economic gains

⁶⁴ Surrey, *Pathways*, above n 3, 4. Bittker notes that, given the often incomplete analysis of direct spending programs, it is somewhat ironic for Surrey to be proposing that tax expenditures receive equivalent treatment: Bittker, *Subsidies*, above n 40, 244 n1. More recently, Heen’s work noting the poor oversight of spending programs indicates that Bittker’s point had some merit: ML Heen, “Reinventing Tax Expenditure Reform: Improving Program Oversight Under the Government Performance and Results Act” (2000) 35 *Wake Forest Law Review* 751, 772.

⁶⁵ Surrey, *Pathways*, above n 3, 155, 179, 180 and 247.

⁶⁶ *Ibid* 18. See also P McDaniel and S Surrey, *International Aspects of Tax Expenditures: A Comparative Study* (1985) 5-6. This clearly entailed that the tax expenditure concept would be somewhat fluid – changing as wider community understanding of the comprehensive tax base concept increased: Surrey, *Pathways*, above n 3, 18.

⁶⁷ Thus, for example, he excluded the taxation of imputed rent on owner-occupied housing from the benchmark.

on an accruals basis suggested that the legislature had opted for a realisation basis. Taxation on a realisation basis was therefore not intended to be a direct spending program – it was a part of the core tax rules necessary to make the tax system work.

The subjective judgments embedded within the “objective” concept of economic income, combined with Surrey’s approval of some departures from the economic income concept, opened a Pandora’s box. Some of the literature after Surrey has considered the application of economic income to items such as accelerated depreciation⁶⁸ and personal medical expenses,⁶⁹ concluding that both are consistent with taxation upon economic income. Others have attempted to identify which departures from the tax base are substitutable for a direct spending program.⁷⁰ Under both lines of inquiry, for example, some have argued that accelerated depreciation is while others have argued that it is not substitutable and therefore not a tax expenditure.⁷¹ Some commentators have taken the substitution requirement one step further by suggesting that tax expenditures are only those departures from a benchmark which are substitutable for spending provisions, in the sense that direct spending will achieve the legislative purpose(s) at least as effectively.⁷² This additional limitation was promoted upon the basis that it focused the tax expenditure concept upon those departures from a normative benchmark which were susceptible to change during the course of budget deliberations. Thus, for example, in times past the Australian Treasury adopted a definition of the benchmark income tax which was framed from this pragmatic standpoint:

⁶⁸ D Kahn, “Accelerated Depreciation – Tax Expenditure or Proper Allowance for Measuring Net Income?” (1979) 78 *Michigan Law Review* 1.

⁶⁹ W Andrews, “Personal Deductions in an Ideal Income Tax” (1972) 86 *Harvard Law Review* 309.

⁷⁰ See, eg, Thuronyi, above n 4, 1186.

⁷¹ S Fiekowsky, “The Relation of Tax Expenditures to the Distribution of the Fiscal Burden” (1980) 2 *Canadian Taxation* 211, 215; and Thuronyi, above n 4, 1188.

⁷² Thuronyi, above n 4, 1187.

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For example, prior to 1987-88 when the classical system of company taxation operated, no tax expenditures were identified in relation to the treatment of distributed and undistributed income even though it departed significantly from the ideal benchmark. With the introduction of the imputation system of company taxation from 1 July 1987, imputation was incorporated into the benchmark from the 1987-88 income year ... This approach recognises that the treatment of ideal tax benchmarks needs to be tempered to ensure that the analysis of tax expenditures remains relevant.⁷³

These alternative approaches to the tax expenditure concept are but minor variations to the Surrey theme. In them one can discern the consequences of the most important legacy of Surrey's work - the fact that he limited his tax expenditure concept by focusing upon those departures from the comprehensive tax base which amounted to "spending".⁷⁴ This emphasis upon spending restricted Surrey's concept of transparency to what might be called fiscal transparency. The tax expenditure report was basically conceived as a budgetary document - a report of tax spending to be taken into account when, for example, implementing government spending cuts. If direct spending was to be subject to a cut so, Surrey argued, the tax expenditure side of the ledger should be cut to the same degree.⁷⁵ This emphasis upon fiscal transparency has affected deliberations upon which institution should prepare the TES, the definition of "tax expenditure" and also the nature of the information to be provided in a competent TES.

First, as the TES was conceived of by Surrey as a fiscal document, it was assumed that Treasury was the appropriate institutional entity to prepare such a document, given that Treasury

⁷³ Commonwealth of Australia, *Taxation Expenditures Statement 1997-98* (1999) 60 ("Statement 1997-98").

⁷⁴ Surrey, Pathways, above n 3, 6. For adoption of this view see M McIntyre, "A Solution to the Problem of Defining a Tax Expenditure" (1980) 14 *UC Davis Law Review* 79, 88.

⁷⁵ Surrey, Pathways, above n 3, 32-33.

had historically assumed the role of primary overseer of the annual budget.

Second, as noted above, Surrey's focus was upon creating a budget "hit-list" which could be considered during the preparation of the annual federal budget. Surrey did not perceive the tax expenditures report as some form of report card upon the merits and dysfunctions of the tax system overall. As such, the TES focused upon overt tax concessions rather than providing a tax policy appraisal of the tax system overall. Consideration of whether the income tax was an optimal tax, for example, was to be ignored. Further, negative tax expenditures were ignored.⁷⁶ The definition of tax expenditures in the US legislation⁷⁷ implicitly excluded negative expenditures. Similarly, although negative tax expenditures are recognised in Australia, the reporting of them is imperfect.⁷⁸

In more recent times this particular aspect of Surrey's legacy has diminished in some jurisdictions as a more general governance norm may be discerned in a broader, albeit fiscal, approach to tax expenditures reporting.⁷⁹ Rather than focusing upon "spending", this broader approach adopts the alternative discourse of discrimination – which tax provisions discriminate in favour of or to the detriment of particular taxpayers? Further, the differentiation between tax expenditures that are candidates for repeal and "entrenched" expenditures is less significant. Under this approach, assuming that accelerated depreciation and negative tax expenditures or "tax

⁷⁶ This continues to be the case in the United States of America: United States of America, *Analytical Perspectives, Budget of the United States Government, Fiscal Year 2006* (2005) 350-351 ("Analytical Perspectives").

⁷⁷ *Budget Act 1974* (US), Pub L No 93-344, 88 Stat 297, s 3(3).

⁷⁸ Thus, for example, although the Australian Treasury accepts that it is possible to have a negative tax expenditure and actually reports some negative tax expenditures, Treasury notes that "tax expenditures are substitutes for direct expenditures, delivered through the tax system and accordingly affect the budget position": Tax Expenditures, above n 7, 1.

⁷⁹ Note that this is by no means a universal shift in focus: United Kingdom, *Tax Ready Reckoner and Tax Reliefs* (2004) 6 (para 12) ("Ready Reckoner").

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penalties”⁸⁰ represent departures from the specified norm, such items must be reported. Thus, in the Australian TES at times it seems that the intention is that all departures from a specified benchmark, whether they be positive or negative tax expenditures, be reported.⁸¹ In Canada a similar approach is adopted⁸² while in the United States tentative moves have been made towards reporting negative tax expenditures.⁸³ Nevertheless, recognition of “tax penalties” imposed upon taxpayers has been partial and, it seems, not pursued with the same alacrity as the identification of positive expenditure hit lists. While one can never be sure, arguably this is a consequence of the perceived fiscal character of the tax expenditures document.

The third consequence of Surrey’s “spending” legacy is that very little of the literature after Surrey has specifically elaborated upon the nature and extent of information a tax expenditure statement should provide. By continually referring to the TES as a “list of tax expenditures”⁸⁴ Surrey implied that merely identifying and quantifying tax expenditures would be enough to attract the scrutiny of the legislature and his treasury colleagues: “once the knowledge exists, appropriate analysis becomes possible”.⁸⁵ A second stage inquiry into the efficacy of each tax expenditure would then be undertaken, and that inquiry would be undertaken by the appropriate budget committees, in consultation with advisors such as Treasury staff, “behind closed doors”.⁸⁶

⁸⁰ A term coined by McDaniel and Surrey: McDaniel and Surrey, above n 20, 61.

⁸¹ “A negative tax expenditure occurs when these arrangements impose an additional charge rather than a benefit”: Tax Expenditures, above n 7, 1.

⁸² Canada, *Tax Expenditures and Evaluations* (2004) 9 (“Canada Expenditures”).

⁸³ Analytical Perspectives, above n 76, 350-1: where the absence of negative tax expenditures from the tax expenditures list is noted and examples of such expenditures provided.

⁸⁴ See, eg, Surrey and McDaniel, above n 2, 690.

⁸⁵ See, eg, *ibid* 692.

⁸⁶ See, eg, the discussion of the significance of “closed sessions” of parliamentary review committees in Shaviro, above n 14. In particular, note the discussion of the

Surrey's "scrutiny" of tax expenditures was therefore a limited form of scrutiny – the public would have access to the list of tax expenditures, but would not be able to readily access the material associated with the second order inquiry into the efficacy of each tax expenditure. This point is critical because it illustrates the limited nature of Surrey's recourse to the discourse of transparency. Surrey did not consider that the tax expenditures report should be the output of a standing committee of inquiry into the operation of the taxation system, or that it should inform wide public debate upon tax reform. Given the influence of legislative committees in the United States in this era,⁸⁷ his concept of tax reform was winning the agreement of a legislative committee (and possibly the support of the committee chairperson would be sufficient)⁸⁸ in order to win the repeal of tax expenditures. Although the Committee was appointed by the legislature, there was arguably little in the way of the committee being responsive to the wider public. This absence of community consultation is arguably one reason why Surrey's TES has been accepted into official discourse without having had any obvious significant impact upon the repeal of tax expenditures.⁸⁹

After Surrey it seems to have been generally accepted that a TES will be adequate if it records departures from one of the alternative benchmarks and quantifies each such departure.⁹⁰ This narrow vision of government transparency is, perhaps, what is referred to as the "minimum international standard" of tax expenditure reporting. The IMF and OECD guides on this point appear to suggest that this is

Wilbur Mills "hegemony" from 1958 to 1974, at 83-84. See also J Witte, above n 12, chs 8-9.

⁸⁷ Witte, above n 12, chs 8-9.

⁸⁸ Given the unusual standing of Wilbur Mills as chair of the Ways and Means Committee, see Shaviro, above n 14, 83.

⁸⁹ Thuronyi, above n 4, 1170-1171.

⁹⁰ So, eg, McIntyre refers to "lists" of tax expenditure items: McIntyre, above n 74, 88-89; similarly see McDaniel and Surrey, above n 20, 6.

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so.⁹¹ This minimum standard of transparency may be contrasted with the broader concept of transparency underlying some aspects of the recent Ralph Review. In the course of recommending that there be greater open and public involvement in tax policy design, overseen by a Board of Taxation, the Ralph Review noted:

An additional attraction of this proposal is that it requires inevitable trade-offs between competing priorities and objectives to be made more explicit, thereby adding greater accountability and transparency to the policy development process.⁹²

Here the Ralph Review appears to adopt a far broader concept of transparency which entails informing the public about the competing imperatives underlying any taxation system and explaining why a compromise between those competing imperatives was fashioned in a particular way when resolving a particular technical aspect of the law.

4.3.3 Open Public Scrutiny of the Tax System as a Whole

This consideration of the nature of transparent tax policy review brings us to the third stated purpose of tax expenditures reporting, which is to contribute “to the design of the tax system, by promoting and assisting public debate on all elements of the tax system”.⁹³ The Canadian Department of Finance elaborated upon this purpose in an earlier TES:

The purpose of this report is to serve as a source of information for parliamentarians, government officials and others who wish to analyze Canada’s federal income tax system and the goods and services tax (GST). It is also an important input into the process of evaluating the operation of these tax systems. However, it should be emphasized that this report itself does not attempt to make judgments

⁹¹ OECD Practices, above n 1, 7 item 2.2; OECD Guidelines, above n 1, 13, Guideline 11; and IMF Report, above n 1.

⁹² Ralph Review, above n 15, 124.

⁹³ See Tax Expenditures, above n 7, 2; and Commonwealth, *The Treasury Annual Report 2003-4*, 50-51.

about either the appropriateness of government policy objectives or the effectiveness of the various tax provisions in achieving those objectives.⁹⁴

As already noted, as originally conceived by Surrey the TES was not intended to inform public debate regarding the taxation system – primarily it was intended to be used by the technocrats of treasury and relevant legislative committees in the course of preparing the annual federal budget. Surrey’s concept of transparent scrutiny was therefore directed towards a limited class of technocrats. The reference to public scrutiny in the third purpose is extremely significant because it springs from the discourse of participatory democracy and therefore shifts the intended readership of tax expenditure reporting from those directly involved in the budget to the wider public.

The metamorphosis of the TES from a budgetary document to being an input into wider public discussion of taxation reform would mean that at least two issues would need to be re-examined. First, whether new institutional structures should be created to facilitate wide public consultation and participation in tax system oversight. If new institutional structures were created, Treasury may not be the most effective agency for producing the TES. Second, the role of a tax expenditures report within the process of public consultation, and in particular the nature and type of information it should convey. I will return to the first question later in this article.⁹⁵

With respect to the second question, envisaging the TES as part of a systematic and transparent, in the sense of participatory, and ongoing review of the tax system suggests that a broad range of information would need to be organised and made publicly available. Compliance with the third purpose of tax expenditures reporting would require explicit critical appraisal of the definition of the tax

⁹⁴ Canada, *Tax Expenditures* (1999) 33 (“Canada 1999”).

⁹⁵ See the discussion under the heading “Institutional responsibility for issuing tax expenditures statements”.

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expenditure concept, the quantification of individual tax expenditures, an elaboration upon their nature and operation, consideration of the interaction of individual tax expenditures with the taxation framework (such as distributional outcomes on an individual expenditure basis and on an aggregated basis, pressures on the tax structure such as “tax avoidance”, perceptions of fairness/unfairness and the consequent benefits/costs in terms of voluntary compliance), reference to the existence of any international norms regarding the provision of similar tax expenditures. Further, transparent administration of tax expenditures would seem to require that most official literature⁹⁶ regarding the tax expenditures be made available to the public to facilitate tax expenditure reviews by members of the public. Much of this information with respect to a significant number of tax expenditures is regularly prepared on behalf of the United States Senate Budget Committee.⁹⁷ Alternatively, the TES could refer the reader to official literature where such information may be obtained.⁹⁸ If this latter approach were adopted, the reference to relevant review literature would serve to highlight those tax expenditures which had not been critically reviewed, or for which reviews were overdue.

Further, if the operation of a nation’s tax system is to be assessed meaningfully, it should prepare a national TES which provides an accounting for all tax expenditures at federal, state/territory and local levels.⁹⁹ With such information at hand, for example, it would be possible to identify which segments of the community were the primary beneficiaries of tax expenditures and, indeed, whether a

⁹⁶ Of course, there could be a case for limited exclusions such as Cabinet deliberations. There is considerable debate regarding the validity of the wide exclusions allowed under the current Australian freedom of information legislation.

⁹⁷ United States, *Tax Expenditures: Compendium of background information on Individual Provisions* (2004) (“Compendium”).

⁹⁸ Australia, *Shared Endeavours: Report of the Inquiry Into Employee Share Ownership in Australia* (2000).

⁹⁹ Note that such national tax expenditures statements are provided in Austria and Italy: Brixi et al, above n 5, 16.

positive tax expenditure allowed by one level of government was reduced or negated by a negative tax expenditure imposed by another level of government.

Moreover, as noted by Roin¹⁰⁰ and Shaviro,¹⁰¹ a fiscal allocation can easily be converted into a tax expenditure or a regulatory requirement.¹⁰² A government wishing to take an item off the budget and TES could conceivably create a regulatory impost upon particular sectors of the community and thereby escape the ongoing scrutiny reserved for fiscal items and tax expenditures. For example, is a legislated minimum wage equivalent to a negative tax expenditure imposed upon particular employers?¹⁰³ The purpose of measuring the size of government would therefore suggest that more comprehensive reporting of government activity, including regulatory imposts, is necessary. Thus, for example, it would be possible to determine whether a tax expenditure imposed by one level of government conflicted with a regulatory impost imposed by a different arm of the same level of government or a different level of government.

4.4 Which Purpose Should be Adopted as the Primary Purpose?

The preceding discussion indicates that the three purposes of TES do not necessarily justify the same approach to tax expenditure reporting. For example, quantifying the size of government does not necessitate the provision of information regarding the nature and operation of tax expenditures. Alternatively, preparing a TES in fulfilling the second purpose would generally satisfy the first purpose as well, but would be less likely to entail the provision of sufficient information in a manner designed to foster wide public consultation

¹⁰⁰ Roin, above n 57.

¹⁰¹ Shaviro, above n 56, 190.

¹⁰² Although Shaviro notes that this is subject to some limits, if the experience of the Clinton administration is a guide: Shaviro, above n 56, 192-193.

¹⁰³ Ibid 190.

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upon, and assessment of, the tax system as a whole, given that the second purpose focuses upon the preparation of a “hit list” for expenditure review purposes. However, it would be reasonable to expect that a comprehensive TES which facilitated fulfilment of the third purpose would also facilitate the fulfilment of the first two purposes. The preceding discussion also demonstrates that national practices with respect to tax expenditures reporting vary. Thus, in the United States alone different approaches to tax expenditures reporting are adopted by different branches of the Federal Government.¹⁰⁴ In the absence of any normative tax expenditure reporting standard which may be derived from *all of* the purposes of TES and/or international practice, it is necessary to determine which purpose of tax expenditures reporting should form the basis of a normative reporting standard.

Although there is neither legal obligation nor international norm compelling the provision of sufficient information to fulfil the third purpose of TES, there are two key pragmatic reasons why the third purpose should be adopted as the primary purpose of tax expenditure reporting.

4.4.1 A Fairer Taxation System, or Wider Recognition of the Fairness of the Tax System

It is axiomatic that community perceptions of the fairness of a taxation system have a direct bearing upon the extent to which members of a particular community voluntarily comply with that legislation.¹⁰⁵ It can hardly be doubted that a comprehensive TES, which fulfilled the third purpose identified above by reporting information regarding the nature, scope, operation and ultimate beneficiaries of each tax expenditure as well as the overall incidence of the income tax, would enhance the transparency of the taxation

¹⁰⁴ See Analytical Perspectives, above n 76; Compendium, above n 97; and United States, *Estimates of Federal Tax Expenditures for Fiscal Years 2005-2009* (Report of the Joint Committee on Taxation 2005) (“US Estimates”).

¹⁰⁵ See, eg, IMF Report, above n 1, para 1.

system. With this information, for example, it would be possible to test the progressivity of the income tax system for the purpose of determining whether the tax expenditures undermined vertical equity.¹⁰⁶

It could be expected that this more transparent taxation system would either generate political pressure for the creation of a fairer taxation system or lead to greater recognition of the fairness of the existing taxation system. In either case, assuming that the hypothesis regarding the correlation between fairness and voluntary compliance holds, the voluntary compliance with Australian taxation laws could (if reforms towards a fairer system are enacted) or would (if the tax expenditure statements demonstrated the fairness of the tax system and these findings were widely publicised) be enhanced.

The limited information necessary for the first and second purposes of TES would not lead to this outcome.

In arguing that a pluralist approach to the dissemination of tax policy information will enhance Australian tax policy outcomes I am cognisant of the countervailing view put by, amongst others, Witte.¹⁰⁷ Witte argues that opening the tax policy process to public participation in a political system characterised by diffuse political power, such as that of the United States of America, is counterproductive in terms of achieving a “rational” political compromise between competing values. To overcome this problem Witte suggests that the political power for tax reform should be centralised in the executive arm of government.¹⁰⁸ However, Witte’s thesis that concentration of power in the executive branch may curb

¹⁰⁶ Assuming that the relevant community actually wanted to adhere to the principle of vertical equity. For discussion of problematic aspects of this principle see: H Blum and W Kalven, *The Uneasy Case for Progressive Taxation* (1963). In the context of the US, see eg, J Pechman, *The Rich, the Poor and the Taxes they Pay* (1986) 58. For discussion of alternative ways of presenting this data, see Thuronyi, above n 4, 1198-2000.

¹⁰⁷ Witte, above n 12.

¹⁰⁸ Ibid 384.

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the provision of tax concessions to rent seekers is open to question in light of the Australian experience. Although the government of the day has rarely controlled the Senate, this has not stopped a steady stream of tax expenditures finding their way on to the statute books. If anything, the Australian experience suggests that the actions of the executive branch should be subjected to transparent and comprehensive critical scrutiny if tax expenditures are to be brought before the public eye.

4.4.2 Ongoing and More Efficient Scrutiny of the Taxation System

In more recent times scrutiny of the taxation system has been facilitated by the conduct of a number of inquiries into the operation of the Australian taxation system.¹⁰⁹ These inquiries have broadly agreed upon the nature of the benchmark taxation system which ought be adopted in developing a taxation system. Although these inquiries have been useful in fostering tax reform in Australia, they are a less than satisfactory means of facilitating ongoing public scrutiny as they are only called on an ad hoc basis and their terms of reference may be restricted in any number of ways.¹¹⁰ Further, as noted in the most recent government review of the taxation system, such inquiries are often hamstrung by the lack of relevant information.¹¹¹ This is a sorry tale of “managing” from ignorance a taxation system that exceeds \$200 billion per annum.¹¹²

There is clearly a need for ongoing review of the Australian tax system, and a TES which provided the broader range of information envisaged by the third purpose of tax expenditures noted above could

¹⁰⁹ Commonwealth, *Taxation Review Committee - Full Report* (1975) (“Taxation Review”); Commonwealth, *Reform of the Australian Taxation System* (1985) (“Taxation Reform”); and Commonwealth, *A Strong Foundation* (1998) ch 6 (“Strong Foundation”).

¹¹⁰ Note, eg, the limitation imposed upon the most recent review of taxation which restricted it to “business taxation”: Ralph Review, above n 15, vi.

¹¹¹ *Ibid* 149-150.

¹¹² This figure is based upon Treasury’s limited definition of a tax expenditure, and ignores all of those unquantified tax expenditures: Budget Paper, above n 30, 24.

fill the information gap noted by the Ralph Review. The piecemeal information required under the first and second purposes of TES is simply inadequate for the purposes of reviewing the broad operation of the Australian tax system.

While some might say that the government cannot afford the extra resources to expand the TES, the obvious response is that the government cannot afford to continue to run a tax system upon the basis of such poor information and, possibly, misinformation. Indeed, it might be suggested that the Australian public has a right to a comprehensive TES that is founded upon well resourced research. Although the preparation of a comprehensive TES might entail a substantial increase in the budgetary allocation to the relevant institution to enable it to undertake this function, such costs might well be recouped as a result of tax reforms flowing from review of the information contained in the TES.¹¹³

If the TES provided a broader range of information it would serve three purposes. First, it would fulfil the relatively limited purpose envisaged by Stanley Surrey – to flush tax expenditures out into the open and render them liable to public and legislative scrutiny. Second, it would amount to a tax policy resource compendium which would facilitate public scrutiny of particular aspects of the taxation system by tax professionals, treasury, legislators, public interest groups, journalists and political lobbyists.¹¹⁴ Of course, specific policy recommendations upon proposed reforms would be beyond the scope of the TES. However, a more robust statement would obviate much of the work currently undertaken by the reviews of taxation undertaken on an ad hoc and

¹¹³ In recent times the ATO has received funding for additional staff upon the basis that the additional staff will generate additional tax revenue: Australia, *Treasury Portfolio Budget Statements 2004-05* (2004) 188 Table 1.2. Although it would be nonsensical to adopt a similar approach with respect to resources allocated to the preparation of a tax expenditure statement by Treasury, the same “spending a penny to save a pound” principle applies.

¹¹⁴ See Compendium, above n 97.

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often limited and ill-informed basis.¹¹⁵ Thirdly, an expanded TES would be useful to those charged with implementing the tax law. The statement would lower compliance costs as it would be a research pathway to extrinsic materials and secondary commentary relied upon when interpreting the tax law. Although the days when there is a comprehensive and free database which annotates the tax legislation may be far off, at least an expanded TES would serve to identify relevant government reports etc dealing with each particular tax expenditure. One need only review the Congressional Research Service report prepared on behalf of the US Senate Budget Committee to see what can be achieved in terms of transparent scrutiny of tax expenditures.¹¹⁶

5. THRESHOLD ISSUES IN FRAMING A TAX EXPENDITURES STATEMENT

Assuming that a TES designed to fulfil all three purposes should be prepared, there are a number of threshold issues which should be considered.

5.1 Institutional Responsibility for Issuing Tax Expenditures Statements

The nature of the information necessary to fulfil the third purpose impacts upon the selection of the most appropriate government institution charged with the task of preparing the TES. Although this responsibility is generally invested in the Treasury,¹¹⁷ Treasury is not necessarily the best institution for the preparation of such a document.

Over the past two decades there is a growing literature regarding the perceived deprofessionalisation of the public service in

¹¹⁵ Ralph Review, above n 15, 149-150.

¹¹⁶ Compendium, above n 97. See also US Estimates, above n 104.

¹¹⁷ Brixi et al, above n 5, passim.

Australia.¹¹⁸ While it is doubtful that any institutional framework will exclude any possibility of public servants being “captured” by the government of the day,¹¹⁹ this does not mean that close attention to institutional arrangements which minimise this prospect is otiose. Given that the Treasury Secretary is not appointed as a Commissioner it is possible that Treasury may be reluctant to provide frank and fearless advice to the government of the day. The experience in the United States suggests that such conflicts of interest may jeopardise the integrity of tax expenditure reporting:

Beyond the summary descriptions and estimates, there is no regular and systematic evaluation of tax expenditures conducted by the executive branch of the federal government ... Clinton’s Treasury Department, of which I was a part from 1998 to 2000, was unenthusiastic about performing these evaluations, reasoning that a comprehensive evaluation of tax expenditures would necessarily raise serious objections to measures enthusiastically advanced by the Administration. The result would either be a waste of staff time, as a credible analysis would never be published, or a whitewash that would damage the credibility of the Treasury staff. Although the menu of favourite tax expenditures changed when President Bush took office, the Office of Management and Budget has not published any new tax expenditure analyses as part of [*the Government Performance Results Act 1993*], suggesting that the same concerns still hold sway.¹²⁰

Whether or not such conflicts actually exist in Australia, this literature suggests that TES should be prepared by an independent Commissioner. As any lawyer should know, when talking about conflict of interest one must be conscious of actual and perceived conflicts of interest. Although the Commissioner of Taxation

¹¹⁸ Editorial, “Let’s Lose Rose Coloured Spectacles Here and Now”, *The Canberra Times*, 1 July 2004, 15; M McKinnon, “Hidden Papers Challenge Democracy” *The Australian*, 10 July 2004, 1; M Costello, “Let’s Re-create Bureaucrats’ Independence” *The Australian*, 7 May 2004, 15.

¹¹⁹ P Kelly, “Risk of Deceit”, *The Australian*, 28 August 2004, 19.

¹²⁰ LE Burman, “Is the Tax Expenditure Concept Still Relevant?” (2003) 56 *National Tax Journal* 613.

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(“Commissioner”) may be a logical choice, it should be noted that the Commissioner is only appointed for a limited term and so may be influenced by the government.¹²¹ The statutory protections of the independence of the Commissioner should therefore be reconsidered in conjunction with transfer of the tax expenditure reporting function, or the tax expenditure reporting function be transferred to an alternative and independent government agency.

5.2 Integrating the Tax Expenditures Statement into a Tax Policy Review Framework

Australia has developed a considerable depth in its tax policy literature. Remarkably, however, no concerted effort has been made to systematise that literature. Given the oft noted shift to purposive construction of legislation, one would have thought that greater effort would have been devoted to developing and systematising the extrinsic materials underlying Australia’s tax legislation. Especially Australia’s tax legislation, given its economic significance and the evident uncertainty of many key taxation concepts. Unfortunately the official tax policy literature is remarkably diffuse, making public and legislative oversight of the tax system extremely difficult. Tax legislation, Australian Taxation Office annual reports, Treasury papers including the TES, ad hoc government taxation reviews, parliamentary committee reports, government agency reports and the reports of various statutory bodies are scattered across the official landscape like so much confetti.

I am not aware of any literature specifically dealing with this issue, but doubtless the separation of powers doctrine represents a compelling justification for not concentrating review of the taxation system in one body.¹²² But this does not necessarily dictate that the

¹²¹ Compare the attempts to entrench the independence of the Commissioner of Inland Revenue in New Zealand: *State Sector Act 1988* (NZ), Pt 3; and *Tax Administration Act 1994* (NZ), s 6B.

¹²² This would explain why in the United States, for example, tax expenditures statements are prepared on behalf of the executive (Analytical Perspectives, above n

work of each review agency/body/committee cannot be structured around some core taxation principles expressed in a framework document. These core principles have been expressed time and time again in successive Commonwealth reviews of the Commonwealth taxation system.¹²³ Indeed, the Ralph Review even recommended that a “Charter of Business Taxation” incorporating a statement of taxation principles be adopted.¹²⁴ Although these fundamental taxation principles would not lead to a determinate taxing rule on each particular issue,¹²⁵ in enacting specific legislation the legislature could refer to these principles in justifying each particular rule, noting the compromises which had to be made and the reasons for why a compromise was framed in a particular way. The principles would be a part of the tax framework, routinely referred to by legislators, judges, practitioners and public alike. Although not suggested by the Ralph Review, the functionality of such a statement of principles could have been enhanced by the inclusion of an appendix comprising an annually updated compendium of relevant official literature dealing with the taxation law.

Such a statement of fundamental taxation principles would be the starting point for any TES – defining the benchmark taxation system would be a matter of applying those principles in constructing a normative taxation system.

76), Congress (US Estimates, above n 104) and the Senate (Compendium, above n 97) respectively.

¹²³ See the material referred to in note 109 above.

¹²⁴ Ralph Review, above n 15, ch 1.

¹²⁵ For a critical consideration of alternative interpretive theories in the context of taxation law see M Burton, “The Rhetoric of Tax Interpretation” (Paper delivered at 17th Australasian Tax Teachers Association Conference; Wellington; 26-28 January 2005).

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6. GRAPPLING WITH THE DEFINITION OF A TES BENCHMARK

6.1 A TES Founded Upon Benchmark Taxes, a Benchmark Tax System or a Benchmark Legal Framework?

In elaborating upon the tax expenditure concept, Surrey focused upon the income tax but noted, almost as an afterthought, that the tax expenditure concept could also be applied to other tax bases.¹²⁶ Despite this recognition of the relevance of the tax expenditure concept to alternative tax bases, Surrey suggested that the concept was an inappropriate policy tool for developing a global appraisal of a national taxation system.¹²⁷ However, if discrimination between taxpayers is the lynchpin of the tax expenditure concept, shouldn't a TES reflect the discriminatory effects of a nation's tax system regardless of whether or not those discriminatory effects result from express or implied legislative choices?

One obvious example here is a nation's treatment of pollution. If the benchmark norm is defined in terms of neutrality, a failure to tax or regulate a person's externalised costs of economic activity may be discriminatory. It will be discriminatory where another person is subject to a pollution tax or to regulation, or where a producer of the same good does not create externalities. Take, for example, the case of wind powered electricity generation and coal fired electricity. Leaving to one side the visual pollution which some see in a wind generator, failing to tax or regulate the externalised costs of coal fired thermal power stations amounts to a breach of the neutrality principle and hence, an implicit tax or regulatory "expenditure". Now what if the legislature decided to try and even up this non-

¹²⁶ Surrey, *Pathways*, above n 3, 26-29. Note Bittker's observations upon the limitations of the tax expenditure concept in its application to other tax bases: Bittker, *Subsidies*, above n 40, 259-260.

¹²⁷ Surrey, *Pathways*, above n 3, 27. For a fascinating account of the early recognition of the need for a holistic approach to tax system design see W Kennedy, *English Taxation 1640-1799* (1913).

neutrality by introducing an income tax concession for sustainable energy production – accelerated depreciation or a tax exemption, for example. According to Surrey’s view, such a concession would be a tax expenditure because it would represent a departure from the normative income tax base. However, by looking at the tax/regulatory system as a whole, there would be no tax expenditure (assuming that the tax concession was considered to achieve neutrality between alternative forms of energy production). Of course, Surrey might have responded to this criticism by saying that the broader analysis envisaged in the preceding sentences would have been undertaken at the second stage of the tax expenditure inquiry – where each tax expenditure was put to the test of efficiency and outcomes achieved.¹²⁸ However, the point of the discussion is that this second order inquiry could be obviated if an alternative tax expenditure concept, framed upon neutrality, were applied in identifying tax expenditures.

If a TES is meant to be used for the purpose of appraising a nation’s taxation system overall, shouldn’t such implicit discrimination be brought into the open just as much as provisions which expressly discriminate in favour of or against particular taxpayers?¹²⁹ And what of discriminatory regulatory settings? Not to report such items merely entrenches the status quo and slows the wheels of change towards neutral fiscal and regulatory settings. Surrey’s reluctance to incorporate such considerations into his tax expenditures report is attributable to his desire to enhance the rhetorical appeal of the tax expenditure concept. Doubtless he was mindful of the absence of relevant information to enable this broader tax expenditures reporting. Indeed it is doubtful that there will ever

¹²⁸ Surrey and McDaniel, above n 2, 696.

¹²⁹ In this regard it is interesting to compare the respective approaches to ecotaxes adopted in the reviews of business taxation undertaken in Canada and Australia respectively in the late 1990s. In Canada, an entire chapter was devoted to the subject: Canada, *Technical Committee on Business Taxation Report* (1998). In Australia consideration of this issue was merely mentioned in passing: Strong Foundation, above n 109, para 6.10.

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be sufficient and accurate data to quantify, with relative accuracy, the externalised costs of economic activity. What is the externalised cost of cyanide released into the environment as a part of the gold refining process, for example?¹³⁰ How does this compare to the externalised costs arising from the release of radioactive material into World Heritage wetlands? The subjectivity of such judgements would have left Surrey's purportedly objective tax expenditure concept in tatters, mired in an academic bog rather than having the real political effect which he desired.

Surrey's argument for restricting the tax expenditure appraisal to a tax by tax approach is unconvincing if it is accepted that a tax expenditure statement should play a significant role in tax system review. While comprehensive and global reporting of regulatory and tax provisions with discriminatory effect is an attractive ideal, it is doubtful that such an ideal could ever form the basis of a working tax expenditures/regulatory intervention statement. Nevertheless, at the least, some discussion of these issues in the TES would enhance public scrutiny of the choices made in framing the statement itself. And the discussion would prompt greater awareness of the second order effects of key tax policy decisions such as the limited use of pollution taxes by comparison to some other jurisdictions.¹³¹

6.2 Dealing with the Problematic Nature of the Tax Expenditure Concept – towards a transparent consideration of alternatives

Assuming that, for the time being, Surrey's tax by tax approach to tax expenditure reporting must be adopted for pragmatic reasons, it is generally accepted that some relatively uncontroversial

¹³⁰ M Burton and W Gumley, "Tax and the Environment" (Paper delivered at the 12th Australasian Tax Teachers Association Conference; Monash University, Melbourne; 3-5 February 2000).

¹³¹ For an overview of the increasing range of eco tax measures adopted in OECD countries see OECD, *Environmentally related taxes in OECD Countries: Issues and Strategies* (2001).

definition of the tax expenditure concept must be identified.¹³² In light of the earlier discussion of the competing discourses in the tax expenditure literature, it is most unlikely that this ideal will ever be achieved. At its most general level, a tax expenditure has been defined as “a departure from the generally accepted or benchmark tax structure, which produces a favourable tax treatment of particular types of activities or groups of taxpayers”.¹³³ However, even this definition is contentious as it ignores the possibility that the tax laws may operate to impose a more onerous burden upon particular classes of taxpayers than that dictated by the benchmark system (ie a negative tax expenditure). Similarly, it has long been accepted that the definition of “tax expenditure” begs the question as to the nature of the “generally accepted or benchmark tax structure”.¹³⁴ Any tax system must address certain fundamental questions – what I call the who, what, when, where, how and how much questions. Who pays the tax (taxable entities), what is subject to the tax (the tax base), when is the tax payable (the tax period), which jurisdiction claims the tax, how is the tax raised (tax administration) and how much tax is payable. The enormous literature dealing with these issues evidences the fact that it is unlikely that there ever will be universal agreement upon an ideal of any one of these components of a tax system, let alone a combination of these components (which may entail compromises).

The search for a universal definition of the benchmark taxation system may be a forlorn quest, nevertheless transparent administration dictates that problematic issues must be resolved in a transparent way. There may not be definitions of the tax expenditure concept or of the benchmark taxation system which are absolutely right, but transparency dictates that this absence of a universal norm be acknowledged and open to critical consideration. Although the

¹³² Shaviro, above n 56, 217.

¹³³ OECD, *Tax Expenditures*, Paris, 1984, 1; and Surrey and McDaniel, above n 40, 3.

¹³⁴ Bittker, *Tax Base*, above n 40.

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fractured reporting of tax expenditures in the United States is not necessarily a template to be followed elsewhere,¹³⁵ the practice of the US Treasury Service in measuring tax expenditures against alternative tax base benchmarks is instructive.¹³⁶ By acknowledging and accommodating the competing discourses underlying much of the debate regarding TES, the United States Treasury fosters a critical appreciation of the key tax policy issues embedded in the United States income tax. In the following sections I will illustrate how the framework taxation principles might deal with some aspects of the who, what, when, where, how and how much questions.

6.3 Defining the Benchmark Tax Base

Defining a benchmark tax base has proven to be problematic and a substantial body of literature has been devoted to this subject.

6.3.1 *Categorising the Tax*

Defining a benchmark tax base essentially entails a judgement call regarding the essential character of the tax. Even in the case of the Commonwealth “income tax”, this is not as easy as it sounds because the “income tax” in fact includes some consumption tax hallmarks. Thus, for example, the concessionary treatment of retirement savings during the contribution phase is consistent with the consumption tax benchmark – the non-taxation of savings. However, in the case of the “income tax” Stanley Surrey ignored the consumption tax aspects of the existing US income tax¹³⁷ and settled upon a benchmark framed in terms of Simons’ comprehensive income tax base. Surrey’s dogmatic assertion that the “income” tax was to be measured against an income tax benchmark meant that a provision of the “income tax” such as the deferral of taxation with respect to contributions to a pension fund will be labelled a “tax expenditure”, but would not be a tax expenditure if measured against

¹³⁵ See the material referred to in note 122 above.

¹³⁶ Analytical Perspectives, above n 76, ch 19.

¹³⁷ Surrey, Pathways, above n 3, 21.

a consumption tax benchmark. The same proposition holds in Australia where the concessionary treatment of superannuation contributions is labelled a “tax expenditure”.¹³⁸ Indeed, under a consumption tax benchmark, the imposition of income tax upon deductible superannuation contributions as well as the imposition of Superannuation Contributions Surcharge¹³⁹ would be negative tax expenditures if measured against a consumption tax benchmark.

In response to this debate regarding the categorisation of the “income” tax, in the United States the Treasury Service offers alternative tax expenditure accounts measured against income and consumption tax base benchmarks respectively.¹⁴⁰ A similar approach, if adopted in Australia, would only serve to enhance tax policy deliberations by compelling the categorisation of particular tax provisions as well as prompting a transparent review of the targeting of those provisions. For example, for some time reform of the taxation treatment of retirement savings has been mooted but only piecemeal changes rather than fundamental reform have materialised.¹⁴¹ As it stands, much of the complexity of retirement savings in Australia arises from the fact that the rules governing the taxation of retirement savings represent a compromise between income and consumption tax imperatives – our tax rules do not know whether to treat retirement savings as “an accretion to wealth” and hence income or as savings and hence non-consumption. A more comprehensive discussion of alternative taxation benchmarks in the Australian TES would serve to highlight such conceptual issues and,

¹³⁸ Tax Expenditures, above n 7, 159.

¹³⁹ *Superannuation Contributions Tax Imposition Act 1997* (Cth); and *Superannuation Contributions Tax (Members of Constitutionally Protected Superannuation Funds) Imposition Act 1997* (Cth).

¹⁴⁰ See Analytical Perspectives, above n 76, 351-355.

¹⁴¹ Most recently, the Australian Treasury released a discussion paper regarding relatively minor changes to the rules governing the types of pensions which could be provided by DIY superannuation funds: Commonwealth, *Review of Provision of Pensions in Small Superannuation Funds* (2005).

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possibly, be the catalyst of public pressure for legislative reform in this area.

6.3.2 Benchmarks for Non-income/Consumption Taxes

The same categorisation problem arises with respect to other tax bases. Although some variation upon the Schanz-Haig-Simons definition of horizontal equity is generally recognised as the appropriate benchmark for the purposes of appraising the income tax system, it is generally accepted that the principle of equity is not an appropriate standpoint for assessing other taxes imposed at both Commonwealth and State levels.¹⁴² For example, the income benchmark is clearly an inappropriate critical standpoint from which to assess the merits of the so called “sin taxes” imposed upon tobacco and alcohol and any Pigovian tax which imposes the cost of pollutants emitted upon the polluters.

In appraising such taxes alternative benchmarks must therefore be developed. This necessarily entails a determination regarding the essential character of the tax. As already noted, many commentators appear to proceed upon the basis that this characterisation of a tax entails recourse to the legislative intention underpinning the Act. In the context of the “income” tax, this is problematic because the income tax is a curious meld of income and consumption tax bases. In the case of Pigovian taxes, presumably the rationale for such a tax is neutrality – levelling playing field by bringing the externalised costs of economic activity home to the economic actor producing them. However, what if a Pigovian tax is modified to take account of equity concerns by, for example, allowing an exemption/rebate for low income earners? In the case of the sin taxes, taxes upon consumption and immigration taxes, the benchmark may be more problematic.

The fact that there is some degree of subjectivity in the definition of the benchmark and/or in the application of the benchmark to

¹⁴² Surrey, Pathways, above n 3, 26-29.

particular circumstances is not, in itself, reason to abandon such benchmarks. Transparency would suggest that the difficulties of identifying the relevant benchmark be acknowledged.

6.3.3 *Identifying a Benchmark Income Tax Base*

Even if it is accepted that the appropriate benchmark for the “income tax” is a comprehensive income tax base, many conceptual difficulties must be resolved. Having defined income as the sum of consumption plus savings over any defined period, Simons acknowledged that no income tax could achieve this tax base in practice.¹⁴³ The inclusion of leisure income¹⁴⁴ and self provided services, for example, were recognised as particularly problematic and were therefore excluded from the benchmark upon pragmatic grounds.¹⁴⁵ Conceptual difficulties arise with respect to the definition of consumption.¹⁴⁶ There is also some controversy regarding the assumption that income, as defined, is an accurate comparative measure of an individual’s circumstances.¹⁴⁷ Practical difficulties arise with respect to the ascertainment of the market value of some investments,¹⁴⁸ the recognition of inflation, the difficulty of accounting on an accruals basis rather than on a realisation basis and

¹⁴³ H Simons, *Personal Income Taxation* (1938) ch 2.

¹⁴⁴ *Ibid* 52.

¹⁴⁵ *Ibid* 111-112.

¹⁴⁶ W Turnier, “Personal Deductions and Tax Reform: The High Road and the Low Road” (1986) 31 *Villanova Law Review* 1703, 1705-1707; Andrews, above n 40, 335; R Musgrave and P Musgrave, *Public Finance in Theory and Practice* (5th ed, 1989) 342-343; Canada, *Report of the Royal Commission on Taxation (Canada)* (1966-1967) (vol 3), 5ff (“Carter Royal Commission Report”); and S Koppelman, “Personal Deductions Under an Ideal Income Tax” (1988) 43 *Tax Law Review* 679, 712.

¹⁴⁷ In particular, the reliance upon “market value” assumes that there is one marketplace.

¹⁴⁸ For example, in the context of transfer pricing the identification of a market value is particularly problematic where there is no market for the particular item under consideration.

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the difficulty of measuring some forms of consumption income such as imputed income.¹⁴⁹

Given the substantial obstacles to the implementation of Simons' comprehensive income concept, it is not surprising that Surrey jettisoned this as the basis for a workable tax expenditure definition. Instead, Surrey modified the concept of comprehensive income having regard to the vague standard of "communal acceptance" of a particular benchmark tax base.¹⁵⁰ As communal understanding of the income concept changed, Surrey noted, so would the tax expenditure benchmark. Thus, for example, the taxation of imputed income from owner-occupied housing was not included in Surrey's formulation of the income benchmark. However, the taxation of capital gains on a realisation basis rather than an accruals basis was included in the benchmark.¹⁵¹ Responding to Surrey's formulation of the tax expenditure concept, Bittker argued that adoption of the Haig-Simons concept of income was inappropriate because too many departures from this ideal were dictated by necessity.¹⁵² In such circumstances, Bittker argued, it could hardly be said that a government had decided to confer a preferential tax benefit when it decided, for example, to adopt a realisation basis of accounting for capital gains in the same way that it had conferred a tax benefit by allowing accelerated depreciation of farming equipment.¹⁵³

A choice must be made here – to report all departures from a comprehensive income base including those which are unlikely to be altered, to restrict the list of tax expenditures to those items which are realistically open to reform or repeal or to attempt some combination of the two? For a time the Australian Treasury flirted

¹⁴⁹ Simons, above n 143, 50-58.

¹⁵⁰ Surrey, Pathways, above n 3, 18.

¹⁵¹ Ibid 18-19.

¹⁵² Bittker, Subsidies, above n 40, passim.

¹⁵³ Ibid 249-250.

with the second approach,¹⁵⁴ but in more recent times it has moved towards the first approach.¹⁵⁵ The Canadian Department of Finance adopts a broad income tax base benchmark and therefore essentially adopts the first approach.¹⁵⁶ The arms of the US government which issue TES, the US Treasury,¹⁵⁷ Joint Committee on Taxation¹⁵⁸ and the Congressional Research Service¹⁵⁹ collectively adopt the third approach but exclude negative expenditures owing to the limited legislative definition of the tax expenditure concept.¹⁶⁰

The US Treasury applies both a “normal” tax benchmark and also a “reference” law benchmark in appraising the various taxes examined in the tax expenditures report. The normal tax benchmark is modelled upon a comprehensive definition of income, although there are some departures from the comprehensive income base – one notable example being the denial of attribution of corporate profits to corporators. The reference law benchmark is more closely modelled upon the existing law, and identifies those principles considered fundamental to the law so that any departures from that principle made for programmatic purposes can be identified as tax expenditures.¹⁶¹ Thus, in the context of the federal income tax, accelerated depreciation is identified as a tax expenditure under the normal tax benchmark but not under the reference tax benchmark.¹⁶² It should also be noted that the Joint Committee on Taxation adopts a somewhat different definition of the tax expenditure concept –

¹⁵⁴ Commonwealth of Australia, *Taxation Expenditures Statement 1997-98* (1999) 60: noting that departures from the benchmark were necessary to ensure that the tax expenditure concept remained “relevant”.

¹⁵⁵ Tax Expenditures, above n 7, 20: where modifications to the comprehensive income tax base are apparently only made to take account of “structural” factors.

¹⁵⁶ Canada, *Tax Expenditures and Evaluations 2004* (2004) 9.

¹⁵⁷ Analytical Perspectives, above n 76, ch 19.

¹⁵⁸ US Estimates, above n 104.

¹⁵⁹ Compendium, above n 97.

¹⁶⁰ *Budget Act 1974*, s 3(3).

¹⁶¹ Analytical Perspectives, above n 76, 330-331.

¹⁶² *Ibid* 331.

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serving to enhance the transparency of the substantive appraisal of tax expenditures.¹⁶³

The preceding discussion demonstrates that essentially subjective judgements must be made in defining an income tax base benchmark. For the purposes of enhancing public understanding of the tax policy underlying the Commonwealth taxation framework, and also for the purpose of enhancing the transparency of the decision making involved in framing the TES, it would be preferable if the reasoning behind adopting particular benchmarks was clearly expressed.

For example, the Australian Treasury states that “the income tax benchmark applies to nominal rather than real income, consistent with a longstanding feature of Australia’s taxation arrangements”.¹⁶⁴ It would be beneficial if Treasury noted the implications of this judgement – the fact that this decision means that some negative tax expenditures are ignored. The failure to index capital asset cost bases and interest income, for example, means that taxpayers’ taxable incomes will often exceed their economic income. Further, accelerated depreciation and the concessional treatment of capital gains may be justified, at least to some extent, as an attempt to redress this failure of the core income tax rules.¹⁶⁵ If a comprehensive tax base were to be adopted, loss deduction restrictions would also need to be recognised as negative tax expenditures. Thus, for example, the passive loss rules,¹⁶⁶ the restrictions upon the ability to utilise capital losses, the double-quarantining of collectable asset losses and the wastage of losses upon death should all be counted as negative tax expenditures.

¹⁶³ Compendium, above n 97, 6.

¹⁶⁴ Tax Expenditures, above n 7, 21.

¹⁶⁵ Analytical Perspectives, above n 76, 331.

¹⁶⁶ ITAA97, Div 35.

6.4 Identifying a Durable Benchmark

The vagaries of the tax expenditure concept make it all the more important that Treasury identify a durable benchmark taxation system. Although Stanley Surrey accepted that the benchmark may change over time, it is doubtful that he had in mind the seemingly whimsical variation of the benchmark evident in Australian tax expenditures reporting from time to time. A review of recent TES reveals an unsettling preparedness on the part of Australian Treasury to vary the “benchmark” on pragmatic grounds – a practice which devalues the force of the benchmark concept.¹⁶⁷

Thus, for example, in 1999 the Commonwealth Treasury issued the *Tax Expenditures Statement 1997-98*,¹⁶⁸ suggesting that it had categorised “marginal” items as tax expenditures for the sake of completeness.¹⁶⁹ However, that TES seems to have excluded some items upon the basis of an assessment of political reality rather than any consideration of economic policy. Thus, for example, the taxation of inheritance income was summarily dismissed:

The income received from an inheritance would ... fall within the Schanz-Haig-Simons definition of income, but the non-taxation of ... [this item] is considered part of the benchmark for the purposes of this statement.¹⁷⁰

For the purposes of the *Tax Expenditures Statement 2004*, it seems that the tax deferral of gain recognition with respect to assets transmitted under a deceased estate is no longer part of the benchmark and is therefore itemised as a tax expenditure.¹⁷¹ However, this item is not quantified and is therefore excluded from any consideration of the policy implications of tax expenditures, this

¹⁶⁷ Statement 1997-98, above n 73, 60.

¹⁶⁸ Ibid.

¹⁶⁹ Ibid 60.

¹⁷⁰ Ibid 64.

¹⁷¹ Ralph Review, above n 15, 140, item E10.

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consideration only being undertaken with respect to *measured* tax expenditures.¹⁷²

With respect to the capital gains provisions, cost base indexation prior to 21 September 1999 was considered to be “an intrinsic feature of the capital gains tax system”¹⁷³ and was therefore included in the benchmark. This was consistent with the measurement of economic gains rather than nominal gains. However, this “intrinsic” feature was quickly removed from the benchmark following the repeal of cost base indexation with respect to assets acquired on or after 21 September 1999.¹⁷⁴

The need to identify a durable benchmark has been recognised in Canada, where the Finance Department takes a far more comprehensive, and hence durable, approach:

This report takes a broad approach and includes estimates and projections of the revenue loss associated with all but the most fundamental structural elements of the tax system, such as the progressive personal income tax rate structure. This includes not only measures that may reasonably be regarded as tax expenditures but also other measures that may be considered part of the benchmark tax system. The latter are listed separately under “Memorandum Items”.¹⁷⁵

In more recent TES the Australian Treasury appears to have moved towards the Canadian approach by adopting a comprehensive tax base as the benchmark, but nevertheless substantial advances need to be made if this process is to be completed. For example, in some cases the TES omits departures from the stated benchmark. For example, the exemption of collectable assets with a first element cost base of \$500 or less,¹⁷⁶ the exemption of lottery winnings and such

¹⁷² Ibid.

¹⁷³ Statement 1997-98, above n 73, 61; see also the consideration of the company imputation system: *ibid* 62.

¹⁷⁴ Commonwealth, *Tax Expenditures Statement 2000* (2001) 17.

¹⁷⁵ Canada Expenditures, above n 82, 9.

¹⁷⁶ *Income Tax Assessment Act 1997* (Cth), s 118-10(1) (“ITAA97”).

like¹⁷⁷ and the exclusion of personal use asset gains where those assets have a first element cost base of \$10,000 or less¹⁷⁸ are just some examples of this partial approach to applying the stated benchmark.

Further, although the TES currently records the fact that there can be negative tax expenditures (ie penalties imposed upon taxpayers under the existing law), such tax expenditures are often not recorded in the TES. From a tax policy perspective, it would be preferable to know whether a particular positive tax expenditure was effectively cancelled out by a negative tax expenditure arising elsewhere in the tax system, or even by a direct subsidy. A comprehensive listing of negative tax expenditures should therefore be included in the TES. Some examples of such negative tax expenditures are the so called “black hole” expenditures,¹⁷⁹ the penal treatment of trust income under s 99A,¹⁸⁰ the denial of any deduction for bribes paid to public officials¹⁸¹ and the modified tax rate scale with respect to “unearned income” under *Income Tax Assessment Act 1936* (Cth), Div 6AA (“ITAA36”). Only the latter item is expressly referred to by Treasury.¹⁸²

6.5 Substance and Form

Having settled upon a durable definition of the benchmark tax base, a decision must be made as to whether a substance oriented or a form oriented approach should be applied in making the numerous judgements necessary in measuring existing law against the benchmark. At present, the Australian Treasury appears to adopt an

¹⁷⁷ ITAA97, s 118-37(1)(c).

¹⁷⁸ ITAA97, s 118-10(3).

¹⁷⁹ Commonwealth, above n 109, Strong Foundation, 18-19.

¹⁸⁰ *Income Tax Assessment Act 1936* (Cth), s 99A (“ITAA36”). In certain circumstances, trust income to which no beneficiary is presently entitled is taxed at the top marginal rate of tax.

¹⁸¹ ITAA97, ss 26-52 and 26-53.

¹⁸² Tax Expenditures, above n 7, 65, Item A52.

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inconsistent approach. Thus, in stating that the Goods and Services Tax (“GST”) is ignored because the GST revenue is collected on behalf of the states and Territories,¹⁸³ Treasury is essentially adopting a substance oriented approach. However, in listing departures from the taxation benchmark, Treasury essentially adopts a formalistic approach by focusing upon tax concessions expressly set out in the legislation. This formalistic approach means that some categories of implicit tax concessions are ignored. For example, the expensing of advertising costs,¹⁸⁴ the expensing of stamp duty paid upon the acquisition of an income-producing leasehold in the Australian Capital Territory,¹⁸⁵ the exceptions to Pt III Div 6AA which allow income splitting with testamentary trusts, the failure to tax corporate benefits provided to shareholders,¹⁸⁶ the limited accrual of foreign source income under ITAA36, Pt X and the omission of the differential treatment of companies and trusts discussed below are just some examples of implicit tax concessions overlooked by Australian Treasury.

6.6 Selection of Tax Entity

6.6.1 *Individuals and the corporate form*

The substance/form issue is also significant to the determination of the benchmark tax entity(ies). The Australian TES states that the taxable entity with respect to personal taxation is the individual, while the taxable entity with respect to corporate taxation is the company.¹⁸⁷ In the absence of express consideration of the

¹⁸³ Ibid 5.

¹⁸⁴ Cf Canada. Expenditures, above n 82, Table 2 under heading “General Business and Investment”.

¹⁸⁵ ITAA97, s 25-20. Given that there are no private freehold interests in the Australian Capital Territory and that the acquisition of a leasehold is effectively identical to the acquisition of a freehold interest, this is an implicit tax concession to the acquisition of commercial/rental property in the Australian Capital Territory.

¹⁸⁶ Cf the definition of “distribution” under the proposed unified entities regime, considered by the Ralph Committee: Ralph Review, above n 15, ch 12.

¹⁸⁷ Tax Expenditures, above n 7, 24.

justification for these choices, one can only speculate about what rules comprise the “personal taxation system” and what rules comprise the “corporate taxation system” and why these entities were adopted for benchmarking purposes. This is hardly a transparent explanation of Treasury’s judgements with respect to a critical aspect of the benchmark tax system.

From the perspective of economic substance, the ideal tax system would be founded upon a full integration of shareholders with companies such that shareholders would be taxed upon their share of corporate income on an accruals basis.¹⁸⁸ In the case of closely held companies, this full integration model could be modified by a substance rule which attributes income to the true controllers of the income and possibly even the person who generates the income.

6.6.2 Neutrality Across Entities

The recognition of individuals and companies as tax units for the benchmark income tax system ignores the fact that trusts are treated as something of a hybrid for income tax purposes. Thus, the differential treatment of discretionary trusts and unit trusts under CGT Event E4 is ignored, despite the fact that the flowthrough of tax deductions allowed to discretionary trusts represents a clearly concessional treatment by comparison to fixed trusts and companies. Similarly the washout of corporate tax preferences through the dividend imputation system, by contrast to the flow through of tax preferences adopted for partnerships, discretionary trusts and in some cases unit trusts, constitutes discrimination against the corporate form. With respect to the latter point, the Australian Treasury observes:

The value of some concessions reported in this statement is partially offset as a result of the imputation system. For example, concessions that reduce company tax may be “clawed back” through the subsequent taxation of dividends in the hands of shareholders. The

¹⁸⁸ See, eg, Taxation Reform, above n 109, 196.

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estimates in this statement generally make no allowance for this clawback due to the practical difficulties of doing so.¹⁸⁹

The lack of data is understandably a problem. However, as discussed later, such information is clearly significant if the third purpose of TES is to be achieved. The tax expenditures aggregates may be substantially less than the figures reported and the non-neutral treatment of corporate profits is clearly a significant tax system design issue which needs to be considered in the light of comprehensive information. The indication that “generally” such non-neutrality is not factored into the individual tax expenditure estimates is unhelpful – for which tax expenditures is sufficient data available and is it possible to extrapolate from these to some estimate of the quantum of this “washout” effect?

With these and other anomalies in mind, the Australian Government had announced proposals for the taxation of trusts to move away from the current full integration approach towards the partial integration approach adopted in the case of companies under the imputation system.¹⁹⁰ This proposal has now been rejected by the government but this does not mean that the existing treatment of trusts should be tacitly accepted as part of the benchmark. The treatment of trusts under a benchmark taxation system needs to be spelt out if the preferential treatment of some classes of trust income are to be recognised and this opportunity for tax minimisation subjected to open critical scrutiny along with other tax concessions.

6.6.3 *Individuals and Income Splitting*

There is a considerable body of literature dealing with the most appropriate unit of taxation.¹⁹¹ With respect to personal taxation, the

¹⁸⁹ Tax Expenditures, above n 7, 17.

¹⁹⁰ Commonwealth, *Tax Reform: Not a New Tax, a New Tax System* (1998) 113. This proposal was considered at length by the Ralph Review of Business Taxation: Ralph Review, above n 15.

¹⁹¹ For discussion of the question of family unit taxation as opposed to taxation of the individual see J Head and R Krever (eds), *Tax Units and Tax Rate Scale* (1996);

mainstream view is that the individual is the most appropriate unit of taxation, and with some exceptions this has been the general approach adopted under Commonwealth tax legislation.¹⁹² The identification of the individual as part of an income tax benchmark is therefore relatively uncontroversial provided that a broad concept of economic income is adopted, particularly one which includes the value of market rights controlled by a particular individual.

Unfortunately, it seems that the benchmark adopted for the purposes of the TES does not incorporate such a substance rule. Accordingly, income splitting through partnerships, companies and trusts is ignored. Given the substantial distributional impact of this implicit tax concession, the omission of this proviso from the income benchmark diminishes the value of the TES if the third purpose of TES is to be fulfilled.

6.6.4 Income Sheltering and the Corporate Form

As corporate tax rates have fallen relative to the top personal marginal tax rate, the incentive to shelter income in the corporate form has only increased after the effective repeal of the “sufficient distribution requirement” in 1987.¹⁹³ The failure to impose income

J Davies, “The Tax Treatment of the Family” R Bird and J Mintz, *Taxation to 2000 and Beyond* (1992) 166 (see also N Brooks, “Comment” in the same volume, at 200). For official consideration of this matter with respect to the taxation of companies see, eg, Commonwealth, *Second Report of the Royal Commission on Taxation* (1922) 80-88; (“Second Report”); Commonwealth, *First Report of the Royal Commission on Taxation* (1933) 7-18 (“First Commission”); Commonwealth, *Report on Taxation of Income of Companies – Private and Non-Private – and of Shareholders* (1952) (“1952 Commission”); and Commonwealth, Strong Foundation, above n 109, 13-19.

¹⁹² Note the recognition of family income for the purposes of family tax benefit. Also note the ability of a spouse to “transfer” superannuation entitlements to their spouse, thereby enabling a couple to maximise the RBL threshold.

¹⁹³ See ITAA36, Pt III, Div 7. Division 7 was repealed upon the basis that the corporate tax rate was equivalent to the top personal marginal tax rate (47%): *Explanatory Memorandum* to the Taxation Laws Amendment Bill (No 2) 1987 (Cth).

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tax and/or fringe benefits tax with respect to the value of corporate benefits received by shareholders¹⁹⁴ only exacerbates this tax leakage. An integration rule with a substance rule would prevent this form of tax minimisation. Prior to 1987, the sufficient distribution requirement more or less adopted a full integration approach with respect to “private” companies. However, there are a number of practical¹⁹⁵ and fiscal obstacles to the implementation of this ideal on a more general basis that have troubled policymakers virtually since the inception of the Commonwealth income tax.¹⁹⁶

At present the income tax system incorporates elements of partial integration, full integration and also a substance rule. If the TES adopts the classical system of corporate taxation as the benchmark, this would suggest that the treatment of personal services income derived through the corporate form should be a (generally negative) tax expenditure. This argument is supported by the fact that Treasury saw the need to expressly incorporate international tax integrity rules, such as the modified integration approach embodied in ITAA36, Pt X. Given that Pt 2-42 effectively pierces the corporate veil with respect to a particular category of domestic corporate income, consistency would dictate that Pt 2-42 be incorporated into the benchmark or be recognised as a (possibly negative) tax expenditure.

The identification of a benchmark taxation unit is therefore problematic. On the one hand theoretical purity and the need to

¹⁹⁴ Note the broad definition of “distribution” proposed by the Ralph Review of Business Taxation: Ralph Review, above n 15, 429ff. Also note the exclusion of such benefits from the scope of the fringe benefits legislation as a consequence of the employee/employer nexus requirement within the definition of “fringe benefit”: *J & G Knowles & Associates Pty Ltd v FC of T* 2000 ATC 4151; and *Starrim v FC of T* 2000 ATC 4460.

¹⁹⁵ Ralph Review, above n 15, 429ff. See also Taxation Review, above n 109, ch 17.

¹⁹⁶ First Commission, above n 191, 11; 1952 Commission, above n 191, 14 (Appendix A); Taxation Review, above n 109, 227; and Commonwealth, *Final Report of the Committee of Inquiry into the Australian Financial System*, Parl Paper No 208 (1981) ch 14.

accurately portray the preferential treatment of some categories of income would suggest that the individual ought be the only unit of taxation. On the other hand, there are a host of practical reasons for rejecting this approach, including fiscal cost.¹⁹⁷ Once again, the identification of the appropriate benchmark is a matter of judgement rather than a matter of science. However, once again in light of the purposes of the TES, it would be appropriate for the TES to incorporate some explicit justification for the tax unit adopted. Further, some discussion of the implications of the selection of this benchmark referring to, for example, the exclusion of the tax concession effectively allowed to those with the capacity to shelter property/business income in the corporate form, would be appropriate if the TES is to be as transparent as possible.

Such transparency is significant because these tax expenditures can all too easily be forgotten when considering whether other tax concessions should be created. Thus, for example, the justification for the original small business capital gains concessions was that small business proprietors did not have access to the same superannuation concessions available to wage and salary earners. This ignored the common practice of conducting a small business through a company or trust in order to attract full deductibility for superannuation contributions made on behalf of the proprietor/employee. Further, the implicit concessions of income sheltering and income splitting were completely ignored.

6.7 The Tax Administration Norm

6.7.1 Treatment of Tax Compliance Costs

All other things being equal, a less complex taxation system is clearly a desirable attribute. Complexity can take many different forms and arise from any number of sources within the tax system. The recent Ralph Review has considered this issue at some length, in

¹⁹⁷ Taxation Reform, above n 109, para 17.14; and Ralph Review, above n 15, 63, para 277.

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relation to the business income tax system.¹⁹⁸ There is therefore no need to rehearse the discussion presented there. However, to date the discussion regarding tax complexity/simplification has focused upon compliance costs without linking this discussion to the tax expenditure concept.

As noted in the discussion of the purposes of TES, a government can readily convert a fiscal outlay into a regulatory impost. The self assessment system of taxation is a case in point. Rather than raising more taxes to pay for the additional resources needed to undertake a comprehensive review of each taxpayer's return at the government level, the Australian Government imposes the obligation of "getting the return right" upon taxpayers. While the cost of tax advice is tax deductible, there is clearly an after tax cost borne by the taxpayer. On the basis that a dollar is a dollar, the first and second purposes of TES would be furthered by including such compliance costs in TES (as a negative tax expenditure).

It might be argued that compliance costs ought properly be categorised as part of the benchmark taxation system. However, if one adopts the standpoint of distributive justice, this argument is only convincing if compliance costs borne by individual taxpayers match the progressive income tax rate scale. That is, if compliance costs increase in gross and in proportionate terms with increasing income. If this is not the case, the third purpose of TES suggests that compliance costs should be expressly recognised in order to facilitate discussion of tax policy options. Given the dearth of current and compelling information regarding the incidence of compliance costs,¹⁹⁹ there is clearly much room for further research here. An enhanced TES might, for example, include some information regarding the compliance costs of taxpayers within different

¹⁹⁸ Strong Foundation, above n 109, 75-130.

¹⁹⁹ See, eg, B Tran-Nam, "Tax Compliance Costs Methodology – A Research Agenda for the Future" in C Evans et al, *Tax Compliance Costs: A Festschrift for Cedric Sandford* (2001) 51, 63-66.

functional groupings. This information might be obtained by even relatively limited statistical sampling of taxpayers' returns.

6.7.2 Commissioner's General Discretion to Waive Interest/Penalties

The Commissioner of Taxation regularly exercises his general administrative discretion by:

1. choosing not to impose penalties and/or interest upon particular categories of taxpayers, or agreeing to defer such payments; and
2. not enforcing the law.

With respect to the former, over the past year the Commissioner has issued numerous statements directed towards particular segments of the community, indicating that special tax arrangements would be made for members of that segment.²⁰⁰ Such decisions clearly constitute a tax concession allowed to particular groups of taxpayers respectively, and ought be incorporated into the TES for a number of reasons. From the perspective of transparency, the cost to the budget, the intended beneficiaries, the distributive impact and possibly even the allocative impact of such administrative largesse ought be readily available. Further, from the perspective of monitoring the operation of the taxation system, the exercise of such discretions may indicate the existence of problematic taxation provisions in need of reform.²⁰¹

With respect to the exercise by the Commissioner of his general discretion in not enforcing the law, reporting this as a tax expenditure is problematic where there is legitimate uncertainty regarding the meaning of the law. However, one example is the apparent reluctance of the Commissioner to test whether superannuation funds with substantial share trading activities are carrying on a business.²⁰² Although superannuation funds are supposed to carry on their

²⁰⁰ See, eg, PS LA 2004/5 (GA) (GIO shareholders); Australian Taxation Office, *Media Release* (Nat 01/25) (settlement offer for mass marketed scheme investors).

²⁰¹ See McDaniel and Surrey, above n 20, 61.

²⁰² RL Deutsch et al, *Australian Tax Handbook* (2005) 1241-1242.

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activities for the sole purpose of providing for their members' in their retirement, this does not necessarily mean that some superannuation funds are not carrying on a business, thereby taking some of their profits outside of the concessional capital gains rules.²⁰³

6.7.3 Penalty Provisions

While the imposition of penalties for non-compliance with the tax law under Pt 4-25 of the *Tax Administration Act 1953* (Cth) is more readily accepted to fall outside of the concept of a negative tax expenditure,²⁰⁴ there is a second category of penalty provisions which operate by denying deductions or tax concessions that would otherwise have been allowed. One example of such provisions is the exclusion of deductibility for royalty payments where withholding tax has not been withheld from payment to a non-resident.²⁰⁵

The operation of this penalty provision was considered in *McDermott Industries (Aust) Pty Ltd v FC of T*,²⁰⁶ the taxpayer being denied a deduction of some \$43 million as a result of its failure to comply with the withholding requirements. Arguably, had the administrative penalty provisions been applicable, the taxpayer would have had a reasonably arguable position and no penalty would have been applied. However, s 26-25 is not circumscribed by a "reasonably arguable" proviso, and so the taxpayer faces absolute liability if they misinterpret the law regardless of whether that

²⁰³ Given that the test of the existence of a business is essentially based upon objective factors, including the objective purpose of the taxpayer.

²⁰⁴ Although even here political judgements must be made – the "reasonably arguable position" test seems to accept that the rule of law is somewhat fluid in the tax realm which, to some, is anathema in a liberal democracy. To staunch advocates of liberal legalism, the onus should be on the government to write clear tax legislation and, if the government fails in this, any penalty should be borne by the government alone.

²⁰⁵ ITAA97, s 26-25.

²⁰⁶ [2004] FCA 1044. For a case note regarding this decision see M Burton, "The Meaning of 'Permanent Establishment' in *McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation* [2004] FCA 1044 [2004] *CCH Tax Week* 844.

misinterpretation is reasonable. *McDermott* illustrates the point that some provisions in the income tax legislation impose an exceptional burden upon taxpayers charged with self assessing their income tax liability. By contrast, the benchmark administrative system allows taxpayers immunity from penalty provided that they take reasonable care and, in some cases, adopt a reasonably arguable position. The operation of provisions such as s 26-25, then, arguably generates a negative tax expenditure which cannot be reconciled with the general administrative framework.

Although McDaniel and Surrey focused upon a definition of tax expenditures which was premised upon the equivalence of tax concessions to spending programs, they clearly recognised that the exceptional administrative treatment of particular categories of taxpayers could comprise a tax expenditure:

A country must establish a set of rules and procedures to administer its [Personal Income Tax] and [Corporate Income Tax]. These rules must be examined to see if special treatment is provided to particular types of taxpayers. Examples might include special valuation techniques, provisions whereby certain classes of taxpayers are permitted to pay their taxes over longer periods of time than is generally provided, etc. Any such deviations from the generally applicable administrative and procedural rules presumptively constitute tax expenditures.²⁰⁷

Although McDaniel and Surrey stated that “a rule which defers a deduction until income to which it is related is included in the tax base does not constitute a tax penalty”,²⁰⁸ it is not clear whether the authors had the exceptional operation of rules such as s 26-55 in mind. Arguably, McDaniel and Surrey’s maxim should be subject to the proviso that such deduction denial rules are subject to the same

²⁰⁷ McDaniel and Surrey, above n 20, 61.

²⁰⁸ Ibid 12.

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administrative penalty provisos applied elsewhere in the Act (viz reasonable care and reasonably arguable position).²⁰⁹

6.7.4 Exclusion of Above Market Interest Rate Imposed by ATO

At present taxpayers are charged a substantial rate of interest upon overdue tax debts.²¹⁰ Given the legislative protections afforded to the Commonwealth as a creditor with respect to such unpaid tax debts, it is possible that the interest rate is above the market rate of interest that would be imposed upon debts with comparable terms. Assuming that the interest rate exceeds the prevailing market rate of interest, it should either be incorporated within the benchmark upon the basis that it is a penalty for failure to pay tax on time, or be recognised as a negative tax expenditure.

6.8 Selection of Tax Period

The selection of the appropriate period of taxation is also a matter for conjecture. From the perspective of equity, the ability of the taxpayer to pay tax should be measured over her or his lifetime so that periodic fluctuations in income do not give rise to an excessive or reduced taxation liability by comparison to another taxpayer whose income is spread evenly over her or his lifetime. However, this lifetime taxation is impractical for a number of reasons and has never been adopted in practice. Rather, an annual tax period is generally adopted across all tax jurisdictions. In an attempt to ameliorate the perceived inequity of imposing tax at progressive rates of tax upon a taxpayer whose income may fluctuate across tax years the Commonwealth legislature allows income averaging to certain taxpayers²¹¹ and also the carry forward of tax losses to be set against income of future income years.

²⁰⁹ *Taxation Administration Act 1953* (Cth), Sch 1, Pt 4-25.

²¹⁰ *Taxation Administration Act 1953* (Cth), s 8AAD.

²¹¹ ITAA97, Divs 392 and 405.

The omission of a general averaging rule arguably constitutes a negative tax expenditure.²¹² The restriction of income averaging to identified taxpayer categories, undertaken at a time when social conditions were markedly different,²¹³ arguably justifies the classification of this measure as a tax expenditure. Once again, the point is that Treasury should transparently discuss the alternative viewpoints and opt for what it perceives to be the better approach. In this way, the decision making underlying the TES is open to scrutiny.

Another aspect of adopting the financial year as the appropriate tax period is that this may generate inequity. Even given that the Australian taxation system incorporates a loss carry forward rule, international practice in the treatment of losses also suggests that a loss carryback rule may be appropriate.²¹⁴ Further, even with a loss carry forward rule, some losses will be wasted upon the death of a natural person taxpayer with retained tax losses or upon the termination of a loss company. The indefinite carry forward of tax losses is merely incorporated within the benchmark without comment, and in particular without any consideration of why this should be adopted as the benchmark, given that the practice in other jurisdictions varies upon this point.

6.9 Defining the Benchmark Tax Rates

The adoption of the principle of vertical equity is not without controversy.²¹⁵ Nevertheless, it is a common practice across many jurisdictions to adopt the tax rate scale applicable at the time of

²¹² McDaniel and Surrey would agree with this: above n 20, 56.

²¹³ For the reasoning behind the restriction of the averaging rules to particular categories of taxpayer see Commonwealth, *First Report of the Royal Commission on Taxation*, Parl Paper No 147 (1921) 9; Second Report, above n 191; and Commonwealth, *Third Report of the Royal Commission on Taxation* (1922).

²¹⁴ Commonwealth of Australia, *Taxation Expenditures Statement 1997-98* (1999) 61. In Canada, for example, non-capital losses may be carried back for three years and may also be carried forward for just seven years.

²¹⁵ Blum and Kalven, above n 109.

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publication of a TES.²¹⁶ In the absence of any universal standard that might be adopted as the benchmark, it is sufficient to comply with the general practice by specifically stating that the existing tax rate scale will generally be adopted as the benchmark. However, given the effect of bracket creep, it would be appropriate to note the negative tax expenditure arising from the absence of tax rate threshold indexation.²¹⁷

7. ACQUIRING AND PRESENTING THIRD PURPOSE DATA

7.1 A National Tax Expenditures Statement?

Even if a comprehensive and global TES is not possible, at the least there is a good case for developing a TES which incorporates tax expenditures allowed by all levels of Australian government. The exclusion of any reference to tax expenditures under the GST is arguably a notable failure to comply with the IMF Fiscal Transparency Manual and represents a departure from the international norm with respect to the reporting of tax expenditures. An OECD overview of tax expenditure reporting in 14 OECD countries indicates that many of these countries provide a statement of tax expenditures across their entire respective tax systems.²¹⁸

Despite the fact that the GST is formally a Commonwealth tax, the omission of GST tax expenditures is apparently justified upon the substance-oriented basis that the GST is “imposed and collected by the Commonwealth on behalf of the states and territories”.²¹⁹

²¹⁶ See, eg, the express inclusion of tax rate scales within the benchmark in: Canada 1999, above n 94, 35.

²¹⁷ Note that since 2000 Canada has indexed its tax rate thresholds as well as its income thresholds applicable for most tax exemptions and credits: Canada Projections, above n 63, 9.

²¹⁸ OECD Experiences, above n 5, passim.

²¹⁹ Tax Expenditures, above n 7, 5. See also C Brown, “Tax Expenditures in Australia” in Brixi et al, above n 5, 45, 55 where Brown (a Treasury official) suggests that the GST is “treated as a state tax”.

However, the TES 2004 is at best misleading when it states that “this statement only reports tax expenditures that relate to Australian Government taxes. Therefore the consumption tax benchmark does not include the goods and services tax.”²²⁰ The GST is a Commonwealth tax both in form and in substance – at any time the Commonwealth can exercise its legislative power to repeal the legislation under which the GST revenue is distributed amongst the states and territories.²²¹ Tax expenditures under the GST should be reported in the Commonwealth TES if compliance with the IMF norm is to be achieved.

However, even if the Commonwealth reported all tax expenditures, it is clear that such a TES would provide but an imperfect account of the relative tax benefits provided to particular classes of taxpayers within the Australian community. Although unusual at the international level, there are good reasons for adopting the practice of Austria and Italy in reporting tax expenditures at all levels of government.²²² A positive tax expenditure under the Commonwealth tax base may be negated by a negative tax expenditure imposed at state or municipal level. While it is understandable that the Commonwealth TES should focus upon tax expenditures under Commonwealth taxes, the imperfect picture of tax expenditures at the national level is a national issue upon which the Commonwealth ought assume a leadership role. Initially the Commonwealth TES might incorporate an appendix of tax expenditures at state and municipal level. However, for this information to be useful, the aggregation of data is necessary such that the distributive and allocative effects of the national tax expenditures program can be mapped. Perhaps more reasonably, the

²²⁰ Tax Expenditures, above n 7, 28.

²²¹ Presumably the Commonwealth considers that it is a bare trustee for GST revenues it receives. In this regard it is interesting to compare the income tax treatment of trust income where the settlor of the trust has absolute control over the trust, akin to the Commonwealth’s power to vary the terms of its legislation: ITAA36, s 102.

²²² Brixi et al, above n 5, 16.

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Commonwealth might promote the production at state and Territory level of a uniform TES.

7.2 Managing the Data Necessary for an Effective Tax Expenditures Statement

As it stands, the current TES goes some way to fulfilling the first two of its three stated purposes although the preceding discussion suggests that there must be some reservations. In the course of preparing the annual budget it would be reasonable to expect the government to review the list of tax expenditures with a view to determining whether savings might be made. Further, the approximate quantification of the total tax expenditures budget facilitates discussion of the size of government. However, the current TES does little in the way of enabling appraisal of the tax system because it simply fails to provide the type of information which would enable such consideration. The dearth of relevant and current information was noted in the final report of the Ralph Review,²²³ but the Review's recommendation on this matter appears not to have been acted upon.

The type of information which would be of assistance in contextualising a particular tax expenditure, and thereby facilitating greater critical appraisal, includes:

1. specification of who are the ultimate beneficiaries of the tax expenditure (ie higher income groups or those less well off?);
2. indication of the relative accuracy of the reported quantum of the tax expenditure (ie what "real world factors" might dramatically affect the cost to the government of the particular tax expenditure – is the tax expenditure actually encouraging desired behaviour or are taxpayers receiving a tax break for what they would be doing anyway?); and

²²³ Ralph Review, above n 15, recommendation 3.10.

3. reference to whether the tax expenditure is in accordance with some more or less established international norm.

Of course, few would argue for less information but resource constraints may limit the Treasury's capacity to deliver the type of information suggested with respect to all tax expenditures. Nevertheless, significant improvements could be made to the TES by targeting the more significant tax expenditures (perhaps the top 10) for the purposes of providing further information. For example, according to the TES 2004 the superannuation and retirement savings tax expenditures are the most significant – totalling approximately \$13 billion.²²⁴ Although the Statement provides some discussion of the methodology applied in quantifying this tax expenditure and notes the limitations of that methodology, the information provided is of little use in appraising the relative success of this tax expenditure program. Given the scale of this public investment in private retirement savings, it would be reasonable to expect that the government would devote considerable resources to assessing the relative merits of its investment.

7.3 Reduction in Number of Tax Expenditures for Which There is no Costing

At present the TES lists 264 tax expenditures, but does not provide information with respect to the cost of 97 of these owing to the lack of sufficient data. If any one of the purposes of the TES is to be fulfilled, the cost of all tax expenditures should, as far as possible, be recorded in the TES and be founded upon more than mere guesswork. A TES which does not provide the respective costs of more than one third of the listed tax expenditures is clearly inadequate as a policy tool. This undermeasurement of tax expenditures can lead to inaccurate assertions regarding the

²²⁴ Tax Expenditures, above n 7, 114-115, Items C1, C2.

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predominant category of tax expenditures – a problem Bittker alluded to almost 50 years ago.²²⁵

By international standards, this underreporting of tax expenditures is also clearly below standard. In the United States an estimate of the cost of all tax expenditures is provided.²²⁶ In Canada, the cost of 49 of 228 tax expenditures is not provided owing to a lack of sufficient data.²²⁷ In the United Kingdom, only tax expenditures with an estimated cost of at least £50 million are included, which implicitly excludes those tax expenditures for which no cost has been determined.²²⁸ While international comparisons of raw figures are tainted by the relative comprehensiveness of the TES, it seems that the Australian TES provides less information than is the norm. For example, the cost of the exemption of capital gains arising from the disposal of a taxpayer's principal residence is not provided in the Australian TES,²²⁹ while in the United States, Canada and the United Kingdom the respective costs of this tax expenditure are provided.²³⁰

Aside from international comparisons, the failure to quantify significant tax expenditures is important when considering some of the Treasury discussion regarding the quantum of particular tax expenditures. Although Treasury notes that the absence of costings for some identified tax expenditures means that “tax expenditure aggregates may underestimate the total benefit provided by tax expenditures”,²³¹ this caveat is reduced to a faint whisper when discussing the Australian tax expenditure program:

As reported in Table 2.4, total measured tax expenditures in 2003-4 are valued at around \$31.2 billion. Social security and welfare tax

²²⁵ Bittker, *Subsidies*, above n 40, 259.

²²⁶ *Analytical Perspectives*, above n 76.

²²⁷ *Canada Expenditures*, above n 82, *passim*.

²²⁸ *Ready Reckoner*, above n 79, Table 7 note 1.

²²⁹ *Tax Expenditures*, above n 7, 138, Item E3.

²³⁰ *Analytical Perspectives*, above n 76, 317, Table 19-1, item 47); *Ready Reckoner*, above n 79, Table 7; and *Canada Expenditures*, above n 82, Table 1 – “Other items”.

²³¹ *Tax Expenditures*, above n 7, 7.

expenditures comprise around 70 per cent of total measured tax expenditures, which largely reflects the concessional taxation of funded superannuation (C1) and the income tax exemption of the Family Tax Benefit, Parts A and B (A37).²³²

The critical reference here is to “measured” tax expenditures. A reader who did not notice the significant number of large unmeasured tax expenditures and/or the caveat at page 7 could easily be left with the misapprehension that the Australian tax expenditure program was broadly consonant with the wealth redistribution aspect of a progressive income tax system. A more explicit caveat in the course of the Treasury discussion of aggregate tax expenditure figures is therefore to be preferred or, better still, a full accounting for all identified tax expenditures. Overcoming this information gathering problem must be resolved if we are to be in a position to make meaningful analytical statements about the tax expenditure component of the national taxation system.

7.4 A More Transparent Methodology

Although Treasury provides a brief discussion of alternative approaches to modelling the effect of removing tax expenditures,²³³ noting the relative advantages and disadvantages of each method, this information is of little use. It would be far more useful if Treasury were to identify which method(s) had been adopted for each measured tax expenditure and if Treasury were also to provide some assessment of the relative accuracy of each particular tax expenditure estimate.

8. CONCLUSION

In propounding the tax expenditure concept Surrey appears to have envisaged a minimalist listing of tax expenditures to be used by those involved with the preparation and parliamentary scrutiny of the annual federal budget. While many have noted that Surrey’s

²³² Ibid 13.

²³³ Tax Expenditures, above n 7, 157-158.

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emphasis upon “spending” is his most significant legacy, I would suggest that it is the more general characterisation of the TES as a “budgetary” document which is more significant. Not only does this characterisation explain Surrey’s emphasis upon spending, it also explains why, to this day, most talk of the TES in terms of a listing of “tax concessions”. Further, by comparison to the vast wealth of literature upon the key components of the tax expenditure concept – the benchmark taxation system, there has been no substantial discussion of how the TES might be used as part of a more general tax reform framework founded upon principles of participatory democracy. If the budget process is to be transparent and open to the scrutiny of the public, in accordance with the rhetoric embodied in the TES, the official international literature and the Charter of Budget Honesty, a credible TES will be one which operates as an effective tax policy report upon the operation of the Australian taxation system. If developed in conjunction with a statement of framework taxation principles of more general application, the TES may be reformulated as an annual report card upon the operation of the national taxation system, measured against those principles. If characterised in this way, the document assumes a far greater significance in fostering critical analysis of the national tax framework, while continuing to fulfil the fiscal function envisaged by Surrey and others after him.