

2.1 Introduction

Tax expenditure aggregates are reported and analysed in this chapter, with a breakdown of tax expenditures by both function and taxpayer affected. Care must be taken when interpreting these aggregates, particularly when making comparisons across time. There are several major considerations that need to be taken into account when analysing tax expenditure aggregates.

- First, some of the identified tax expenditures are not costed because of a lack of suitable data or may not be reported because of taxpayer confidentiality considerations. Hence, tax expenditure aggregates may underestimate the total benefit provided by tax expenditures.
- Second, the trend in aggregates over time reflects changes in the extent to which individual tax expenditures are accessed, changes to benchmark tax rates and changes in the coverage of tax expenditures being costed.
- Third, changes over time in methodology and data used to calculate the cost of tax expenditures can result in quite large revisions to the tax expenditure estimates. Therefore, estimates that were provided in previous editions of the TES may not be directly comparable to figures in this publication.
- Finally, tax expenditure aggregates are *net* aggregates as they include the offsetting effects of negative tax expenditures.

2.2 Trends in tax expenditures

Total measured tax expenditures as a share of GDP are reported in Table 2.1.

Table 2.1: Total measured tax expenditures^(a)

Year	Other tax		Tax expenditures	
	Superannuation \$m	expenditures \$m	Total \$m	as a proportion of GDP (%)
1998-99 (est)	10 100	16 091	26 191	4.4
1999-00 (est)	10 410	17 258	27 668	4.4
2000-01 (est)	9 820	20 497	30 317	4.5
2001-02 (est)	9 770	20 132	29 902	4.2
2002-03 (proj)	10 590	19 681	30 271	4.0
2003-04 (proj)	11 210	18 756	29 966	3.8
2004-05 (proj)	11 890	19 413	31 303	3.7
2005-06 (proj)	12 550	20 346	32 896	3.7

(a) Total measured tax expenditures are derived by summing the individual tax expenditure estimates in Table 5.1, and excluding items with estimates listed as being 'less than' (eg. <1, <5), rounded to zero (..) or na.

Tax expenditures as a proportion of GDP are estimated to have increased from 4.4 per cent in 1998-99 to 4.5 per cent in 2000-01 and are projected to fall to 3.7 per cent in 2005-06.

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The increase in total measured tax expenditures, as a share of GDP in 2000-01, largely reflects the first full year operation of the Family Tax Benefit (a tax-exempt payment) (A45) and the introduction of the capital gains tax (CGT) discount for individuals (D41). The subsequent projected decline reflects the impact of the policy decision to remove accelerated depreciation for plant and equipment (D69).

- The accelerated depreciation for plant and equipment is estimated to decline from a large positive tax expenditure in 1998-99 to a large negative tax expenditure in 2005-06. It becomes a negative tax expenditure because accelerated depreciation merely brings forward tax deductions; hence deductions in coming years for investments made before accelerated depreciation was removed will be lower than they would have been under the benchmark.

2.3 Tax expenditures by function

Total measured tax expenditures by functional category are reported in Table 2.2 for the period 1999-00 to 2005-06. The year-to-year variations in functional aggregates are explained largely by policy decisions, particularly those related to *The New Tax System*. Significant movements in functional categories are listed below. (Tax expenditure reference codes used in chapter 5 and Appendix A are reported in parentheses.)

- The decline in the estimate for total defence tax expenditures between 1999-00 and 2000-01 reflects the tax exemption of pay and allowances for lower numbers of troops deployed in East Timor (A16).
- The increase in total health tax expenditures in 2000-01 reflects the first full year impact of the private health insurance tax offset, while the further increase in 2001-02 reflects increased take-up of private health cover in 2000-01 (A31). The increase also reflects an increase in the tax expenditure for the income tax exemption for registered health benefit organisations due to increased growth in health fund membership and greater profitability in this sector (D1).
- The decline in total social security and welfare tax expenditures in 2001-02 reflects the cessation of the tax expenditures associated with the exemption of the one-off payments made to senior Australians as part of *The New Tax System* (A47, A52). The increases in 2002-03 and beyond largely reflect expected growth in the value of superannuation assets and continued growth in superannuation contributions (B1).
- The increase in total housing and community amenities tax expenditures in 2000-01 reflects the extension of an FBT exemption for remote area housing benefits to all employers (C16).

Table 2.2: Aggregate tax expenditures by function^(a)

	Estimates (\$m)			Projections (\$m)			
	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
General public services							
A. Legislative and executive affairs	3	2	4	4	2	4	4
B. Financial and fiscal affairs	0	0	0	0	0	0	0
C. Foreign economic aid	275	245	265	335	360	400	440
D. General research	0	0	0	0	0	0	0
E. General services	8	13	12	13	13	13	14
F. Govt superannuation benefits	0	0	0	0	0	0	0
Defence	108	95	96	101	101	101	101
Public order and safety	0	0	0	0	0	0	0
Education	8	6	6	6	7	7	7
Health	1 020	1 315	1 535	1 540	1 525	1 615	1 780
Social security and welfare	17 558	18 192	17 900	19 020	19 993	21 119	22 295
Housing and community amenities	210	250	245	260	265	270	280
Recreation and culture	66	62	45	45	74	69	84
Fuel and energy	1 630	1 750	1 670	1 635	1 655	1 685	1 700
Agriculture, fisheries and forestry	230	310	451	788	150	157	159
Mining and mineral resources (other than fuels), manufacturing and construction	3 104	2 588	1 728	914	247	- 39	- 236
Transport and communications	35	40	50	50	50	50	50
Other economic affairs							
A. Tourism and area promotion	85	85	70	60	65	65	70
B. Labour and employment affairs	17	22	21	13	9	9	9
C. Other economic affairs, nec	1 411	3 543	4 072	3 714	3 450	3 745	4 229
Other purposes							
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-government transactions	0	0	0	0	0	0	0
D. Natural disaster relief	1	0	0	0	0	0	0
E. Contingency reserve	0	0	0	0	0	0	0
F. Asset sales	0	0	0	0	0	0	0
Not allocated to function	1 899	1 799	1 732	1 773	2 000	2 033	1 910
Total(b)	27 668	30 317	29 902	30 271	29 966	31 303	32 896

(a) Total tax expenditures by functional category are derived by summing the individual tax expenditure estimates in Table 5.1, and excluding items with estimates listed as being 'less than' (eg. <1, <5), rounded to zero (..) or na.

(b) Items may not sum due to rounding.

- The decline in total recreation and culture tax expenditures from 1999-00 to 2002-03 reflects the change in the tax incentives for film investment which is estimated to decline from a positive tax expenditure in 2000-01 to a negative tax expenditure in 2001-02 (D48).
 - The projected increase in total recreation and culture tax expenditures in 2003-04 reflects the introduction of a tax offset for large scale film production (D50).

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- The decline in total fuel and energy tax expenditures in 2001-02 and 2002-03 reflects a decline in the value of the excise concession on aviation gasoline and aviation turbine fuel (E6).
- The increase in total agriculture, fisheries and forestry tax expenditures from 2000-01 to 2002-03 reflects a significant increase in the value of tax expenditures aimed at smoothing the impact of fluctuating incomes for primary producers (D9, D92).
 - While the cost of income tax averaging rose, the main increase is due to strong growth in Farm Management Deposit Scheme (FMD) contributions by primary producers. Due to the volatility of farm incomes and FMD deposits, these tax expenditures are not reported beyond 2002-03, which results in a significant decline in total tax expenditures in 2003-04.
- The significant fall in the cost of mining, manufacturing and construction tax expenditures results from the removal of accelerated depreciation for businesses with an annual turnover of \$1 million or more on 21 September 1999 (D69).
- The increase in total tax expenditures for other economic affairs in 2000-01 reflects the introduction of the capital gains tax (CGT) discount for individuals (D41) and the transitional arrangements for prepayments (D84). The latter is estimated to cost \$660 million in 2000-01 before becoming a negative tax expenditure from 2001-02.
 - The decline in total tax expenditures for other economic affairs projected in 2002-03 reflects the transitional exemption of small business from abolition of accelerated depreciation, balancing charge offset and low-value pooling (D76), which changes from a large positive tax expenditure in 2001-02 to a negative tax expenditure in 2002-03.
- The decline in estimates for total measured tax expenditures that are 'not allocated to function' in 2000-01 largely reflects the cessation of the savings tax offset (B9). The further decline in 2001-02 is attributable to the immediate deductibility of Y2K related information technology upgrades (D81) and the immediate deductibility of GST related plant and software (D82), which both change from a positive tax expenditure in 2000-01 to a negative tax expenditure in 2001-02.
 - The increase for total measured tax expenditures that are 'not allocated to function' in 2003-04 is attributable to the introduction of a Fringe Benefits Tax exemption for certain payments to prescribed employee entitlement funds from 1 April 2003 (C57).

Changes in functional aggregates relative to the *2001 Tax Expenditures Statement* largely reflect the availability of estimates for items that were previously unquantifiable, the availability of new data that causes existing estimates to be significantly revised and the introduction of new tax expenditures.

- Estimates are now available for venture capital concessions (D36), small business 50 per cent exemption (D37) and CGT scrip-for-scrip roll-over relief (D42) which all fall under the other economic affairs functional category. In addition, estimates are now provided for the capital expenditure deduction for mining, quarrying and petroleum operations (D60) which falls under the mining, manufacturing and construction category.

- The reduction in total fuel and energy tax expenditures relative to the *2001 Tax Expenditures Statement* largely reflects a downward revision in the tax expenditure for the excise exemption for compressed natural gas (E4).

2.4 Comparison with direct expenditure

The tax expenditure estimates for 2001-02 by functional category are presented alongside direct government expenditure in Table 2.3. The list of direct expenditures by function is reproduced from Table 3 of the *2001-02 Final Budget Outcome*.

Comparisons between tax expenditures and direct expenditures are informative in broad terms, although the costings are not strictly comparable for the following reasons:

- A tax expenditure tends to provide a higher benefit than a direct expenditure of the same magnitude. This is because direct expenditures are often taxable, whereas tax expenditures are not. Therefore, a direct expenditure will, in some circumstances, have a smaller net budgetary impact than a tax expenditure of equivalent nominal value.
- The removal of a tax expenditure or a direct expenditure of the same magnitude may have different effects on the underlying fiscal balance for reasons discussed in chapter 1.4.

For tax exempt and tax offset personal cash transfers, the addition of tax expenditures and direct expenditures will tend to overstate the impact on the fiscal balance. For example, in the case of A40 (exemption of certain social security and repatriation payments), the direct expenditure column includes the full cost to government of the programme; however there is also an associated tax expenditure for the value of the income tax exemption to the recipient. Other examples include A31 and A41 to A48. (An equivalent point applies to the addition of refundable tax offsets and the value of the tax exemption in Table 2.2 for tax expenditures A31 and A45¹.)

1 From 2001-02, refundable tax offsets are identified as an expense and are therefore no longer treated as tax expenditures. Prior to that time they were treated as either expenses or tax expenditures. The value of the income tax exemption to the recipient is still treated as a tax expenditure.

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Table 2.3: Aggregate tax expenditures and direct expenditures by function in 2001-02

	Tax expenditures(a)	Direct expenditures
	\$m	\$m
General public services		
A. Legislative and executive affairs	4	778
B. Financial and fiscal affairs	0	3 567
C. Foreign economic aid	265	2 151
D. General research	0	1 698
E. General services	12	550
F. Govt superannuation benefits	0	1 497
Defence	96	12 017
Public order and safety	0	1 856
Education	6	11 761
Health	1 535	27 614
Social security and welfare	17 900	69 081
Housing and community amenities	245	2 210
Recreation and culture	45	2 036
Fuel and energy	1 670	3 052
Agriculture, fisheries and forestry	451	1 691
Mining and mineral resources (other than fuels), manufacturing and construction	1 728	1 686
Transport and communications	50	2 647
Other economic affairs		
A. Tourism and area promotion	70	142
B. Labour and employment affairs	21	3 243
C. Other economic affairs, nec	4 072	513
Other purposes		
A. Public debt interest	0	4 995
B. Nominal superannuation interest	0	4 987
C. General purpose inter-government transactions	0	6 561
D. Natural disaster relief	0	87
E. Contingency reserve	0	0
F. Asset sales	0	64
Not allocated to function	1 732	0
Total(b)	29 902	166 482

(a) Total tax expenditures by functional category are derived by summing the individual tax expenditure estimates in Table 5.1, and excluding items with estimates listed as being 'less than' (eg. <1, <5), rounded to zero (..) or na.

(b) Items may not sum due to rounding.

As reported in Table 2.3, total measured tax expenditures in 2001-02 are valued at \$29.9 billion. Social security and welfare tax expenditures comprise 60 per cent of total measured tax expenditures.

When compared to the sum of both total measured tax expenditures and total direct expenditure, 15 per cent of total government assistance is provided through tax expenditures.

The proportion of government assistance delivered through tax expenditures, however, varies greatly by functional category. In most cases, the assistance provided by direct expenditure significantly exceeds the benefit provided by tax expenditures. The exceptions are:

- mining, manufacturing and construction, although this category includes the accelerated depreciation tax expenditures which have been removed from 21 September 1999 for businesses with an annual turnover of \$1 million or more (D69, D70); and
- other economic affairs, due to a number of large tax expenditures in this category including the concessional rate of fringe benefits tax on motor vehicles (C32), the CGT discount for individuals (D41) and the transitional exemption of small business from abolition of accelerated depreciation, balancing charge offset and low-value pooling (D76).

2.5 Tax expenditures by taxpayer affected

While many tax expenditures may be accessed by more than one group of taxpayers, they are often targeted to particular taxpayer groups. This section provides a broad indication of how the main taxpayer groups benefit from tax expenditures. The purpose of this analysis is to provide an overall picture of the direction of tax expenditures despite the difficulties in determining the final beneficiary of the assistance.

For the purpose of this analysis, the classification of 'taxpayer affected' is by the legal incidence of the tax. Legal incidence should not be confused with the economic incidence of a tax measure. Legal incidence refers to the taxpayer upon which the tax is levied. In contrast, the economic incidence of a tax relates to the taxpayer (or taxpayers) that bear the cost of a tax, or benefit from a tax expenditure. Economic incidence will differ from legal incidence if the group bearing the legal incidence is able to pass on some or all of the cost or benefit of the tax, and thus have it feed through into prices (including factor prices, such as wages and the return on capital).

- For instance, the legal incidence of a tax expenditure may be on the manufacturer of a product. However, the economic incidence may actually fall on consumers of the product via a change in price.

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Total measured tax expenditures by taxpayer affected are reported in Table 2.4. The major influences behind changes in taxpayer-affected aggregates are generally the same as those listed in chapter 2.3. For example, the increase in personal income tax expenditures in 2000-01 reflects the introduction of both the CGT discount for individuals (D41) and Family Tax Benefit (A45) (a tax-exempt payment). The increase in the tax expenditures for primary producers from 1999-00 to 2002-03 mainly reflects increased use of Farm Management Deposits (FMDs) (D92). The subsequent decline for primary producers reflects the change in projected tax expenditures for averaging of primary producer incomes (D9) and FMDs, which, due to the volatility in the estimates, are not reported beyond 2002-03.

Table 2.4: Aggregate tax expenditures by taxpayer affected^(a)

Taxpayer	Estimates (\$m)				Projections (\$m)			
	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
Businesses	4 870	5 219	6 068	4 798	3 517	2 520	2 451	2 658
Defence	407	438	465	476	501	511	531	551
Donors	230	250	300	330	350	380	420	450
Employees	1 550	1 470	1 275	1 225	1 170	1 115	1 065	1 010
Employers	1 098	1 133	1 118	1 128	1 150	1 381	1 421	1 466
Financial institutions	40	35	150	175	155	155	155	20
Government	95	90	95	95	85	90	95	95
Hospitals	145	155	115	120	125	125	130	135
Superannuation funds and beneficiaries	10 100	10 410	9 820	9 770	10 590	11 210	11 890	12 550
Non-profit organisations	540	575	625	725	744	779	799	824
Personal income taxpayers	2 743	3 232	5 930	6 994	7 328	7 643	8 145	8 808
Retirees/allow ees	3 335	3 570	3 215	2 762	2 840	2 920	3 020	3 110
Property ow ners	0	0	0	0	0	0	0	0
Primary producers	219	230	310	451	788	150	157	159
Students	8	8	6	6	6	7	7	7
Non-residents	800	830	810	830	905	965	1 000	1 035
Miscellaneous(b)	11	23	15	17	17	15	17	18
Total(c)	26 191	27 668	30 317	29 902	30 271	29 966	31 303	32 896

- (a) Total tax expenditures by taxpayer affected are derived by summing the individual tax expenditure estimates in Table 5.1, and excluding items with estimates listed as being 'less than' (eg. <1, <5), rounded to zero (..) or na.
- (b) Expenditures included in the 'Miscellaneous' category are those for which the 'taxpayer affected' does not belong to any of the other identified categories.
- (c) Items may not sum due to rounding.

Chapter 2: Overview of tax expenditure aggregates

The following provides, for measured tax expenditures, a list of tax expenditure reference codes that correspond to each category of taxpayer affected.

Businesses	B5, D18, D25, D36-D38, D59-D61, D63, D64, D69-D73, D75-D82, D84, D98, D102, E1, E2, E4-E6, E8-E10
Defence force personnel, including veterans and their families	A10, A11, A16, A19, A21, A48, C3, C4
Donors to approved organisations	A65
Employees	B2-B4
Employers	C16, C20, C23, C32, C33, C42, C57, D21
Financial institutions	D22, D29, D103
Government	D31
Hospitals and State and Territory authorities	C8
Superannuation funds and beneficiaries, termination payment recipients	B1, B6
Non-profit organisations	C13, C35, C37, D1, D6, D8, D20
Personal income taxpayers	A9, A18, A27-A34, A36-A39, A41, A43-A46, A53, A54, A59, A69, A70, A72, B9, D16, D41, D42, D44, D48, D87, D89
Retirees and allowees	A35, A40, A42, A47, A52
Primary producers	D9, D12, D14, D51-D53, D55-D58, D91, D92, E7
Students	A23
Non-residents	A6, D50, D95, D101, D110
Miscellaneous	A2, A3, A55, A67, C22, D27, D28

