FINANCIAL REVIEW

Robert Carling

Rorts for the rich are a myth

We need an informed and balanced debate, not a one-sided campaign wrapped in dodgy data and the new politics of inequality. **Photo: Paul Jones**

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Tax concessions in areas such as superannuation, capital gains and GST are under attack like never before. Those who would slash such concessions say they waste billions in potential tax revenue and distribute benefits 'unfairly'. In this climate, Treasury's recent tax expenditure statement – a key exhibit in the case against concessions – is being used as ammunition for a fresh assault.

Campaigns for good tax reform are one thing, but the campaign against concessions lacks balance. Concessions contain elements of good policy as well as bad, and the challenge is to differentiate. Many of the criticised concessions are soundly based and, far from wasting revenue and creating distortions and loopholes, are necessary to remove biases that would otherwise prevent efficient outcomes. Tax expenditure estimates suffer major measurement and conceptual weaknesses. They are at best just one of many inputs to policy deliberation, and at worst rubbery figures based on flawed concepts.

Treasury itself warns tax expenditures can be difficult to quantify; they do not measure the revenue that could be gained by removing concessions (because taxpayers adjust behaviour in response to loss of concessions); they are not additive; and they are only as valid as the benchmark against which they are measured. But these warnings are blithely ignored by critics who can see nothing but 'rorts', 'loopholes' and 'subsidies to the rich'.

By far the most important caveat to the tax expenditure billions concerns the benchmark against which they are measured. Treasury advises TES users that benchmarks "involve judgment, may be contentious and can be arbitrary".

In some cases the benchmark is straightforward. It is clear that GST-free food is a tax expenditure against the benchmark for a broad-based consumption tax. But the benchmark is contentious in the case of income tax concessions such as those for superannuation and capital gains. The enormity of tax expenditures reported for these items is a result of the comprehensive income benchmark that is commonly, but often inappropriately, used.

The notion of comprehensive income tax is that all income regardless of source should normally be taxed at the same rate. This was once generally accepted among tax economists, but the now more widely-accepted principle of optimal taxation says tax policy should take account of the differential economic impacts of taxing different tax bases.

The Henry tax review was at pains to explain that the principle of optimal taxation leads to savings income being taxed at lower rates than labour income (at least when tax on labour income is as high as it is). To do otherwise is to create a systemic bias against saving and investment. The review argued that the tax treatment of superannuation should be assessed against an expenditure (consumption) tax benchmark, under which super fund earnings and contributions (but not end-benefits) would be tax-free. Such limited data as are available suggest that tax expenditure measured this way is a small fraction of that reported.

The consumption tax benchmark seriously undermines, if not destroys, much of the campaign against tax concessions. Many of these concessions are not unjustifiable loopholes at all but a route to more efficient taxation. For example, scrapping the 50 per cent capital gains discount – the most unfairly maligned of all concessions –would score an economic policy own-goal, damaging investment while raising little if any extra revenue.

Dividend imputation and negative gearing have also been challenged, most recently by the financial system inquiry. These are not officially classified as tax expenditures. That should not exempt them from scrutiny, but they exist in the tax structure for good reasons.

A key plank in the critique of concessions is that they are poorly targeted because most of the benefit goes to those with above average incomes. This views tax concessions as if they were social benefits, which largely they are not. The case for taxing saving and investment at reduced rates applies at all income levels, and the concessions ought to apply neutrally. Judgments about distributional effects are most sensibly based on the tax/transfer system as a whole, not component parts of it.

Tax expenditures and concessions more generally should not escape scrutiny in the forthcoming white paper tax review. But we need an informed and balanced debate, not a one-sided campaign wrapped in dodgy data and the new politics of inequality.

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