

## CHAPTER 2: TRENDS IN TAX EXPENDITURE ESTIMATES

This chapter provides details on the trends in tax expenditure estimates. The changes in the overall level of tax expenditures since the *2007 Tax Expenditures Statement* largely stem from including GST tax expenditures for the first time, revisions to the estimates of existing tax expenditures and revisions to benchmarks.

### 2.1 Interpretation of trends and aggregates

Care must be taken when interpreting tax expenditure aggregates, particularly when making comparisons across time and against direct expenditures. There are several major considerations that need to be taken into account when analysing tax expenditure aggregates.

- The cost of some tax expenditures are not reported owing to a lack of data or because of taxpayer confidentiality. Hence, tax expenditure aggregates underestimate the total benefit provided by tax expenditures.
- The trend in aggregates reflects changes in the extent to which individual tax expenditures are accessed, changes to the benchmarks, and changes in the number of tax expenditures being reported.
- Changes over time in methodology and data used to calculate the cost of tax expenditures can result in large revisions to the tax expenditure estimates. Estimates that were provided in previous editions of the Tax Expenditures Statement may not be directly comparable to estimates reported in this publication.
- Tax expenditure aggregates are net aggregates as they include the offsetting effects of negative tax expenditures.

Further details on how to interpret tax expenditure estimates are provided in *Chapter 3: Measuring tax expenditures*.

## 2.2 Trends in tax expenditures

Total measured tax expenditures are reported in Table 2.1. Measured tax expenditures as a proportion of GDP are projected to fall from 7.1 per cent in 2007-08 to 6.4 per cent in 2008-09 and 6.3 per cent in 2009-10 mainly as a result of the impact of personal income tax cuts.

**Table 2.1: Total measured tax expenditures<sup>(a)</sup>**

Year	Superannuation \$m	Other tax expenditures \$m	Total \$m	Tax expenditure as a proportion of GDP (%)
2004-05 (est)	17,288	32,952	50,240	5.3
2005-06 (est)	22,885	36,154	59,039	6.1
2006-07 (est)	30,379	40,548	70,927	7.1
2007-08 (est)	29,230	44,466	73,696	7.1
2008-09 (proj)	24,593	42,848	67,441	6.4
2009-10 (proj)	24,943	43,313	68,256	6.3
2010-11 (proj)	26,922	45,971	72,893	6.6
2011-12 (proj)	29,456	49,792	79,248	6.9

(a) Total measured tax expenditures are derived by summing the individual tax expenditure estimates, excluding estimates that are rounded to zero (..) or unquantifiable (\*).

Table 2.2 presents measured tax expenditures by the benchmark against which they are estimated for the period 2004-05 to 2011-12. The retirement savings benchmark, containing the superannuation tax expenditures, is the largest benchmark classification. This is followed by the goods and services tax benchmark. For all reported years, the total measured tax expenditures representing the commodity taxes benchmark give rise to a negative estimate, largely reflecting customs duty (F22) and the higher rate of excise levied on cigarettes (F7).

**Table 2.2: Measured tax expenditures by benchmark (\$m)<sup>(a)</sup>**

Benchmark	2004-05 (est)	2005-06 (est)	2006-07 (est)	2007-08 (est)	2008-09 (proj)	2009-10 (proj)	2010-11 (proj)	2011-12 (proj)
<b>Income tax</b>								
Personal income	10,557	11,301	11,385	11,568	11,811	11,950	12,256	12,629
Business income	5,165	5,290	6,517	6,436	6,935	7,360	7,871	8,372
Retirement savings	19,243	24,920	32,294	31,370	26,693	27,083	29,172	31,761
Fringe benefits tax	3,092	3,051	3,797	3,191	3,288	3,485	3,602	3,714
Capital gains tax	5,515	6,170	8,015	11,235	9,350	8,102	8,421	10,626
<b>Consumption</b>								
Commodity taxes	-4,203	-3,444	-3,878	-4,048	-4,625	-4,115	-3,570	-3,810
Natural resource taxes	550	770	790	980	550	450	450	450
Goods and services tax	10,321	10,981	12,007	12,964	13,439	13,941	14,691	15,506

(a) Measured tax expenditures by benchmark are derived by summing the individual tax expenditure estimates, excluding estimates that are rounded to zero (..) or unquantifiable (\*).

## 2.3 Large tax expenditures

Table 2.3 provides a list of the largest measured tax expenditures for 2008-09. The largest tax expenditure is the concessional taxation of superannuation entity earnings (C6) which is estimated to provide a benefit to taxpayers of around \$12.2 billion in 2008-09. The next largest measured tax expenditures for 2008-09 are the concessional taxation of employer contributions (C5) and the capital gains tax discount for individuals and trusts (E11). These tax expenditures are estimated to provide benefits to taxpayers in 2008-09 of around \$10.2 billion and \$8.6 billion respectively.

The largest negative tax expenditures in 2008-09 are customs duty (F22) and the higher rate of excise levied on cigarettes (F7). These tax expenditures are estimated to be around -\$3.7 billion and -\$1.2 billion respectively.

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**Table 2.3: Large measured tax expenditures in 2008-09**

<b>Tax expenditure</b>	<b>Estimate \$m</b>
<b>Large positive tax expenditures</b>	
C6 Superannuation — concessional taxation of superannuation entity earnings	12,150
C5 Superannuation — concessional taxation of employer contributions	10,150
E11 Capital gains tax discount for individuals and trusts	8,640
H22 GST — Food — uncooked, not prepared, not for consumption on premises of sale and some beverages	5,200
A46 Exemption of Family Tax Benefit, Parts A and B, including expense equivalent	2,490
H15 GST — Health; medical and health services	2,300
H12 GST — Education	2,250
B12 Exemption from interest withholding tax on widely held debentures	1,910
D24 Application of statutory formula to value car benefits	1,830
C3 Concessional taxation of non-superannuation termination benefits	1,450
C8 Superannuation — deduction and concessional taxation of certain personal contributions	1,350
H2 GST — Financial Supplies; input taxed treatment	1,270
A24 Exemption of 30 per cent private health insurance refund, including expense equivalent	1,050
A23 Exemption from the Medicare levy for residents with a taxable income below a threshold	1,010
A8 Reduced withholding tax under international tax treaties	900
A34 Senior Australians' Tax Offset	860
H11 GST — Imported services	850
F6 Exemption from excise for 'alternative fuels'	830
B104 Income tax exemption for public and municipal authorities and other local governing bodies	830
A71 Deduction for gifts to approved donees	800
F3 Concessional rate of excise levied on aviation gasoline and aviation turbine fuel	710
D8 Capped exemption for public benevolent institutions (excluding public and not-for-profit hospitals)	670
A42 Exemption of certain income support benefits, pensions or allowances	610
A37 Tax offsets for dependent spouse, child-housekeeper and housekeeper who cares for a prescribed dependant	600
<b>Large negative tax expenditures</b>	
F22 Customs duty	-3,730
F7 Higher rate of excise levied on cigarettes with less than 0.8 grams of tobacco	-1,244

There are a number of tax expenditures for which an estimate is not available but which have been assigned an order of magnitude classification (for details refer to *Chapter 6: Tax expenditures*). The largest such tax expenditures are as follows:

- Income tax exemption for State and Territory bodies (B105);
- Capital gains tax main residence exemption (E4);
- Exemption for health care benefits provided to members of the Defence Force (D4); and
- Quarantining of capital losses (E25).

## **2.4 Trends in tax expenditures by function**

Total measured tax expenditures by functional category are reported in Table 2.4 for the period 2005-06 to 2011-12. Significant changes underlying movements in functional categories are listed below.

- The increase in the aggregate for health tax expenditures between 2005-06 and 2011-12 largely reflects the introduction of the GST tax expenditure benchmark, the estimates for the exemption of 30 per cent private health insurance refund, including expense equivalent (A24), and the income tax exemption for registered health benefit organisations (B17).
- The total for transport and communication is also estimated to increase over the reported period owing to the statutory effective life caps (B81) tax expenditure.
- The increase in the general purpose inter-governmental transactions aggregate is due to the income tax exemption for municipal authorities and other local governing bodies (B104).
- The increase in the social security and welfare aggregate is mainly due to increases in the concessional taxation of superannuation entity earnings (C6) and the concessional taxation of employer contributions (C5).
- The negative tax expenditure for mining, manufacturing and construction is mainly due to customs duty (F22) which is a negative tax expenditure in respect of imported goods.

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**Table 2.4: Aggregate tax expenditures by function<sup>(a)</sup>**

	Estimates (\$m)				Projections (\$m)		
	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
<b>General public services</b>							
A. Legislative and executive affairs	3	2	3	3	3	3	3
B. Financial and fiscal affairs	1,105	1,215	1,288	1,348	1,409	1,489	1,559
C. Foreign affairs and economic aid	978	1,279	1,318	1,428	1,539	1,539	1,550
D. General research	0	0	0	0	0	0	0
E. General services	13	12	12	77	190	494	608
F. Government superannuation benefits	0	0	0	0	0	0	0
<b>Defence</b>	200	224	274	264	284	300	311
<b>Public order and safety</b>	0	0	0	0	0	0	0
<b>Education</b>	1,859	2,013	2,166	2,266	2,312	2,512	2,662
<b>Health</b>	3,421	3,962	4,296	4,416	4,641	4,951	5,246
<b>Social security and welfare</b>	31,981	39,099	37,713	33,453	33,481	35,677	38,416
<b>Housing and community amenities</b>	1,240	1,395	1,460	1,490	1,925	1,720	1,670
<b>Recreation and culture</b>	227	248	231	232	240	243	249
<b>Fuel and energy</b>	1,880	1,610	1,920	1,510	1,490	1,565	1,540
<b>Agriculture, forestry and fishing</b>	558	569	585	160	-18	-76	-141
<b>Mining, manufacturing and construction</b>	-2,879	-3,160	-3,415	-3,605	-3,205	-2,648	-2,773
<b>Transport and communication</b>	205	265	340	415	455	480	495
<b>Other economic affairs</b>							
A. Tourism and area promotion	-4	6	1	7	7	7	7
B. Total labour and employment affairs	743	841	738	683	676	691	703
C. Other economic affairs, nec <sup>(b)</sup>	16,969	20,667	24,016	22,464	21,907	22,916	26,003
<b>Other purposes</b>							
A. Public debt interest	0	0	0	0	0	0	0
B. Nominal superannuation interest	0	0	0	0	0	0	0
C. General purpose inter-governmental transactions	540	680	750	830	920	1,030	1,140
D. Natural disaster relief	0	0	0	0	0	0	0
E. Contingency reserve	0	0	0	0	0	0	0
<b>Total<sup>(c)</sup></b>	<b>59,039</b>	<b>70,927</b>	<b>73,696</b>	<b>67,441</b>	<b>68,256</b>	<b>72,893</b>	<b>79,248</b>

(a) Total measured tax expenditures by functional category are derived by summing individual tax expenditure estimates, excluding estimates that are rounded to zero (..) or unquantifiable (\*).

(b) 'nec' means not elsewhere classified.

(c) Totals may not sum due to rounding.

## 2.5 Comparison with direct expenditure

The tax expenditure estimates for 2007-08 by functional category are presented alongside direct government expenditure in Table 2.5. The list of direct expenditures by function is reproduced from the 2007-08 *Final Budget Outcome*.

**Table 2.5: Aggregate tax expenditures and direct expenditures by function in 2007-08**

	Tax expenditures <sup>(a)</sup> (\$m)	Direct expenditures <sup>(b)</sup> (\$m)
<b>General public services</b>		
A Legislative and executive affairs	3	961
B Financial and fiscal affairs	1,288	6,102
C Foreign affairs and economic aid	1,318	3,881
D General research	0	2,146
E General services	12	925
F Government superannuation benefits	0	2,600
<b>Defence</b>	274	17,670
<b>Public order and safety</b>	0	3,506
<b>Education</b>	2,166	18,433
<b>Health</b>	4,296	44,397
<b>Social security and welfare</b>	37,713	97,842
<b>Housing and community amenities</b>	1,460	2,910
<b>Recreation and culture</b>	231	3,207
<b>Fuel and energy</b>	1,920	5,361
<b>Agriculture, forestry and fishing</b>	585	3,834
<b>Mining, manufacturing and construction</b>	-3,415	1,410
<b>Transport and communication</b>	340	4,129
<b>Other economic affairs</b>		
A Tourism and area promotion	1	207
B Total labour and employment affairs	738	4,506
C Other economic affairs, nec <sup>(c)</sup>	24,016	1,213
<b>Other purposes</b>		
A Public debt interest	0	3,544
B Nominal superannuation interest	0	6,011
C General purpose inter-governmental transactions	750	45,277
D Natural disaster relief	0	28
E Contingency reserve	0	8
<b>Total<sup>(d)</sup></b>	<b>73,696</b>	<b>280,109</b>

(a) Total measured tax expenditures by functional category are derived by summing individual tax expenditure estimates, excluding estimates that are rounded to zero (..) or unquantifiable (\*).

(b) Direct expenses by function, as reported in the 2007-08 *Final Budget Outcome*.

(c) 'nec' means not elsewhere classified.

(d) Totals may not sum due to rounding.

### *Tax Expenditures Statement*

Comparisons between tax expenditures and direct expenditures are informative in broad terms, although the costings are not strictly comparable. For example:

- Tax expenditure estimates measure the benefit of the tax concession to the recipient, whereas direct expenditure estimates measure the impact of the expenditure on the budget in pre-tax dollars.
- Direct expenditures are often taxable, whereas tax expenditures are not.
- The removal of a tax expenditure or a direct expenditure of the same magnitude may have different effects on the fiscal balance, owing to different behavioural responses.

The addition of tax expenditures and direct expenditures will also tend to overstate the impact on the fiscal balance. For example, in the case of the exemption of certain income support benefits, pensions or allowances (A42) the direct expenditure includes the full cost of the program to government but there is also an associated tax expenditure for the value of the income tax exemption to the recipient.

Total measured tax expenditures in 2007-08 are estimated at around \$74 billion. Social security and welfare tax expenditures comprise around 50 per cent of total measured tax expenditures, which largely reflects the superannuation tax expenditures and the income tax exemption of the Family Tax Benefit, Parts A and B (A46).