TAX AND THE ENVIRONMENT: AN EVALUATION FRAMEWORK FOR AUSTRALIAN TAX POLICY REFORM

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Introduction

- tax measures
- accurate targeting of tax measures to encourage environmentally responsible behaviour
- the need to limit investment in direct tax concessions to those "which will have a beneficial environmental impact"
- Developing a rigorous framework for evaluating environmental tax concessions
- Case study of the mine site rehabilitation tax concession

Tax measures

- Taxation has a social, economic and political role.
- Tax measures refers to any amendment to existing tax laws enacted by the Australian Parliament in the pursuit of a policy objective of government and includes (but is not limited to) deductions, incentives and any other form of concessionary treatment.
- Part of the tax expenditure system utilised by governments to intervene in the market and influence the behaviour of certain classes of taxpayers or industries.
- Functionally equivalent to subsidies or direct spending programs aimed at providing direct benefits to society given that the taxpaying public is effectively paying for them through forgone revenue.

Targeting of tax measures

- Tax measures such as concessions are part of the tax expenditure system utilised by governments to intervene in the market and influence the behaviour of certain classes of taxpayers or industries.
- Tax measures driven by environmental goals need to be evaluated for their efficiency and effectiveness in achieving those goals in order to justify the inequity of the revenue expended in favour of a particular industry and/or class of taxpayers.
- The success of such tax measures are said to be dependent on the closeness of the link between the incentive and the environmental damage to be remedied or behaviour desired.

Investment in direct tax concessions

- Goes against the OECD espoused 'polluter pays principle' and Pigouvian theory requiring the internalisation of externalities like pollution.
- Offends a fundamental premise of the Australian/any tax system, namely, neutrality.
- However, neutrality is often foregone whenever the government believes that "the free market is unlikely to produce the optimum social returns".
- However the Brundtland Report also recognised the importance of economic incentives working together with environmental regulations to ensure the necessary investment in environmental measures by industry.
- There is, therefore, a shift from the consumer of the product to the taxpayer as the party who ultimately pays for the preventative or restorative measure.
- That leads us to the need for evaluation.

Developing a framework for evaluation

- An evaluation framework has the potential to enable greater transparency and accountability in terms of the effectiveness of environmental tax measures and could impact on both the form and quality of future environmental tax policies.
- A starting place for any such evaluation must be the four maxims of taxation espoused by Scottish economist and philosopher, Adam Smith, in 1776, noting proportionality, convenience, transparency and neutrality as key criteria.

Developing a framework for evaluation

- Krever points out that evaluation of such intervention programs requires identification of the deviation from the neutral tax, establishment of the goals behind the concession, and a comparison with alternative government instruments that might accomplish the same ends.
- The issue of complexity resulting from attempts to reduce abuse of a concession is another criterion deserving consideration.
- One suggestion is that tax concessions be evaluated in line with budgetary criteria used in assessing other government spending programs.

Developing a framework for evaluation

- Brooks advocates a four-stage inquiry considering whether:
  - the measures are meeting a valid government objective;
  - the program is fair and efficient;
  - other policy instruments would better achieve the program objectives; and
  - where the tax system is to be used, considering the most appropriate design of the instrument.

Developing a framework for evaluation

- The criteria suggested by the OECD in its 1993 report include:
  - the nature of the administrative structure,
  - consistency or ‘mutual reinforcement’ between environmental and tax policies and between their institutional frameworks,
  - the use of combined strategies between the tax regime and environmental regulatory regimes,
  - the closeness of the link between the concession and the environmental damage to be remedied or behaviour desired,
  - simplicity of the fiscal structure,
  - Transparency; and
  - the cost to the community.

Developing a framework for evaluation

- In Australia the 1985 Draft White Paper on tax reform identified three further criteria for assessment, namely, equity, controllability and accountability.
- The Henry Tax Review emphasises that each of these existing environmentally based tax measures in Australia should be evaluated but no mechanism was provided for such an evaluation.
- Our project proposes to address this gap.

Mine Site Rehabilitation Tax Concession Case Study

- In 1991, Australia introduced a regime of tax measures for current and capital expenditure incurred in the process of rehabilitation of mining sites, obtaining environmental impact studies and (in 1992) general environmental protection activities.
- Prior to this regime of tax measures, rehabilitation and other environmentally related expenditure tended to fall outside the scope of normal business expenditure and were therefore not deductible.
- This created a problem for industries like the mining industry, as mining licences (mostly granted by the states and territories) were (and still are) often accompanied by the requirement to deposit sizable bonds for rehabilitation purposes .

Mine Site Rehabilitation Tax Concession Case Study

- Failure to rehabilitate a site after mining would result in forfeiture of such bonds.6 However, mining companies considered forfeiture a better option than spending the often much larger sum needed to rehabilitate the mining site, as such expenditure was not deductible as a genuine business expense due to the primarily capital nature of the expense and the fact that rehabilitation takes place after mining operations and the business of mining ceased.
- Remediation expenditure may be classified as blackhole expenditure but then most forms of environmentally related expenditure can be so classified. The impact of the pre-1991 situation was to reduce the effectiveness of the command and control regulations requiring rehabilitation and other environmental protection activities.

Mine Site Rehabilitation Tax Concession Case Study

- Since the introduction of the environmental tax measures in 1991, the mining industry has engaged in significant environment protection and rehabilitation activities and even developed a Code of Practice for Environment Management.
- This project has identified the mining site rehabilitation deduction provisions as an appropriate tax measure for testing and refining the evaluative framework.
- The tax provisions are industry specific and discrete, making data collection manageable.

Evaluation Criteria

- the closeness of the link between the concession and the environmental damage to be remedied or behaviour desired;
- consistency or 'mutual reinforcement' between environmental and tax policies and between their institutional frameworks and administrative structures;
- efficiency and the need to identify the deviation from the neutral tax;
- administrative costs including compliance costs;
- the establishment of the goals behind the concession;
- considering whether the measures are meeting a valid government objective;

Evaluation Criteria

- whether other policy instruments would better achieve the program objectives;
- considering what is the most appropriate design of the instrument;
- simplicity of the fiscal structure;
- transparency and the cost to the community;
- equity including intergenerational equity of the program;
- controllability; and
- accountability.

Project Process

- developing a specific/tailor-made tax policy framework for evaluating the effectiveness of environmental tax measures;
- testing that framework by applying it to the mining site rehabilitation measures to determine their effectiveness; and
- refining that framework for use in evaluating other environmental tax measures.

Concluding Remarks

- Intended Impact of the Outcomes of the Project:
  - First, the framework will provide a useful tool for evaluating other existing environmental tax concessions and future environmental tax concessions.
  - Second, while the framework of evaluation contains certain features that are peculiar to environmental tax concessions, the process of deriving such a framework is of sufficient generality for the framework to be applied in evaluating tax and indeed any public policy issues in general.
  - Third, the evaluation of the mining site rehabilitation tax concession should provide reliable knowledge more generally about the success or otherwise of the utility of such concessions in achieving environmental goals.