

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 *2002 Tax Expenditures Statement* largely reflect the availability of estimates for items that were previously unquantifiable and the availability of new data that allowed existing estimates to be revised.

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.

- Some of the identified tax expenditures are not costed because of a lack of suitable data or their cost may not be reported because of taxpayer confidentiality considerations. Hence, tax expenditure aggregates may underestimate the total benefit provided by tax expenditures.
- 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.
- 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. Therefore, estimates that were provided in previous editions of the Tax Expenditures Statement may not be directly comparable to figures reported in this publication.
- Finally, 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. Tax expenditures as a proportion of GDP are estimated to fall from around 4.5 per cent in 1999-2000 to around 3.6 per cent in 2006-07.

Table 2.1: Total measured tax expenditures^(a)

Year	Superannuation \$m	Other tax expenditures \$m	Total \$m	Tax expenditures as a proportion of GDP (%)
1999-00 (est)	10 675	17 909	28 584	4.5
2000-01 (est)	9 685	20 091	29 776	4.4
2001-02 (est)	9 215	20 555	29 770	4.2
2002-03 (est)	10 075	19 946	30 021	4.0
2003-04 (proj)	10 960	19 486	30 446	3.8
2004-05 (proj)	11 775	19 478	31 253	3.7
2005-06 (proj)	12 625	19 814	32 439	3.7
2006-07 (proj)	13 450	20 302	33 752	3.6

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

The projected decline largely reflects the impact of the policy decision to remove accelerated depreciation for plant and equipment (B52)¹ with effect from 2001-02. The accelerated depreciation for plant and equipment is estimated to decline from a large positive tax expenditure in 1999-2000 to a large negative tax expenditure in 2006-07. 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 Large tax expenditures

Table 2.2 provides a list of the largest measured tax expenditures, in terms of their absolute magnitude, for 2003-04. The twelve largest positive tax expenditures account for around 78 per cent of the aggregate value of tax expenditures in 2003-04.

The largest tax expenditure is the concessional treatment of funded superannuation (C1) which is estimated to provide a benefit to taxpayers of around \$10.5 billion in 2003-04. The next largest measured tax expenditures for 2003-04 are the income tax exemption of the Family Tax Benefit, Parts A and B (A36) and the capital gains tax

1 Throughout the remainder of this document, where a reference to a particular tax expenditure is made, the tax expenditure reference code used in Chapter 6 is reported in parentheses.

discount for individuals and trusts (E15). These tax expenditures are estimated to provide a benefit to taxpayers in 2003-04 of around \$2.6 billion and \$2.4 billion respectively.

The largest negative tax expenditures in 2003-04 are the higher rate of excise levied on cigarettes (F1) and the reduced deductions allowed under the accelerated depreciation regime for plant and equipment (B52). These tax expenditures are estimated to be around -\$1.3 billion and -\$0.7 billion respectively.

Table 2.2: Large measured tax expenditures in 2003-04

Tax Expenditure		Value \$
Large positive tax expenditures		
C1	Concessional taxation of funded superannuation	10,490
A36	Exemption of Family Tax Benefit, Parts A and B, including expense equivalent	2,560
E15	Capital gains tax 50 per cent discount for individuals and trusts	2,360
A28	Senior Australians' Tax Offset	1,670
D26	Application of statutory formula to value car benefits	1,070
A35	Exemption of certain income support benefits, pensions or allowances	960
A27	Tax offset for recipients of certain social security benefits, pensions or allowances	930
A22	Exemption of 30 per cent private health insurance refund, including expense equivalent	850
F6	Exemption from excise for 'alternative fuels'	830
C3	Concessional treatment of non-superannuation termination benefits	780
F5	Concessional rate of excise levied on aviation gasoline and aviation turbine fuel	750
B86	Exemption from interest withholding tax on widely held debentures	650
Large negative tax expenditures		
F1	Higher rate of excise levied on cigarettes with less than 0.8 grams of tobacco	-1,340
B52	Accelerated depreciation allowance for plant and equipment	-680

2.4 Trends in tax expenditures by function

Total measured tax expenditures by functional category are reported in Table 2.3 for the period 2000-01 to 2006-07. Significant movements in functional categories are listed below.

- 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 (B11 and B19). The estimates of these tax expenditures are expected to fall in 2003-04 reflecting the impact of the drought on farm income.
 - While the cost of income tax averaging rose, the main increase is due to strong growth in Farm Management Deposit Scheme contributions by primary producers. Due to the volatility of farm incomes and the uncertain impact of the drought on the level of Farm Management Deposit Scheme deposits, these tax

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expenditures are reported as unquantifiable beyond 2003-04, which results in a significant decline in total tax expenditures in 2004-05.

- The significant fall in the cost of mining, manufacturing and construction tax expenditures results from the decision to remove accelerated depreciation for plant and equipment (B52).
- The consistent growth in the social security and welfare tax expenditures reflect the growth in the tax concessions for funded superannuation (C1).
- The changes in the estimated value of health tax expenditures reflect: a change in the classification of the refundable tax offset for private health insurance (A21) and movements in the estimated tax concessions for registered health benefit organisations (B1) and high sulphur diesel (F3).
- The reduction in total health tax expenditures relative to the *2002 Tax Expenditures Statement* reflects the negative tax expenditure for the higher rate of excise on cigarettes (F1), which was previously unquantifiable.

Table 2.3: Aggregate tax expenditures by function^(a)

	Estimates (\$m)			Projections (\$m)			
	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07
General public services							
A. Legislative and executive affairs	2	1	1	1	1	1	1
B. Financial and fiscal affairs	0	0	0	0	0	0	0
C. Foreign affairs and economic aid	238	329	443	503	547	626	706
D. General research	0	0	0	0	0	0	0
E. General services	11	8	9	9	9	10	10
F. Govt superannuation benefits	0	0	0	0	0	0	0
Defence	86	93	98	103	89	89	89
Public order and safety	0	0	0	0	0	0	0
Education	6	5	6	6	6	7	7
Health	75	270	45	45	101	246	287
Social security and welfare	18 615	18 335	19 224	20 168	21 346	22 287	23 249
Housing and community amenities	645	775	615	530	550	560	590
Recreation and culture	68	53	50	58	58	64	66
Fuel and energy	1 885	1 830	1 785	1 830	1 840	1 855	1 875
Agriculture, fisheries and forestry	531	633	852	667	74	75	79
Mining and mineral resources (other than fuels), manufacturing and construction	2 498	1 305	381	- 316	- 528	- 631	- 660
Transport and communications	40	50	70	57	57	57	57
Other economic affairs							
A. Tourism and area promotion	85	45	40	40	45	45	45
B. Labour and employment affairs	21	14	10	10	10	10	10
C. Other economic affairs, nec(b)	2 943	4 033	4 265	4 756	4 963	5 136	5 248
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	0	0	0	0	0	0	0
E. Contingency reserve	0	0	0	0	0	0	0
Not allocated to function	2 027	1 991	2 127	1 979	2 085	2 002	2 093
Total(c)	29 776	29 770	30 021	30 446	31 253	32 439	33 752

(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 2002-03 by functional category are presented alongside direct government expenditure in Table 2.4. The list of direct expenditures by function is reproduced from Table 3 of the 2002-03 *Final Budget Outcome*.

Table 2.4: Aggregate tax expenditures and direct expenditures by function in 2002-03

	Tax expenditures(a) \$m	Direct expenditures \$m
General public services		
A. Legislative and executive affairs	1	781
B. Financial and fiscal affairs	0	3 187
C. Foreign affairs and economic aid	443	2 364
D. General research	0	1 830
E. General services	9	553
F. Govt superannuation benefits	0	2 095
Defence	98	13 143
Public order and safety	0	2 104
Education	6	12 342
Health	45	29 734
Social security and welfare	19 224	71 763
Housing and community amenities	615	1 733
Recreation and culture	50	2 111
Fuel and energy	1 785	3 474
Agriculture, fisheries and forestry	852	1 945
Mining and mineral resources (other than fuels), manufacturing and construction	381	1 519
Transport and communications	70	2 268
Other economic affairs		
A. Tourism and area promotion	40	134
B. Labour and employment affairs	10	3 151
C. Other economic affairs, nec(b)	4 265	691
Other purposes		
A. Public debt interest	0	4 627
B. Nominal superannuation interest	0	5 350
C. General purpose inter-government transactions	0	3 638
D. Natural disaster relief	0	141
E. Contingency reserve	0	- 144
Not allocated to function	2 127	0
Total(c)	30 021	170 534

(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.

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.
- A tax expenditure tends to provide a higher benefit than 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, due 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 (A35) the direct expenditure column includes the full cost to government of the program; however there is also an associated tax expenditure for the value of the income tax exemption to the recipient.

As reported in Table 2.4, total measured tax expenditures in 2002-03 are valued at around \$30 billion. Social security and welfare tax expenditures comprise around 64 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 (A36).

When compared to the sum of both total measured tax expenditures and total direct expenditure, total government assistance provided through tax expenditures is expected to remain at around 14-16 per cent. Table 2.5 shows that this ratio has been fairly steady at around this level over recent years.

Table 2.5: Trends in tax expenditures versus direct expenditures

Year	Tax expenditures \$m	Direct expenditures (a) \$m	Tax expenditures as a proportion of total expenditures (b)	
			Per cent	
1999-00 (est)	28 584	154 481	15.6	
2000-01 (est)	29 776	156 817	16.0	
2001-02 (est)	29 770	166 525	15.2	
2002-03 (est)	30 021	170 534	15.0	
2003-04 (proj)	30 446	178 031	14.6	
2004-05 (proj)	31 253	186 521	14.4	
2005-06 (proj)	32 439	194 176	14.3	
2006-07 (proj)	33 752	202 351	14.3	

(a) Source: Statement 13, Budget Paper Number 1, 2003-04 Budget.

(b) Tax expenditures as a proportion of direct expenditures *plus* tax expenditures.

