

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 statement lists 337 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 2005-06 to 2012-13.

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 2009-10*.

This statement incorporates a number of changes to previous years. These include:

- a revised structure and layout of the report intended to aid use and understanding;
- *revenue gain* method estimates for several of the largest tax expenditures, in line with recommendations of the Australian National Audit Office (ANAO) 2007-08 audit of the TES;
- a change in reporting coverage to include quantified estimates for owner-occupied housing with the estimates for all other tax expenditures (in the 2008 TES these estimates were included in a separate Appendix); and
- estimates of tax expenditures relating to the Carbon Pollution Reduction Scheme (CPRS).

Under the new structure the remainder of this statement is divided into the following sections:

- Chapter 1 provides an overview of the Tax Expenditures Statement, trends and aggregates in the estimates and comparison with direct expenditures and an outline of major new or changed tax expenditures.
- Chapter 2 provides background on tax expenditures and the tax expenditure framework, including measuring tax expenditures, and the various approaches used to measure tax expenditures, including Treasury's approach.

Tax Expenditures Statement

- 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 for more recent tax expenditures, 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.
- Appendix B provides comprehensive information on the changes to the list of tax expenditures since the *2008 Tax Expenditures Statement* – new tax expenditures, modified tax expenditures and tax expenditures no longer reported.
- Appendix C provides a discussion and comparison of alternative approaches to quantifying the owner-occupied housing tax expenditures, including estimates of the differing approaches.
- Appendix D provides aggregated information on tax expenditures related to funded superannuation.

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;

- crude oil excise; and
- the Carbon Pollution Reduction Scheme.

Revenue from Australian emissions units issued under the CPRS is treated as taxation revenue in the Government Financial Statistics. Free permits provided by the Government are not included as they are reported on the expense side of the Budget.

Taxes excluded from this statement are:

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

1.3 Trends in tax expenditure estimates

The following tables provide summary and aggregate information on the tax expenditure estimates prepared for the 2009 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 years' 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 are projected to fall from 10.2 per cent in 2007-08 to 8.5 per cent in 2008-09 and 8.4 per cent in 2009-10, mainly as a result of the ongoing impact of the Global Financial Crisis on superannuation returns and Australia's housing market.

In dollar terms, total measured tax expenditures in 2008-09 are estimated at around \$102 billion. Housing tax expenditures comprise over one-third of total measured tax expenditures, followed by social security and welfare tax expenditures which comprise around a quarter of total measured tax expenditures, largely due to the superannuation tax expenditures and the income tax exemption of the Family Tax Benefit, Parts A and B (A44).

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 2.

Table 1.1: Total measured tax expenditures^(a)

Year	Housing \$m	Superannuation \$m	Other tax expenditures \$m	Total \$m	Tax expenditure as a proportion of GDP (%)
2005-06 (est)	39,500	23,305	36,424	99,229	10.3
2006-07 (est)	38,500	30,208	39,899	108,607	10.4
2007-08 (est)	40,000	30,650	44,489	115,139	10.2
2008-09 (est)	31,000	24,458	46,608	102,066	8.5
2009-10 (proj)	31,500	22,696	47,594	101,790	8.4
2010-11 (proj)	31,500	24,426	48,482	104,408	8.1
2011-12 (proj)	31,000	27,845	50,040	108,885	8.0
2012-13 (proj)	30,000	31,995	54,479	116,474	8.0

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

A change in reporting coverage makes comparison of the estimates in the 2009 TES with the estimates provided in previous editions difficult. The 2009 TES includes quantified estimates for owner-occupied housing with the estimates for all other tax expenditures. In the 2008 TES these estimates were included in a separate Appendix.

The inclusion of the quantified estimate for housing has significantly increased the magnitude of aggregate tax expenditures reported in the 2009 TES compared with earlier editions. However, this change in reporting does not represent any change in the level of concessionality (or otherwise) of the Australian tax system in this area.

Table 1.2 presents measured tax expenditures by the benchmark against which they are estimated for the period 2005-06 to 2012-13. The capital gains benchmark, containing the housing tax expenditures, 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 taxes benchmark give rise to a negative estimate, largely reflecting customs duty (F21) and the higher rate of excise levied on cigarettes (F7). The large reduction in the commodity taxes tax expenditure in 2009-10 and 2010-11 is due to a reduction in the customs duty tax expenditure.

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

Benchmark	2005-06 (est)	2006-07 (est)	2007-08 (est)	2008-09 (est)	2009-10 (proj)	2010-11 (proj)	2011-12 (proj)	2012-13 (proj)
Income Tax								
Personal income	10,298	10,389	10,757	11,106	13,522	11,304	10,724	10,780
Business income	5,520	6,818	6,201	6,493	8,299	8,963	7,863	7,403
Retirement savings	25,305	32,108	32,610	27,013	24,956	26,511	29,945	34,095
Fringe Benefits Tax	3,238	3,802	3,507	3,541	3,617	3,807	4,065	4,277
Capital Gains Tax	45,270	45,315	50,730	41,820	37,905	38,955	39,480	39,765
Consumption								
Commodity taxes	-3,630	-4,083	-4,368	-4,408	-3,741	-3,470	-4,075	-4,448
Natural resource taxes	770	790	980	580	490	480	480	480
Goods and Services Tax	12,458	13,468	14,722	15,921	16,742	17,858	18,883	20,152
Externalities								
Carbon Pollution Reduction Scheme	0	0	0	0	0	0	1,520	3,970

(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 provides a list of the largest measured tax expenditures for 2009-10. The largest measured tax expenditures are the concessional capital gains taxation of owner-occupied housing (E4 and E5) which is estimated to provide a benefit to taxpayers of around \$31.5 billion in 2009-10. 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 \$11.4 billion in 2009-10. This is followed by the concessional taxation of superannuation entity earnings (C6) and the GST-free status of food (H23). These tax expenditures are estimated to provide benefits to taxpayers in 2009-10 of around \$9.8 billion and \$5.6 billion respectively.

The largest negative tax expenditures in 2009-10 are customs duty (F21) and the higher rate of excise levied on cigarettes (F7). These tax expenditures are estimated to be around \$3 billion and \$1.4 billion respectively.

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 religious, scientific, charitable or public educational institutions (B23);
- income tax exemption for State and Territory bodies (B110); and
- quarantining of capital losses (E28).

At present, the CPRS is not included in the list of largest tax expenditures because it does not have any revenue forgone in 2009-10. In future, it is expected that the CPRS will enter the list of largest tax expenditures when the scheme comes into force.

Table 1.3: Large measured tax expenditures in 2009-10

Tax expenditure		Estimate \$m
Large positive tax expenditures		
E5	Capital gains tax main residence exemption — discount component	17,500
E4	Capital gains tax main residence exemption	14,000
C5	Superannuation — concessional taxation of employer contributions	11,400
C6	Superannuation — concessional taxation of superannuation entity earnings	9,800
H23	GST — Food — uncooked, not prepared, not for consumption on premises of sale and some beverages	5,600
E14	Capital gains tax discount for individuals and trusts	5,380
H14	GST — Health; medical and health services	2,700
H11	GST — Education	2,550
H2	GST — Financial Supplies; input taxed treatment	2,120
A56	Exemption of Tax Bonus for Working Australians	2,070
A44	Exemption of Family Tax Benefit, Parts A and B, including expense equivalent	2,010
B13	Exemption from interest withholding tax on certain securities	1,640
C3	Concessional taxation of non-superannuation termination benefits	1,500
B99	Small business and general business tax break	1,470
A23	Exemption of 30 per cent private health insurance refund, including expense equivalent	1,110
C8	Superannuation — deduction and concessional taxation of certain personal contributions	1,100
A22	Exemption from the Medicare levy for residents with a taxable income below a threshold	1,070
D26	Application of statutory formula to value car benefits	1,050
H10	GST — Imported services	1,050
A67	Deduction for gifts to approved donees	970
A32	Senior Australians' Tax Offset	950
H3	GST — Financial Supplies; reduced input tax credits	860
B109	Income tax exemption for public and municipal authorities and other local governing bodies	830
D6	Exemption for public and not-for-profit hospitals	830
B87	Statutory effective life caps	775
D11	Exemption for public benevolent institutions (excluding public and not-for-profit hospitals)	760
F6	Exemption from excise for 'alternative fuels'	750
E31	Small business capital gains tax 50 per cent reduction	740
F3	Concessional rate of excise levied on aviation gasoline and aviation turbine fuel	720
A48	Exemption of payments made under the First Home Owners Grant Scheme	690
B96	Research and development — research and development tax concession	640
Large negative tax expenditures		
F21	Customs duty	-2,950
F7	Higher rate of excise levied on cigarettes not exceeding 0.8 grams of tobacco	-1,395

TRENDS IN TAX EXPENDITURES BY FUNCTION

Total measured tax expenditures by functional category are reported in Table 1.4 for the period 2006-07 to 2012-13. Significant changes underlying movements in functional categories are listed below.

- The changes in the aggregate for housing and community amenities largely reflect the inclusion of estimates for owner-occupied housing (E4 and E5);
- The total for transport and communication is also estimated to increase over the reported period owing to the statutory effective life caps (B87) 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 (B109).
- 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 inclusion of the CPRS in the TES (see box) has significant impacts from 2011-12 on the following aggregates:
 - increases in the agriculture, fisheries and forestry and other economic affairs, nec, aggregates due to the exemption of agriculture and deforestation from the CPRS coverage; and
 - a decrease in the fuel and energy aggregate due to the general fuel tax reductions.
- The negative tax expenditure for mining, manufacturing and construction is mainly due to customs duty (F21) which is a negative tax expenditure in respect of imported goods.

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

	Estimates (\$m)				Projections (\$m)		
	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
General public services							
A. Legislative and executive affairs	2	2	2	2	2	2	2
B. Financial and fiscal affairs	2,490	2,660	2,870	2,980	3,140	3,280	3,430
C. Foreign affairs and economic aid	639	658	728	624	504	529	559
D. General research	0	0	0	0	0	0	0
E. General services	12	12	12	11	207	254	317
F. Government superannuation benefits	0	0	0	0	0	0	0
Defence	699	753	777	751	766	776	756
Public order and safety	0	0	0	0	0	0	0
Education	2,012	2,164	2,369	2,563	2,764	2,964	3,214
Health	4,601	4,850	5,180	5,630	6,015	6,215	6,790
Social security and welfare	38,806	39,107	33,729	31,562	32,718	36,135	40,220
Housing and community amenities	39,935	41,520	32,630	33,545	33,580	32,870	31,915
Recreation and culture	144	124	137	161	163	174	177
Fuel and energy	1,545	1,830	1,475	1,495	1,505	1,160	1,065
Agriculture, forestry and fishing	480	494	243	75	-24	877	2,366
Mining, manufacturing and construction	-3,164	-3,415	-3,375	-2,915	-2,618	-2,783	-2,943
Transport and communication	403	545	686	807	916	1,009	1,076
Other economic affairs							
A. Tourism and area promotion	7	1	6	6	6	6	7
B. Total labour and employment affairs	846	709	670	686	694	703	721
C. Other economic affairs, nec(b)	18,429	22,434	23,169	22,969	23,144	23,681	25,661
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	710	680	750	830	920	1,030	1,140
D. Natural disaster relief	11	11	8	8	6	3	1
E. Contingency reserve	0	0	0	0	0	0	0
Total(c)	108,607	115,139	102,066	101,790	104,408	108,885	116,459

(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 2008-09 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 2008-09*.

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, 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 (A40) 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 2008-09

	Tax expenditures (\$m)(a)	Direct expenditures (\$m)(b)
General public services		
A. Legislative and executive affairs	2	728
B. Financial and fiscal affairs	2,870	6,331
C. Foreign affairs and economic aid	728	4,763
D. General research	0	2,237
E. General services	12	995
F. Government superannuation benefits	0	2,142
Defence	777	19,190
Public order and safety	0	3,558
Education	2,369	22,601
Health	5,180	49,146
Social security and welfare	33,729	124,581
Housing and community amenities	32,630	5,080
Recreation and culture	137	3,107
Fuel and energy	1,475	5,806
Agriculture, forestry and fishing	243	2,723
Mining, manufacturing and construction	-3,375	1,911
Transport and communication	686	6,941
Other economic affairs		
A. Tourism and area promotion	6	192
B. Total labour and employment affairs	670	5,040
C. Other economic affairs, nec(c)	23,169	1,275
Other purposes		
A. Public debt interest	0	3,946
B. Nominal superannuation interest	0	6,715
C. General purpose inter-governmental transactions	750	45,248
D. Natural disaster relief	8	312
E. Contingency reserve	0	0
Total(d)	102,066	324,568

(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 2008-09*.

(c) 'nec' means not elsewhere classified.

(d) Totals may not sum due to rounding.

1.4 Period covered by these estimates

The *2009 Tax Expenditures Statement* uses the publication of the *Mid-Year Economic and Fiscal Outlook 2009-10* 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.

