

CHAPTER 1: OVERVIEW

1.1 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 TES lists 364 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 2007-08 to 2014-15.

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 2011-12*.

This statement incorporates a number of changes from previous years. Changes to benchmarks are reflected in Appendix A. Changes to individual tax expenditures are reported in Appendix B.

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

- Chapter 1 provides an overview of the TES, trends and aggregates in the estimates and comparison with direct expenditures.
- Chapter 2 provides background on tax expenditures and the tax expenditure framework, as well as the various approaches used to measure tax expenditures, including Treasury's approach.
- Chapter 3 outlines the benchmarks used to identify and measure tax expenditures, guidance on how to interpret tax expenditure estimates, and details of each tax expenditure, including an estimate (where possible) of the benefit taxpayers derive, a description of the tax expenditure, a legislative reference, and the date the expenditure was introduced.
- Chapter 4 provides revenue gain estimates of several tax expenditures, guidance on how to interpret revenue gain estimates, and comparison to the estimates in Chapter 3.
- Appendix A provides an overview of the various modelling techniques used to estimate tax expenditures, detailed descriptions of the benchmarks used in Chapter 3, and technical notes on the estimates.

Tax Expenditures Statement

- Appendix B provides comprehensive information on the changes to the list of tax expenditures since the 2010 TES – new tax expenditures, modified tax expenditures and tax expenditures no longer reported.

1.2 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;
- minerals resource rent tax;
- crude oil excise;
- carbon tax; and
- other indirect taxes.

1.3 Trends in tax expenditure estimates

The following tables provide summary and aggregate information on the tax expenditure estimates prepared for the 2011 TES. Comparisons across years are made on a consistent basis within this report for individual items and the aggregates.

The TES does not compare previous editions’ estimates with the current estimates except in very limited circumstances. Comparisons across different editions of the TES have always required great care due to the new data available each year and the identification of new tax expenditures, deletion of old tax expenditures and

modifications arising from government policies. Further discussion of these issues is provided in the box *Interpretation of trends and aggregates*.

TRENDS IN MEASURED TAX EXPENDITURES

Total measured tax expenditures are reported in Table 1.1. Measured tax expenditures as a proportion of GDP peaked in 2007-08 at 10.7 per cent of GDP before falling to 8.0 per cent in 2010-11. Growth in tax expenditures over the last two years of estimate data has been somewhat softer than in preceding years. The current relatively muted growth appears, in the main, to result from the impact of the global financial crisis on superannuation returns.

In dollar terms, total measured tax expenditures in 2010-11 are estimated at around \$112 billion. Housing tax expenditures comprise around one-third of total measured tax expenditures, followed by superannuation tax expenditures which comprise around a quarter of total measured tax expenditures.

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 TES 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.
- Tax expenditure estimates are not additive due to overlaps in behavioural responses (removal of one concession will affect the utilisation of other concessions) and will tend to overstate the budgetary impact of removing concessions as the estimates do not take account of behavioural responses.

Chapter 2 provides further details on how to interpret tax expenditure estimates.

Table 1.1: Total measured tax expenditures^(a)

Year	Housing \$m	Superannuation(b) \$m	Other tax expenditures \$m	Total \$m	Tax expenditure as a proportion of GDP (%)
2007-08 (est)	40,500	38,940	47,036	126,476	10.7
2008-09 (est)	29,500	33,117	49,294	111,911	8.9
2009-10 (est)	43,500	25,413	47,509	116,422	9.1
2010-11 (est)	35,500	27,226	48,938	111,664	8.0
2011-12 (proj)	35,500	30,216	46,991	112,707	7.6
2012-13 (proj)	36,000	32,116	51,223	119,339	7.7
2013-14 (proj)	36,000	35,056	54,966	126,022	7.7
2014-15 (proj)	36,500	40,226	59,438	136,164	7.9

(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 to C14 and C19.

Changes to benchmarks makes comparison of the aggregate estimates in the 2011 TES with the aggregate estimates provided in previous editions difficult. For example, the 2010 TES excludes the value of tax concessions arising under the Carbon Pollution Reduction Scheme benchmark as a result of the Government's decision to defer this scheme, whereas the tax expenditures associated with the carbon tax arrangements announced in the *Clean Energy Future* package are included in the 2011 TES.

Table 1.2 presents measured tax expenditures by the benchmark against which they are estimated for the period 2007-08 to 2014-15. The capital gains benchmark is the largest benchmark classification. This is followed by the retirement savings and goods and services tax benchmark.

For all reported years, the total measured tax expenditures representing the commodity and other indirect taxes benchmark give rise to a negative estimate, largely reflecting customs duty (F24) and the higher rate of excise levied on cigarettes (F11).

Table 1.2: Measured tax expenditures by benchmark (\$m)^(a)

Benchmark	2007-08 (est)	2008-09 (est)	2009-10 (est)	2010-11 (est)	2011-12 (proj)	2012-13 (proj)	2013-14 (proj)	2014-15 (proj)
Income Tax								
Personal income	11,846	11,560	14,006	12,197	10,264	10,829	11,030	12,214
Business income	6,423	6,726	8,313	9,035	7,322	6,928	7,984	8,045
Retirement savings	40,910	35,772	27,518	29,196	32,256	34,241	37,301	42,551
Fringe Benefits Tax	3,796	3,876	4,205	4,654	5,166	5,073	5,197	5,426
Capital Gains Tax	51,590	41,135	48,312	40,921	40,921	41,927	42,847	44,458
Indirect Taxes								
Commodity and other indirect taxes	-4,207	-3,815	-3,476	-3,153	-3,500	-4,222	-4,640	-4,727
Natural resources taxes	980	580	600	590	550	0	0	0
Goods and Services Tax	15,138	16,077	16,944	18,224	19,728	21,233	22,793	24,497
Carbon Pricing Mechanism	0	0	0	0	0	3,330	3,510	3,700

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

LARGE TAX EXPENDITURES

Table 1.3 lists the largest measured tax expenditures for 2011-12. The largest measured tax expenditures are the concessional capital gains taxation of owner-occupied housing (E5 and E6) which is estimated to provide a benefit to taxpayers of around \$35.5 billion in 2011-12. Together, these tax expenditures represent the exemption of owner-occupied housing from CGT.

After the owner-occupied housing exemption, the next largest tax expenditure is the concessional taxation of employer contributions to superannuation (C5) of around \$14.9 billion in 2011-12. This is followed by the concessional taxation of superannuation entity earnings (C6) and the GST-free status of food (H29). These tax expenditures are estimated to provide benefits to taxpayers in 2011-12 of around \$14 billion and \$5.9 billion respectively.

Tax expenditures for emissions exempted from the carbon tax are also significant; these are reported from 2012-13 onwards.

The largest negative tax expenditures in 2011-12 are customs duty (F24) and the higher rate of excise levied on cigarettes (F11). These tax expenditures are estimated to be around \$2.5 billion and \$1.8 billion respectively. The temporary flood and cyclone levy also has a large impact in 2011-12, estimated to be \$1.5 billion.

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 3). The largest such tax expenditures are as follows:

- income tax exemption for Commonwealth, State and Territory public authorities, and State and Territory entities (B3);
- off-market share buy-backs (B28);
- philanthropy – Income tax exemption for charitable, religious, scientific, and community service entities (B69); and
- quarantining of capital losses (E32).

Table 1.3: Large measured tax expenditures in 2011-12

Tax expenditure		Estimate \$m
Large positive tax expenditures		
E6	Capital gains tax main residence exemption — discount component	20,000
E5	Capital gains tax main residence exemption	15,500
C5	Superannuation — concessional taxation of employer contributions	14,850
C6	Superannuation — concessional taxation of superannuation entity earnings	14,000
H29	GST — Food — uncooked, not prepared, not for consumption on premises of sale and some beverages	5,900
E17	Capital gains tax discount for individuals and trusts	4,700
H19	GST — Health; medical and health services	3,050
H16	GST — Education	2,900
H2	GST — Financial Supplies; input taxed treatment	2,450
A43	Exemption of Family Tax Benefit, Parts A and B, including expense equivalent	2,060
C3	Concessional taxation of non-superannuation termination benefits	1,450
B16	Exemption from interest withholding tax on certain securities	1,440
A22	Exemption of 30 per cent private health insurance rebate, including expense equivalent	1,320
H3	GST — Financial Supplies; reduced input tax credits	1,290
D14	Philanthropy — Exemption for public benevolent institutions (excluding public and not-for-profit hospitals)	1,260
D18	Application of statutory formula to value car benefits	1,220
A21	Exemption from the Medicare levy for residents with a taxable income below a threshold	1,200
F7	Concessional rate of excise levied on aviation gasoline and aviation turbine fuel	1,060
H11	GST — Imported services	1,050
B93	Statutory effective life caps	1,040
D11	Philanthropy — Exemption for public and not-for-profit hospitals and public ambulance services	1,000
A32	Senior Australians' and Pensioners' Tax Offset	960
C8	Superannuation — deduction and concessional taxation of certain personal contributions	960
A65	Philanthropy — Deduction for gifts to deductible gift recipients	910
B4	Income tax exemption for local government bodies	830
H6	GST — Water, sewerage and drainage	810
B105	Research and development — Research and Development Tax Concession	780
B95	Deduction for capital works expenditure	735
A41	Exemption of certain income support benefits, pensions or allowances	670
B108	Small business and general business tax break	660
H10	GST — Importation Threshold	640
H5	GST — Child Care Services	620
Large negative tax expenditures		
F24	Customs duty	-2,460
F11	Higher rate of excise levied on cigarettes not exceeding 0.8 grams of tobacco	-1,760
A30	Flood and cyclone reconstruction levy	-1,500

TRENDS IN TAX EXPENDITURES BY FUNCTION

Total measured tax expenditures by functional category are reported in Table 1.4 for the period 2008-09 to 2014-15. Significant changes underlying movements in functional categories are listed below.

- The increase in agriculture, forestry and fishing reflects the exclusion of agricultural emissions from the coverage of the carbon pricing mechanism (I5) which impacts on 2012-13 and later years.
- The decrease in the fuel and energy aggregate is due to the increase in excise on aviation fuel (F7) (which is part of the arrangements to make those fuels subject to an effective carbon price), the phased introduction of excise on certain alternative fuels (F8), and the change in the benchmark treatment of crude oil condensate (G7) when that fuel commences to be taxed under the PRRT from 1 July 2012.
- The total for transport and communication is estimated to increase over the reported period owing to the statutory effective life caps (B93) tax expenditure.
- The decrease in the recreation and culture aggregate is due to the expiration of the rebate for broadcasting licence fees tax expenditure (F5).
- The growth in the education aggregate is due to the growth in the value of the GST exemption for education (H16) and the introduction of the Education Tax Refund (A17).
- The growth in the health aggregate is also significantly due to the growth in the value of the various GST exemptions related to health care.

Table 1.4: Aggregate tax expenditures by function^(a)

	Estimates (\$m)				Projections (\$m)		
	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14	2014-15
General public services							
A. Legislative and executive affairs	2	2	3	3	3	3	3
B. Financial and fiscal affairs	3,100	3,270	3,450	3,740	3,980	4,280	4,640
C. Foreign affairs and economic aid	658	660	544	574	599	640	680
D. General research	0	0	0	0	0	0	0
E. General services	47	92	142	153	153	154	154
F. Government superannuation benefits	0	0	0	0	0	0	0
Defence	802	837	867	937	1,006	1,057	1,102
Public order and safety	0	0	0	0	0	0	0
Education	2,321	2,468	2,818	3,038	3,297	3,587	3,847
Health	4,755	5,465	5,865	6,335	7,025	7,260	7,955
Social security and welfare	43,021	34,817	36,492	38,067	40,462	43,852	49,392
Housing and community amenities	31,155	45,640	37,847	37,605	38,209	38,388	39,066
Recreation and culture	132	151	202	292	259	179	189
Fuel and energy	1,635	1,600	1,660	1,620	850	815	785
Agriculture, forestry and fishing	252	189	175	260	2,025	2,147	2,252
Mining, manufacturing and construction	-2,775	-2,265	-1,753	-2,113	-2,503	-2,713	-2,763
Transport and communication	619	739	856	961	1,077	1,123	1,133
Other economic affairs							
A. Tourism and area promotion	0	0	0	0	0	0	0
B. Total labour and employment affairs	2,005	2,040	2,320	2,538	2,150	2,008	1,967
C. Immigration	0	0	0	0	0	0	0
D. Other economic affairs, nec(b)	23,474	19,979	19,390	17,864	19,856	22,322	24,772
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	700	730	780	830	890	920	990
D. Natural disaster relief	8	8	6	3	1	0	0
E. Contingency reserve	0	0	0	0	0	0	0
Total(c)	111,911	116,422	111,664	112,707	119,339	126,022	136,164

(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.

COMPARISON WITH DIRECT EXPENDITURE

The tax expenditure estimates for 2010-11 by functional category are presented alongside direct government expenditures in Table 1.5. The list of direct expenditures by function is reproduced from the *Final Budget Outcome 2010-11*.

Comparisons between tax expenditures and direct expenditures are informative in broad terms, but the costings are not 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, such as grants or Government program outlays, are usually taxable income in the hands of the recipient, 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, the government's direct expenditure on certain income support benefits, pensions or allowances includes the full cost of the program to government, but there is also an associated tax expenditure (A41) for the value of the income tax exemption of the benefits to the recipient.

Table 1.5: Aggregate tax expenditures and direct expenditures by function in 2010-11

	Tax expenditures (\$m)(a)	Direct expenditures (\$m)(b)
General public services		
A. Legislative and executive affairs	3	1,039
B. Financial and fiscal affairs	3,450	7,834
C. Foreign affairs and economic aid	544	5,564
D. General research	0	2,687
E. General services	142	1,208
F. Government superannuation benefits	0	4,150
Defence	867	20,408
Public order and safety	0	3,823
Education	2,818	32,106
Health	5,865	56,070
Social security and welfare	36,492	117,093
Housing and community amenities	37,847	5,543
Recreation and culture	202	3,252
Fuel and energy	1,660	5,914
Agriculture, forestry and fishing	175	2,546
Mining, manufacturing and construction	-1,753	1,456
Transport and communication	856	4,464
Other economic affairs		
A. Tourism and area promotion	0	158
B. Total labour and employment affairs	2,320	4,669
C. Immigration	0	2,206
D. Other economic affairs, nec(c)	19,390	2,013
Other purposes		
A. Public debt interest	0	9,273
B. Nominal superannuation interest	0	6,997
C. General purpose inter-governmental transactions	780	49,298
D. Natural disaster relief	6	6,129
E. Contingency reserve	0	0
Total(d)	111,664	355,900

(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 *Final Budget Outcome 2010-11*.

(c) 'nec' means not elsewhere classified.

(d) Totals may not sum due to rounding.

1.4 Period covered by these estimates

The 2011 Tax Expenditures Statement generally uses the publication of the *Mid-Year Economic and Fiscal Outlook 2011-12* as the cut off for policy and information relevant to the estimation of tax expenditures. It does not take account of any policy decisions made after that date.