

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 *2005 Tax Expenditures Statement* largely stem from the revision of existing estimates and the changes to superannuation tax expenditures resulting from the Simplified Superannuation reforms.

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 4.4 per cent in 2005-06 to 4.0 per cent in 2006-07 mainly as a result of the impact of personal income tax rate reductions on the tax expenditure estimates. The ratio is projected to increase to 4.5 per cent by 2009-10 mainly because of changes in superannuation tax arrangements included in the *Simplified Superannuation* reforms.

Table 2.1: Total measured tax expenditures^(a)

Year	Superannuation ^(b) \$m	Other tax expenditures \$m	Total \$m	Tax expenditures as a proportion of GDP (%)
2002-03 (est)	10,100	19,347	29,447	3.8
2003-04 (est)	13,540	20,015	33,555	4.0
2004-05 (est)	16,600	22,693	39,293	4.4
2005-06 (est)	18,080	24,064	42,144	4.4
2006-07 (proj)	17,255	24,064	41,319	4.0
2007-08 (proj)	20,250	26,420	46,670	4.3
2008-09 (proj)	22,230	27,692	49,922	4.4
2009-10 (proj)	23,940	28,756	52,696	4.5

(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 C1 and C2.

The projected increase in the superannuation tax expenditure from 2007-08 largely reflects the impact of the *Mid-Year Economic and Fiscal Outlook 2006-07* measure to remove the end benefits tax from 1 July 2007 for payments from a taxed source for persons aged 60 or over.

There has also been an upward revision to the estimates for the capital gains tax discount for individuals and trusts (E14)¹, reflecting an increase in nominal capital gains on assets. The value of this tax expenditure is heavily affected by movements in asset prices. This may result in substantial revisions to the estimates in future Tax Expenditures Statements.

Table 2.2 presents measured tax expenditures by the benchmark against which they are estimated for the period 2002-03 to 2009-10. The retirement income 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

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.

benchmark give rise to a negative estimate, largely reflecting the higher rate of excise levied on cigarettes (F7).

Table 2.2: Measured tax expenditures by benchmark (\$m)^(a)

Year	Income tax					Other	
	Personal income	Business income	Retirement income	Fringe benefits	Capital gains	Commodity	Natural resources
2002-03 (est)	9,714	3,647	10,865	2,028	3,150	-137	180
2003-04 (est)	10,896	3,105	14,271	2,175	3,314	-356	150
2004-05 (est)	11,494	3,242	17,388	2,547	4,619	-327	330
2005-06 (est)	12,064	2,886	18,835	2,650	5,575	-116	250
2006-07 (proj)	12,609	2,787	17,940	2,607	5,562	-436	250
2007-08 (proj)	14,724	2,903	21,025	2,691	5,447	-370	250
2008-09 (proj)	15,333	3,088	22,970	2,829	5,712	-260	250
2009-10 (proj)	15,849	3,215	24,685	2,962	5,995	-260	250

(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 2006-07. The twelve largest positive tax expenditures account for over 80 per cent of the aggregate value of tax expenditures in 2006-07.

The largest tax expenditure is the concessional treatment of funded superannuation (C1) which is estimated to provide a benefit to taxpayers of around \$17.1 billion in 2006-07. The next largest measured tax expenditures for 2006-07 are the capital gains tax discount for individuals and trusts (E14) and the income tax exemption of the Family Tax Benefit, Parts A and B (A40). These tax expenditures are estimated to provide benefits to taxpayers in 2006-07 of around \$5 billion and \$2.4 billion respectively.

The largest negative tax expenditures in 2006-07 are the higher rate of excise levied on cigarettes (F7) and the reduction in depreciation deductions for plant and equipment (B47) following the abolition of the accelerated depreciation regime. These tax expenditures are estimated to be around -\$1.4 billion and -\$0.8 billion respectively.

Tax Expenditures Statement

Table 2.3: Large measured tax expenditures in 2006-07

Tax expenditure	Value \$m
Large positive tax expenditures	
C1 Concessional taxation of funded superannuation	17,110
E14 Capital gains tax discount for individuals and trusts	4,980
A40 Exemption of Family Tax Benefit, Parts A and B, including expense equivalent	2,430
A30 Senior Australians' Tax Offset	1,870
A29 Tax offset for recipients of certain social security benefits, pensions or allowances	1,150
D24 Application of statutory formula to value car benefits	1,070
A39 Exemption of certain income support benefits, pensions or allowances	970
A23 Exemption of 30 per cent private health insurance refund, including expense equivalent	950
F5 Concessional rate of excise levied on aviation gasoline and aviation turbine fuel	805
F6 Exemption from excise for 'alternative fuels'	750
A32 Tax offset for low-income earners	640
A64 Deduction for gifts to approved donees	640
Large negative tax expenditures	
F7 Higher rate of excise levied on cigarettes with less than 0.8 grams of tobacco	-1,355
B47 Accelerated depreciation allowance for plant and equipment	-840

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

2.4 Trends in tax expenditures by function

Total measured tax expenditures by functional category are reported in Table 2.4 for the period 2003-04 to 2009-10. Significant movements in functional categories are listed below.

- The increase in the aggregate for health tax expenditures between 2003-04 and 2009-10 is largely a result of the estimates for the medical expenses tax offset (A21) and the exemption from tax of the 30 per cent refund on the costs of private health insurance (A23).
- The total for social security and welfare tax expenditures is also estimated to increase over the reported period. The main tax expenditures affecting this category are the tax offset for recipients of certain social security benefits, pensions or allowances (A29); the Senior Australians' Tax Offset (A30); the income tax exemption of Family Tax Benefit, Parts A and B (A40); and the concessional taxation of funded superannuation (C1).
- The fuel and energy tax expenditures are estimated to increase from about \$1.5 billion in 2003-04 to about \$1.6 billion in 2009-10. The exemption from excise

for 'alternative fuels' (F6) and the excise-free status of condensate (G2) are the main tax expenditures influencing the estimates in this category.

- The total measured tax expenditures in agriculture, fisheries and forestry functional category falls from about \$600 million to \$200 million over the reporting period. The aggregates for this functional category may be misinterpreted given that for some tax expenditures in this category estimates beyond 2006-07 are not available.
 - For example, projections beyond 2006-07 are not reported for the income tax averaging for primary producers (B82) as this tax expenditure is very sensitive to variations in primary production income, which depends on a number of external factors.

Tax Expenditures Statement

Table 2.4: Aggregate tax expenditures by function^(a)

	Estimates (\$m)			Projections (\$m)			
	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
General public services							
A. Legislative and executive affairs	2	2	3	3	3	4	3
B. Financial and fiscal affairs	0	2	0	0	0	0	0
C. Foreign affairs and economic aid	431	421	431	451	451	491	541
D. General research	0	0	0	0	0	0	0
E. General services	10	11	11	12	13	13	14
F. Government superannuation benefits	0	0	0	0	0	0	0
Defence	97	98	102	101	101	106	102
Public order and safety	0	0	0	0	0	0	0
Education	-4	-3	-2	2	2	2	3
Health	50	195	425	551	505	545	570
Social security and welfare	22,542	26,173	27,408	26,997	32,099	34,522	36,570
Housing and community amenities	555	525	570	600	595	615	625
Recreation and culture	48	62	60	63	67	60	63
Fuel and energy	1,465	1,650	1,680	1,285	1,370	1,525	1,565
Agriculture, forestry and fishing	553	471	475	376	186	186	189
Mining, manufacturing and construction	-198	-456	-560	-574	-601	-647	-651
Transport and communications	70	205	250	305	385	435	470
Other economic affairs							
A. Tourism and area promotion	18	15	15	15	15	20	20
B. Labour and employment affairs	10	10	450	510	511	518	515
C. Other economic affairs, nec(b)	5,710	7,350	8,372	8,279	8,453	8,814	9,171
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-governmental 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	2,196	2,562	2,454	2,343	2,515	2,713	2,926
Total(c)	33,555	39,293	42,144	41,319	46,670	49,922	52,696

(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 2005-06 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 *2005-06 Final Budget Outcome*.

Table 2.5: Aggregate tax expenditures and direct expenditures by function in 2005-06

	Tax expenditures(a) \$m	Direct expenditures(b) \$m
General public services		
A. Legislative and executive affairs	3	768
B. Financial and fiscal affairs	0	3,958
C. Foreign affairs and economic aid	431	2,955
D. General research	0	2,346
E. General services	11	560
F. Government superannuation benefits	0	2,203
Defence	102	16,194
Public order and safety	0	2,558
Education	-2	15,883
Health	425	37,549
Social security and welfare	27,408	86,219
Housing and community amenities	570	2,248
Recreation and culture	60	2,585
Fuel and energy	1,680	4,046
Agriculture, forestry and fishing	475	2,780
Mining, manufacturing and construction	-560	1,905
Transport and communications	250	3,075
Other economic affairs		
A. Tourism and area promotion	15	209
B. Labour and employment affairs	450	3,825
C. Other economic affairs, nec(c)	8,372	840
Other purposes		
A. Public debt interest	0	3,628
B. Nominal superannuation interest	0	5,582
C. General purpose inter-governmental transactions	0	3,936
D. Natural disaster relief	0	211
E. Contingency reserve	0	36
Not allocated to function	2,454	
Total(d)	42,144	206,096

(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 2005-06 Final Budget Outcome.

(c) 'nec' means not elsewhere classified.

(d) 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.

Tax Expenditures Statement

- 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.
- 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 programme 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 2005-06 are estimated at around \$42 billion. Social security and welfare tax expenditures comprise around 65 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 (A40).

Table 2.5 shows that total measured tax expenditures were around 17.0 per cent of total government assistance in 2005-06.