CHAPTER 1: INTRODUCTION

The Tax Expenditures Statement (TES) provides details of concessions, benefits, incentives and charges provided through the tax system (tax expenditures) to taxpayers by the Australian Government. The publication of information on the Australian Government's tax expenditures is a requirement under the *Charter of Budget Honesty Act 1998*.

This statement lists around 320 tax expenditures and, where possible, reports the estimated pecuniary value or order of magnitude of the benefit to taxpayers over an eight-year period, from 2004-05 to 2011-12.

The tax expenditures in this statement reflect all announced policies applying up to the date of finalisation of the *Mid Year Economic and Fiscal Outlook 2008-09.*

This statement incorporates a number of changes. These include:

- for the first time, estimates of tax expenditures relating to the goods and services tax (GST);
- a number of changes made in response to the Australian National Audit Office (ANAO) report *Preparation of the Tax Expenditures Statement (Performance Audit Report No. 32 2007-08)*; and
- an appendix setting out preliminary estimates of the value of tax concessions for owner-occupied housing (Appendix C).

1.1 What is a tax expenditure?

A *tax expenditure* is a tax concession that provides a benefit to a specified activity or class of taxpayer. A *negative tax expenditure* arises when arrangements impose an additional charge rather than a benefit. Tax expenditures can be provided in many forms, including tax exemptions, tax deductions, tax offsets, concessional tax rates or deferrals of tax liability.

Tax expenditures are often an alternative to direct expenditures as a method of delivering government assistance or meeting government objectives. Tax expenditures have an impact on the budget position like direct expenditures, although, as discussed in Chapter 3, the tax expenditure estimates presented in this statement are not directly comparable to budget revenue estimates.

Tax expenditures may also redistribute the tax burden between taxpayers as most tax expenditures result in less tax being collected from particular taxpayers. As a result, taxes paid by individuals and businesses not benefiting from the tax expenditure need to be higher to raise the same total revenue.

1.2 Identifying and measuring tax expenditures

The tax expenditure estimates presented in this statement are estimates of the benefit to taxpayers of particular provisions in the law. In order to estimate the value of a tax expenditure, the tax arrangement that would normally apply needs to be identified, so that the nature and extent of the concession can be established. The taxation treatment that would normally apply is known as the *benchmark*. The benchmark should neither favour nor disadvantage similar activities or classes of taxpayer. Tax expenditures are measured as deviations from the benchmark.

Not all concessional elements of the tax system are classified as tax expenditures. This is because some concessions are considered structural elements of the tax system and are incorporated in the benchmark. For example, the personal income tax system includes a progressive marginal tax rate structure, which results in individuals on lower incomes paying a lower marginal rate of income tax than those on higher incomes. This arrangement is a structural design feature of the Australian tax system and is therefore not identified as a tax expenditure.

Tax expenditures in this statement are measured according to the *revenue forgone approach* which is one of several alternative methods of measuring tax expenditures. The estimates derived in this way are not directly comparable to budget estimates and, as noted below, care needs to be taken in their interpretation. Chapter 3 provides details of the alternative approaches to measuring tax expenditures and a comparison of the difference between estimates prepared under the alternative *revenue gain* approach for selected tax expenditures.

Interpreting the estimates of tax expenditures

Care should be taken when interpreting the tax expenditure estimates presented in this document. The estimates of reported tax expenditures are not necessarily reliable indicators of the budgetary impact of removing particular tax concessions. Nor are the aggregate estimates presented in Chapter 2 necessarily reliable indicators of the total value of tax expenditures. Where aggregates are reported, they are only presented as broad indicators of trends in the value and composition of tax expenditures.

Care should also be taken in comparing the level of tax expenditures reported in different editions of the TES, both for individual tax expenditures and in aggregate. Changes may arise without any change in the actual magnitude of tax expenditures. The reasons include revisions to data, changes in methodology, identification of formerly unidentified tax expenditures, quantification of previously unquantified tax expenditures and deletion of abolished tax expenditures.

A full discussion of the issues surrounding interpretation of tax expenditure estimates can be found in Chapter 3.

1.3 Why report tax expenditures?

The publication of the TES is an integral component of the Australian Government's budget reporting. It serves three key functions:

- to allow tax expenditures to receive a similar degree of scrutiny as direct expenditures;
- to allow for a more comprehensive assessment of government activity; and
- to contribute to the design of the tax system, by promoting and informing public debate on all elements of the tax system.

**Tax expenditure reporting in
Organisation for Economic Co-operation and Development (OECD) countries**

In the early 1970s, only Germany and the United States reported tax expenditures. By 1983, Australia, Austria, Canada, France and Spain were also regularly identifying them. Currently, almost all OECD member countries report tax expenditures. Most of these countries, including Australia, report tax expenditures annually.

The purpose of reporting tax expenditures is generally the evaluation of tax expenditures and to promote and assist public debate on the design of the tax system. Australia's TES has a broad coverage including the majority of taxes levied by the Australian Government.

Most OECD tax expenditure reporting countries report tax expenditures that relate to personal and business income taxes and value added taxes, where applicable. Australia (like Belgium, France, Germany, the Netherlands, the United Kingdom and the United States) reports tax expenditures on the majority of central government direct and indirect taxes. Austria and Italy report tax expenditures at all levels of government.

Of the OECD tax expenditure reporting countries, at least nine, including Australia, have noted the importance of reporting tax expenditures and made it a legal requirement. These countries include Austria, Belgium, France, Germany, Italy, Portugal, Spain and the United States. In addition, most of these countries explicitly link tax expenditure reporting to the budget process.

Source: H Brixi, C Valenduc and Z Li Swift, *Tax Expenditures — Shedding Light on Government Spending through the Tax System, Lessons from Developed and Transition Economies*, The World Bank, Washington DC, 2003.

TRANSPARENCY AND SCRUTINY

The TES improves the transparency of the tax system, thereby allowing greater public scrutiny of government policies.

In Australia, direct government expenditures are generally scrutinised during the annual budget process by Parliament and parliamentary committees, the media and the general public.

Tax expenditures, like direct expenditures, affect the government's budget. It is important, therefore, that tax expenditures are reviewed on a regular basis and receive similar scrutiny to that given to direct expenditures. The publication of information on tax expenditures facilitates their review and assessment, and assists in determining whether their objectives are being met at a reasonable cost and in the interest of the community in general.

SCOPE OF GOVERNMENT ACTIVITY

The publication of tax expenditure information allows for a more comprehensive assessment of Australian Government activity. Unless direct expenditures and tax expenditures are both reported, the scope of government influence on the economy and society will be understated. By reporting tax expenditures, all government assistance is transparent.

TAX SYSTEM DESIGN

Transparent reporting of tax expenditures assists the evaluation, design and development of the tax system and helps to determine whether there has been adherence to the three key principles of tax system design — efficiency, equity and simplicity. The provision of detailed information on tax expenditures allows a more thorough assessment of the tax system in respect to:

- its effect on resource allocation and incentives for taxpayer behaviour;
- the most appropriate way to administer concessions, particularly as most tax expenditures could be delivered as direct expenditures; and
- the impact on different entities within the economy, particularly as tax expenditures shift the tax burden to entities that are not treated concessionally.

1.4 Coverage of this statement

This statement covers the following Australian Government taxes:

- income tax (personal and business), including capital gains tax (CGT) and income tax paid on retirement income;
- fringe benefits tax (FBT);
- the goods and services tax (GST);
- excise duties;
- customs duty (including tariffs);
- wine equalisation tax;

- luxury car tax;
- petroleum resource rent tax; and
- crude oil excise.

Taxes excluded from this statement are:

- specific-purpose taxes, such as agricultural levies, which are generally levied for cost recovery purposes.

1.5 Reliability of the estimates

Wherever possible, this statement endeavours to provide estimates of the magnitude of tax expenditures. Data limitations mean that this is not always possible. Where estimates are quantified, the quality of the estimates will vary because of factors such as the quality of data, frequency with which data is available, the extent to which estimates depend upon assumptions and the volatility of the underlying usage of the taxation concessions concerned. Where estimates cannot be quantified, this statement attempts to provide an indication of the broad order of magnitude of the value of taxation concessions.

For the first time, this statement includes assessments of the reliability of the tax expenditure estimates presented in Chapter 6. An overview of this information is summarised in section 3.3.

This statement provides estimates for 211 of the 324 tax expenditures identified. Of these quantified tax expenditures, 56 per cent of the estimates are considered to be of medium to high reliability, accounting for 56 per cent of the total identified value of tax expenditures.

1.6 Australia's Future Tax System review and future taxation policy developments

On 13 May 2008 the Australian Government announced a review into Australia's tax system. The review will look at the current tax system and make recommendations to position Australia to deal with the demographic, social, economic and environmental challenges of the 21st century.

The review will encompass Australian Government and State taxes, except the GST, and interactions with the transfer system. The review panel will provide a final report to the Treasurer by the end of 2009.

The review may make recommendations that have implications for a number of the tax expenditure benchmarks in this statement.

Similarly, the development of the Carbon Pollution Reduction Scheme (CPRS) may have implications for the tax system that need to be taken into account in future editions of this statement.

1.7 Structure of this statement

The remainder of this statement is divided into the following sections:

- Chapter 2, *Trends in tax expenditure estimates,* provides an overview of Australian Government tax expenditures, including trends, aggregates and a comparison with direct expenditures.
- Chapter 3, *Measuring tax expenditures,* outlines the various approaches used to measure tax expenditures and provides guidance on how to interpret tax expenditure estimates.
- Chapter 4, *Benchmarks,* describes the benchmarks used to identify and measure tax expenditures.
- Chapter 5, *New, modified and deleted tax expenditures*, outlines changes to the list of tax expenditures since the *2007 Tax Expenditures Statement* — new tax expenditures, modified tax expenditures and tax expenditures no longer reported.
- Chapter 6, *Tax expenditures,* details each tax expenditure, including an estimate (where possible) of the benefit taxpayers derive, a description of the tax expenditure, a legislative reference, and for more recent tax expenditures, the date the expenditure was introduced.
- Appendix A, *Modelling tax expenditures,* provides an overview of the various modelling techniques used to estimate tax expenditures.
- Appendix B, *Concessional taxation of funded superannuation,* aggregates tax expenditures related to superannuation.
- Appendix C, *Tax concessions for owner-occupied housing*, discusses the concessions provided to owner-occupied housing and provides estimates of the value of those concessions under three alternative benchmarks.