

## 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 *2006 Tax Expenditures Statement* largely stem from revisions to the estimates of existing tax expenditures, particularly the superannuation tax expenditures. The changes to the superannuation estimates are mainly due to:

- Increases in the base data used to estimate the superannuation tax expenditures;
- An expansion in the scope of the estimates; and
- Revised methodology.

### 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 4.8 per cent in 2006-07 to 4.6 per cent in 2007-08 and 4.4 per cent in 2008-09 mainly as a result of the impact of personal income tax cuts.

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

Year	Superannuation <sup>(b)</sup> \$m	Other tax expenditures \$m	Total \$m	Tax expenditure as a proportion of GDP (%)
2003-04 (est)	13,833	16,991	30,824	3.7
2004-05 (est)	17,353	20,718	38,071	4.2
2005-06 (est)	23,065	23,376	46,441	4.8
2006-07 (est)	24,985	25,135	50,120	4.8
2007-08 (proj)	26,845	24,565	51,410	4.6
2008-09 (proj)	27,466	25,036	52,502	4.4
2009-10 (proj)	29,391	27,498	56,889	4.6
2010-11 (proj)	31,807	29,945	61,752	4.8

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

(b) Includes the sum of tax expenditures C4-C14 and C19.

Table 2.2 presents measured tax expenditures by the benchmark against which they are estimated for the period 2003-04 to 2010-11. The retirement savings benchmark, containing the superannuation tax expenditures, is the largest benchmark classification. This is followed by the personal income 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	2003-04 (est)	2004-05 (est)	2005-06 (est)	2006-07 (est)	2007-08 (proj)	2008-09 (proj)	2009-10 (proj)	2010-11 (proj)
<b>Income Tax</b>								
Personal income	10,274	10,558	11,286	11,704	12,037	11,731	12,018	12,341
Business income	3,095	3,191	2,983	3,771	3,615	4,300	5,337	6,328
Retirement savings	15,423	19,098	25,345	27,000	28,780	29,196	31,036	33,357
Fringe Benefits Tax	2,976	3,544	3,452	3,177	3,179	3,326	3,755	3,900
Capital Gains Tax	3,314	5,549	6,607	8,034	7,518	7,833	8,108	8,531
<b>Consumption</b>								
Commodity taxes	-4,408	-4,199	-3,482	-3,886	-4,039	-4,204	-3,685	-3,025
Natural resource taxes	150	330	250	320	320	320	320	320

(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 2007-08. The largest tax expenditure is the concessional taxation of superannuation entity earnings (C6) which is estimated to provide a benefit to taxpayers of around \$13.6 billion in 2007-08. The next largest measured tax expenditures for 2007-08 are the concessional taxation of employer contributions (C5) and the capital gains tax discount for individuals and trusts (E9). These tax expenditures are estimated to provide benefits to taxpayers in 2007-08 of around \$10.2 billion and \$6.9 billion respectively.

The largest negative tax expenditures in 2007-08 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 -\$1.4 billion respectively.

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**Table 2.3: Large measured tax expenditures in 2007-08**

Tax expenditure	Estimate \$m
<b>Large positive tax expenditures</b>	
C6 Superannuation - concessional taxation of superannuation entity earnings	13,600
C5 Superannuation - concessional taxation of employer contributions	10,150
E9 Capital gains tax discount for individuals and trusts	6,870
A43 Exemption of Family Tax Benefit, Parts A and B, including expense equivalent	2,480
C4 Superannuation - capital gains tax discount for funds	1,550
D26 Application of statutory formula to value car benefits	1,490
C3 Concessional taxation of non-superannuation termination benefits	1,400
A33 Tax offset for recipients of certain social security benefits, pensions or allowances	1,200
B12 Exemption from interest withholding tax on widely held debentures	1,030
A31 Senior Australians' Tax Offset	1,010
A39 Exemption of certain income support benefits, pensions or allowances	1,000
A22 Exemption of 30 per cent private health insurance refund, including expense equivalent	1,000
F3 Concessional rate of excise levied on aviation gasoline and aviation turbine fuel	905
A66 Deduction for gifts to approved donees	870
C8 Superannuation - deduction and concessional taxation of certain personal contributions	780
B104 Income tax exemption for municipal authorities and other local governing bodies	770
F6 Exemption from excise for 'alternative fuels'	750
A21 Exemption from the Medicare levy for residents with a taxable income below a threshold	670
<b>Large negative tax expenditures</b>	
F22 Customs duty	-3,682
F7 Higher rate of excise levied on cigarettes with less than 0.8 grams of tobacco	-1,375
B75 Accelerated depreciation allowance for plant and equipment	-800

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);
- Deduction for capital works expenditure (B86); 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 2004-05 to 2010-11. Significant changes underlying movements in functional categories are listed below.

- The increase in the aggregate for health tax expenditures between 2004-05 and 2010-11 is largely reflects the estimates for the exemption of 30 per cent private health insurance refund, including expense equivalent (A22) and the income tax exemption for registered health benefit organisations (B18).
- The total for transport and communication is also estimated to increase over the reported period owing to the statutory effective life caps (B84) 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 between 2004-05 and 2005-06 in the total labour and employment affairs aggregate is mainly due to the Mature Age Worker Tax Offset (A36) which commenced in 2005-06.
- 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)		
	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
<b>General public services</b>							
A. Legislative and executive affairs	2	2	2	2	2	3	3
B. Financial and fiscal affairs	2	0	0	0	0	0	0
C. Foreign affairs and economic aid	428	459	499	510	531	551	581
D. General research	0	0	0	0	0	0	0
E. General services	8	8	7	7	7	7	8
F. Government superannuation benefits	0	0	0	0	0	0	0
<b>Defence</b>	156	180	202	213	217	216	219
<b>Public order and safety</b>	0	0	0	0	0	0	0
<b>Education</b>	1	2	6	8	8	7	7
<b>Health</b>	365	585	876	925	995	1,090	1,210
<b>Social security and welfare</b>	26,951	33,211	34,833	36,495	36,927	39,181	41,521
<b>Housing and community amenities</b>	525	530	605	615	615	620	620
<b>Recreation and culture</b>	202	198	183	197	211	208	224
<b>Fuel and energy</b>	1,660	1,590	1,390	1,490	1,550	1,630	1,745
<b>Agriculture, forestry and fishing</b>	559	524	524	404	267	263	285
<b>Mining, manufacturing and construction</b>	-4,313	-3,787	-4,020	-4,277	-4,524	-4,069	-3,489
<b>Transport and communication</b>	205	240	295	375	450	485	510
<b>Other economic affairs</b>							
A. Tourism and area promotion	15	16	14	14	18	17	17
B. Total labour and employment affairs	542	1,000	1,055	1,028	1,057	1,009	1,003
C. Other economic affairs, nec(b)	10,223	11,053	12,949	12,634	13,311	14,721	16,228
<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	630	700	770	860	950	1,060
D. Natural disaster relief	0	0	0	0	0	0	0
E. Contingency reserve	0	0	0	0	0	0	0
<b>Total(c)</b>	<b>38,071</b>	<b>46,441</b>	<b>50,120</b>	<b>51,410</b>	<b>52,502</b>	<b>56,889</b>	<b>61,752</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 2006-07 by functional category are presented alongside direct government expenditure in Table 2.5. The list of direct expenditures by function is reproduced from Table 3 of the 2006-07 *Final Budget Outcome*.

**Table 2.5: Aggregate tax expenditures and direct expenditures by function in 2006-07**

	Tax expenditures(a) (\$m)	Direct expenditures(b) (\$m)
<b>General public services</b>		
A. Legislative and executive affairs	2	870
B. Financial and fiscal affairs	0	4,641
C. Foreign affairs and economic aid	499	3,282
D. General research	0	2,476
E. General services	7	667
F. Government superannuation benefits	0	2,679
<b>Defence</b>	202	16,854
<b>Public order and safety</b>	0	3,318
<b>Education</b>	6	16,898
<b>Health</b>	876	39,948
<b>Social security and welfare</b>	34,833	92,075
<b>Housing and community amenities</b>	605	2,909
<b>Recreation and culture</b>	183	2,561
<b>Fuel and energy</b>	1,390	4,635
<b>Agriculture, forestry and fishing</b>	524	2,831
<b>Mining, manufacturing and construction</b>	-4,020	1,920
<b>Transport and communication</b>	295	3,296
<b>Other economic affairs</b>		
A. Tourism and area promotion	14	196
B. Total labour and employment affairs	1,055	4,035
C. Other economic affairs, nec(c)	12,949	934
<b>Other purposes</b>		
A. Public debt interest	0	3,592
B. Nominal superannuation interest	0	5,470
C. General purpose inter-governmental transactions	700	2,573
D. Natural disaster relief	0	115
E. Contingency reserve	0	589
<b>Total(d)</b>	<b>50,120</b>	<b>219,362</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 2006-07 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 (A39) 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 2006-07 are estimated at around \$50 billion. Social security and welfare tax expenditures comprise around 69 per cent of total measured tax expenditures, which largely reflects the superannuation tax expenditures (C4-C14 and C19) and the income tax exemption of the Family Tax Benefit, Parts A and B (A43).