

## 2.1 Introduction

Tax expenditure aggregates are reported and analysed in this chapter, with a breakdown of tax expenditures by both function and taxpayer affected. Care must be taken when interpreting these aggregates, particularly when making comparisons across time. There are several major considerations that need to be taken into account when analysing tax expenditure aggregates.

- First, some of the identified tax expenditures are not costed because of a lack of suitable data. Hence, tax expenditure aggregates will tend to underestimate the total benefit provided by tax expenditures.
- Second, the trend in aggregates over time reflects changes in the extent to which individual tax expenditures are accessed, changes to benchmark tax rates and changes in the coverage of tax expenditures being costed.
- Third, changes over time in methodology and data used to calculate the cost of tax expenditures can result in quite large revisions to the tax expenditure estimates. Therefore, estimates that were provided in previous editions of the TES may not be strictly comparable to figures in this publication.
- Finally, tax expenditure aggregates are *net* aggregates as they include the offsetting effects of negative tax expenditures.

## 2.2 Trends in tax expenditures

Total measured tax expenditures as a share of GDP are reported in Table 2.1.

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

Year	Superannuation \$m	Other tax expenditures \$m	Total \$m	Tax expenditures as a proportion of GDP (%)
1997-98 (est)	9 920	15 565	25 485	4.5
1998-99 (est)	9 510	16 243	25 753	4.4
1999-00 (est)	10 210	17 572	27 782	4.4
2000-01 (est)	9 065	20 520	29 585	4.4
2001-02 (proj)	9 485	19 787	29 272	4.2
2002-03 (proj)	10 305	19 500	29 805	4.0
2003-04 (proj)	11 225	19 537	30 762	3.9
2004-05 (proj)	11 875	20 260	32 135	3.9

(a) Total measured tax expenditures are derived by summing the individual tax expenditure estimates provided in Table 5.1, excluding items with estimates listed as being 'less than' (eg. <1, <5), rounded to zero (..) or na.

## Tax Expenditures Statement

Tax expenditures as a proportion of GDP are projected to fall from 4.5 per cent in 1997-98 to 3.9 per cent in 2004-05.

The decline in total measured tax expenditures as a share of GDP largely reflects the policy decision to remove accelerated depreciation for plant and equipment for businesses with an annual turnover of \$1 million or more (tax expenditure reference code D70).

- This item is estimated to decline from a large positive tax expenditure in 1997-98 to a large negative tax expenditure in 2004-05. It becomes a negative tax expenditure because accelerated depreciation merely brings forward tax deductions; hence deductions in coming years for investments made before accelerated depreciation was removed will be lower than they would have been under the benchmark.

## 2.3 Tax expenditures by function

Total measured tax expenditures by functional category are reported in Table 2.2 for the period 1998-99 to 2004-05. The inter-annual variations in functional aggregates are explained largely by policy decisions, particularly those related to *The New Tax System*. Significant inter-annual movements in functional categories are listed below. (Tax expenditure reference codes used in Chapter 5 and Appendix A are reported in parentheses.)

- The increase in total defence tax expenditures in 1999-2000, relative to 1998-99, reflects the tax exemption of pay and allowances for troops deployed in East Timor (A16).
- The increase in total health tax expenditures in 1999-2000 follows the introduction of the 30 per cent rebate for expenditure on private health insurance (A31).
  - There is a further significant increase in total health tax expenditures in 2000-01, reflecting the first full year impact of the private health insurance rebate for those claiming their entitlement as a rebate, and again in 2001-02, reflecting the impact of increased take-up of private health cover in 2000-01.
- The slight fall in total social security and welfare tax expenditures in 2000-01 reflects the effects of reduced personal income tax rates under *The New Tax System* on the value of the concessional treatment of superannuation (B1). The increase in total social security and welfare tax expenditures in 2001-02 reflects the first full year impact of the Family Tax Benefit for those claiming their entitlement as a rebate (A45), while the increases in 2002-03 and beyond largely reflect the growing value of superannuation assets and continued growth in superannuation contributions (B1), partly due to the Superannuation Guarantee schedule.
- The increase in total housing and community amenities tax expenditures in 2000-01 reflects the extension of an FBT exemption for remote area housing benefits to all employers (C16).

**Table 2.2: Aggregate tax expenditures by function<sup>(a)</sup>**

	Estimates (\$m)			Projections (\$m)			
	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
<b>General public services</b>							
A. Legislative and executive affairs	4	3	4	6	7	9	10
B. Financial and fiscal affairs	0	0	0	0	0	0	0
C. Foreign economic aid	250	275	295	295	315	340	370
D. General research	0	0	0	0	0	0	0
E. General services	5	8	7	7	7	8	8
F. Govt superannuation benefits	0	0	0	0	0	0	0
<b>Defence</b>	77	108	95	95	96	101	101
<b>Public order and safety</b>	0	0	0	0	0	0	0
<b>Education</b>	8	7	8	9	10	11	13
<b>Health</b>	600	1 050	1 420	1 675	1 720	1 815	1 915
<b>Social security and welfare</b>	16 852	17 740	17 731	18 236	19 395	20 619	21 640
<b>Housing and community amenities</b>	215	210	255	245	260	265	275
<b>Recreation and culture</b>	85	85	82	76	76	111	108
<b>Fuel and energy</b>	1 570	1 690	1 825	1 890	2 020	2 185	2 225
<b>Agriculture, fisheries and forestry</b>	206	219	213	214	245	256	282
<b>Mining and mineral resources (other than fuels), manufacturing and construction</b>	2 783	2 784	2 308	1 366	669	157	11
<b>Transport and communications</b>	54	58	60	75	75	76	76
<b>Other economic affairs</b>							
A. Tourism and area promotion	85	85	95	100	100	105	110
B. Labour and employment affairs	23	17	22	21	14	9	9
C. Other economic affairs, nec	1 419	1 543	3 270	3 196	3 015	2 892	3 199
<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-government transactions	0	0	0	0	0	0	0
D. Natural disaster relief	2	1	0	0	0	0	0
E. Contingency reserve	0	0	0	0	0	0	0
F. Asset sales	0	0	0	0	0	0	0
<b>Not allocated to function</b>	1 515	1 899	1 895	1 766	1 781	1 803	1 783
<b>Total(b)</b>	<b>25 753</b>	<b>27 782</b>	<b>29 585</b>	<b>29 272</b>	<b>29 805</b>	<b>30 762</b>	<b>32 135</b>

(a) Total tax expenditures by functional category are derived by summing the individual tax expenditure estimates provided in Table 5.1, excluding items with estimates listed as being less than X million dollars (eg. <1, <5), rounded to zero (..) or not available (na).

(b) Items may not sum due to rounding.

- The increase in total recreation and culture tax expenditures in 2003-04 reflects the introduction in 2001 of a tax offset for large scale film production (D51).
- The growth in total fuel and energy tax expenditures between 1998-99 and 2004-05 largely reflects rapid growth in the value of the excise exemption for alternative fuels (E3).
- The significant fall in the cost of mining, manufacturing and construction tax expenditures results from the removal of accelerated depreciation for businesses with an annual turnover of \$1 million or more on 21 September 1999 (D70).

## Tax Expenditures Statement

- The increase in total tax expenditures for other economic affairs in 2000-01 reflects:
  - the introduction of the capital gains tax (CGT) discount for individuals (D44); and
  - transitional arrangements for prepayments (D86), which is estimated to cost \$750 million in 2000-01 before becoming a negative tax expenditure from 2001-02.
- The higher estimates of total measured tax expenditures that are 'not allocated to function', in all years from 1999-2000 relative to 1998-99, is attributable to a number of factors:
  - in 1999-2000 and 2000-01, it largely reflects the impact of the savings rebate (B9), the immediate deductibility of Y2K related upgrades (D83) and the immediate deductibility of GST related plant and software (D84); and
  - from 2001-02, it largely reflects the introduction of the excise concession for draught beer (E9).

Significant changes in functional aggregates relative to the *2000 Tax Expenditures Statement* include a reclassification of the research and development tax concession (D79) from the mining, manufacturing and construction functional category to other economic affairs, not elsewhere classified.

## 2.4 Comparison with direct expenditure

The tax expenditure estimates for 2000-01 by functional category are presented alongside direct government expenditure in Table 2.3. The list of direct expenditures by function is reproduced from Table 3 of the *2000-01 Final Budget Outcome*.

Comparisons between tax expenditures and direct expenditures are informative in broad terms, although the costings are not strictly comparable for the following reasons:

- A tax expenditure tends to provide a higher benefit than a direct expenditure of the same magnitude. This is because direct expenditures are often taxable, whereas tax expenditures are not. Therefore, a direct expenditure will, in some circumstances, have a smaller net budgetary impact than a tax expenditure of equivalent nominal value.
- The removal of a tax expenditure or a direct expenditure of the same magnitude may have different effects on the underlying fiscal balance for reasons discussed in chapter 1.4.

**Table 2.3: Aggregate tax expenditures and direct expenditures by function in 2000-01**

	Tax expenditures(a) \$m	Direct expenditures \$m	Total \$m
<b>General public services</b>			
A. Legislative and executive affairs	4	691	695
B. Financial and fiscal affairs	0	3 980	3 980
C. Foreign economic aid	295	1 978	2 273
D. General research	0	1 523	1 523
E. General services	7	739	746
F. Govt superannuation benefits	0	1 453	1 453
<b>Defence</b>	95	11 360	11 455
<b>Public order and safety</b>	0	1 559	1 559
<b>Education</b>	8	10 966	10 974
<b>Health</b>	1 420	25 242	26 662
<b>Social security and welfare</b>	17 731	66 898	84 629
<b>Housing and community amenities</b>	255	1 763	2 018
<b>Recreation and culture</b>	82	2 043	2 125
<b>Fuel and energy</b>	1 825	2 614	4 439
<b>Agriculture, fisheries and forestry</b>	213	1 718	1 931
<b>Mining and mineral resources (other than fuels), manufacturing and construction</b>	2 308	821	3 129
<b>Transport and communications</b>	60	1 724	1 784
<b>Other economic affairs</b>			
A. Tourism and area promotion	95	125	220
B. Labour and employment affairs	22	2 527	2 549
C. Other economic affairs, nec	3 270	411	3 681
<b>Other purposes</b>			
A. Public debt interest	0	5 836	5 836
B. Nominal superannuation interest	0	4 878	4 878
C. General purpose inter-government transactions	0	5 809	5 809
D. Natural disaster relief	0	92	92
E. Contingency reserve	0	0	0
F. Asset sales	0	31	31
<b>Not allocated to function</b>	1 895	0	1 895
<b>Total(b)</b>	<b>29 585</b>	<b>156 783</b>	<b>186 368</b>

(a) Total tax expenditures by functional category are derived by summing the individual tax expenditure estimates provided in Table 5.1, excluding items with estimates listed as being less than X million dollars (eg. <1, <5), rounded to zero (..) or not available (na).

(b) Items may not sum due to rounding.

- For tax exempt and rebated personal cash transfers, the addition of tax expenditures and direct expenditures will tend to overstate the impact on the fiscal balance. For example, in the case of A40 (exemption of certain social security and repatriation payments), the direct expenditure column includes the full cost to government of the programme; however there is also an associated tax expenditure for the value of the income tax exemption to the recipient. Other examples include A31 and A41 to A48. (An equivalent point applies to the addition of refundable rebates and the value of the tax exemption in Table 2.2 for tax expenditures A31 and A45.)

## Tax Expenditures Statement

As reported in Table 2.3, total measured tax expenditures in 2000-01 are valued at \$29.6 billion. Social security and welfare tax expenditures comprise 60 per cent of total measured tax expenditures.

When compared to the sum of both total measured tax expenditures and total direct expenditure, 16 per cent of total government assistance is provided through tax expenditures.

The proportion of government assistance delivered through tax expenditures, however, varies greatly by functional category. In most cases, the assistance provided by direct expenditure significantly exceeds the benefit provided by tax expenditures. The exceptions are:

- mining, manufacturing and construction, although this category includes the accelerated depreciation tax expenditures which have been removed from 21 September 1999 for businesses with an annual turnover of \$1 million or more (D70-D71); and
- other economic affairs, due to a number of large tax expenditures in this category including the concessional rate of fringe benefits tax on motor vehicles (C32), the CGT discount for individuals (D44) and the transitional arrangements for prepayments (D86).

## **2.5 Tax expenditures by taxpayer affected**

While many tax expenditures may be accessed by more than one group of taxpayers, this section provides a broad indication of the main taxpayer group that benefit from each tax expenditure. The purpose of this analysis is to provide an overall picture of the direction of tax expenditures despite the difficulties in determining the final beneficiary of the assistance.

For the purpose of this analysis, the classification of 'taxpayer affected' is by the legal incidence of the tax. Legal incidence should not be confused with the economic incidence of a tax measure. Legal incidence refers to the taxpayer upon which the tax is levied. In contrast, the economic incidence of a tax relates to the taxpayer (or taxpayers) that bear the cost of a tax, or benefit from a tax expenditure. Economic incidence will differ from legal incidence if the group bearing the legal incidence is able to pass on some or all of the cost or benefit of the tax, and thus have it feed through into prices (including factor prices, such as wages and the return on capital).

- For instance, the legal incidence of a tax expenditure may be on the manufacturer of a product. However, the economic incidence may actually fall on consumers of the product via a change in price.

## Chapter 2: Overview of tax expenditure aggregates

Total measured tax expenditures by taxpayer affected are reported in Table 2.4, including deferral expenditures. Major influences behind changes in taxpayer-affected aggregates are generally the same as those listed in chapter 2.3. (For example, the increase in personal income tax expenditures in 2000-01 reflects the introduction of both the CGT discount for individuals (D44) and the Family Tax Benefit (A45).)

**Table 2.4: Aggregate tax expenditures by taxpayer affected<sup>(a)</sup>**

Taxpayer	Estimates (\$m)				Projections (\$m)			
	1997-98	1998-99	1999-00	2000-01	2001-02	2002-03	2003-04	2004-05
Businesses	4 636	4 667	5 071	6 081	4 605	3 766	3 121	3 211
Defence	382	407	438	465	425	446	461	481
Donors	210	230	250	300	300	320	350	370
Employees	1 840	1 870	1 940	1 860	1 930	2 020	2 110	2 210
Employers	1 057	1 098	1 133	1 138	1 172	1 206	1 226	1 256
Financial institutions	70	40	55	170	190	170	170	170
Government	95	95	90	95	95	85	90	95
Hospitals	130	145	155	115	120	125	125	130
Superannuation funds and beneficiaries	9 920	9 510	10 210	9 065	9 485	10 305	11 225	11 875
Non-profit organisations	495	545	580	590	575	579	609	619
Personal income taxpayers	2 229	2 786	3 301	5 644	6 732	6 984	7 302	7 529
Retirees/allowees	3 220	3 335	3 480	2 975	2 522	2 620	2 720	2 880
Property owners	0	0	0	0	0	0	0	0
Primary producers	235	206	219	213	214	245	256	282
Students	10	8	7	8	9	10	11	13
Non-residents	950	800	830	850	880	905	965	992
Miscellaneous(b)	6	11	23	16	18	19	21	22
<b>Total(c)</b>	<b>25 485</b>	<b>25 753</b>	<b>27 782</b>	<b>29 585</b>	<b>29 272</b>	<b>29 805</b>	<b>30 762</b>	<b>32 135</b>

- (a) Total tax expenditures by taxpayer affected are derived by summing the individual tax expenditure estimates provided in Table 5.1, excluding items with estimates listed as being less than X million dollars (eg. <1, <5), rounded to zero (..) or not available (na).
- (b) Expenditures included in the 'Miscellaneous' category are those for which the 'taxpayer affected' does not belong to any of the other identified categories.
- (c) Items may not sum due to rounding.

## Tax Expenditures Statement

The following provides, for measured tax expenditures, a list of tax expenditure reference codes that correspond to each category of taxpayer affected.

Businesses	B5, D18, D25, D41, D60, D62, D65, D70, D72-D80, D82-D84, D86, D100, D104, E1, E3-E5, E7-E9
Defence force personnel, including veterans and their families	A10, A11, A16, A19, A21, A48, C3
Donors to approved organisations	A63
Employees	B2-B4
Employers	C16, C20, C23, C32, C33, C42, D21
Financial institutions	D22, D26, D29, D105
Government	D31
Hospitals and State and Territory authorities	C8
Superannuation funds and beneficiaries, termination payment recipients	B1
Non-profit organisations	C13, C35, C37, D1, D6, D9, D20
Personal income taxpayers	A9, A27-A34, A36, A39, A41, A43-A46, A53, A67, A68, B9, D16, D37, D38, D44, D47, D49, D89, D91
Retirees and allowees	A35, A40, A42, A47, A52
Primary producers	D10, D13, D15, D52, D54, D56-D59, D93, D94, E6
Students	A23
Non-residents	A6, D51, D110
Miscellaneous	A2, A54, A65, C22, D27, D28