

CHAPTER 6: TAX EXPENDITURE AND CONCESSIONS STATEMENT

- ◆ Tax expenditures in 2003-04 are estimated at \$2,810 million (compared with \$2,800 million in 2002-03) and concessions at \$709 million (\$686 million in 2002-03).
- ◆ The full year effect on insurance duty tax expenditures of reducing the general insurance duty rate, from 10 percent to 5 percent, from 1 August 2002, is the main reason the increase in tax expenditures between 2002-03 and 2003-04 is so small.

6.1 INTRODUCTION

This chapter estimates revenue forgone from tax expenditures and concessions as well as discussing definition and measurement issues related to the estimates. Appendix B presents a comprehensive listing and, where possible, costing of each tax expenditure and concession reflecting all announced policies up to and including this Budget.

Tax concessions – termed *tax expenditures* as they have a similar policy and fiscal impact as expenditures – involve granting certain taxpayers, activities or assets more favourable tax treatment than that applicable to taxpayers generally. An easily recognisable example of a tax concession is transfer duty (formerly known as contracts and conveyances stamp duty) exemptions/reductions provided to first home buyers.

Concessional charges involve the government providing goods and services to certain classes of users at a lower charge/fee than available to the community generally. An easily recognisable example of a concession is lower public transport fares for pensioners and senior citizens.

Tax expenditures and concessional charges are designed to provide a benefit to a specified activity, class of taxpayer or class of consumer in accordance with government policy. These benefits, in most cases, could be provided equally by direct spending. In the examples above, first home buyer assistance could be provided by direct grants to first home buyers, and pensioners could receive payments to cover the cost of public transport.

Direct government spending is generally subject to annual scrutiny through the budget process, and the attention that process receives through Parliament. Tax expenditures and concessional charges have the same budgetary and welfare effects as direct outlays. However, they are less visible than direct outlays because their cost is in revenue forgone rather than dollars spent.

This chapter and Appendix B make transparent the nature and estimated cost of tax expenditures and concessions, to permit a more comprehensive assessment of New South Wales Government activity.

6.2 CONCEPTS AND METHODS

DEFINITIONS

Tax expenditures can take the form of:

- ◆ exempting certain taxpayers from a tax;
- ◆ applying a lower rate of tax, a rebate or deduction, to certain taxpayers; or
- ◆ deferring the time for payment by certain taxpayers of a tax liability.

Concessions on user charges and fees can take the form of:

- ◆ exempting certain users from a charge generally applied to the community for government goods and services or exempting certain sections from a fee generally applied to the community; or
- ◆ imposing on certain sections of the community a charge lower than that applied to the general community for government goods and services, or imposing fees lower than the general fee.

There is an element of judgement in deciding what constitutes a tax expenditure or concession and what constitutes a structural feature of the underlying taxation or service delivery system.

- ◆ For example, stamp duty on property transfers is charged at different marginal rates according to the value of the property involved. This could be construed as providing a concessional rate of taxation for lower valued properties. However, those lower marginal rates are not identified here as tax expenditures. Rather, the different rates are regarded as an integral design feature of the duty arrangements. In other words, they are regarded as part of the definition of the tax base rather than variations to the tax base.

- ◆ Similarly, providing a good or service at varying subsidised rates according to set eligibility criteria for clients could be construed as a concession to those charged lower rates. However, according to the definition used here, no concession is involved if the good or service is provided only to an eligible section of the community (even if at varying rates) and not to the general community at a general community rate. For instance, public housing is targeted assistance provided only to some members of the community, rather than a concession in relation to generally available services.

There is also judgement involved in deciding what concessions funded by explicit Budget payments are included in this chapter and in Appendix B.

- ◆ Concessions are included even where the reduction in agency revenue is compensated from the Consolidated Fund through Social Program Policy Payments (SPPPs). Such concessions are included to make the cost of the concession to the total public sector apparent, irrespective of whether intra-government transfers offset the cost of the concession for the agency concerned.
- ◆ Concessions are not included where subsidies are paid from the budget to the private sector for concessions provided by the private sector to certain purchasers of goods and services. An example is payments to private sector transport operators for providing free transport for eligible students to and from school. Subsidies provided to the private sector are direct outlays and do not represent revenue forgone.

METHODS

Both tax expenditures and concessions have been valued on the basis of public sector revenue forgone. A full discussion of alternative ways to measure tax expenditures and concessions is contained in the 1998-99 Budget Papers.

The revenue forgone approach involves applying the general, non-discriminatory rate of tax or charge for the class of activity or asset concerned to the current volume of exempt or lower taxed or charged activities or assets. The first step is to identify the taxation/charging arrangement that would normally apply, called the benchmark. As noted above, there is often some judgement involved in establishing the benchmark. In the second step, deviations from the benchmark are identified as tax expenditures or concessions. Information on usage of the tax expenditure or concession then is used to estimate revenue forgone. Estimates for the Budget year are based on estimates of future usage.

Measurement of revenue forgone in tax expenditures and concessions in many cases is impossible or highly approximate. In some cases, information is simply not available on current usage of a tax expenditure or concession. Even where information on usage is available, measurement of revenue forgone will not take into account possible behavioural changes induced by the existence of the tax expenditure or concession. Moreover, since some tax expenditures and concessions may be complementary or substitutable, the existence of one may affect usage of another.

Therefore, some caution should be exercised when using estimates of revenue forgone.

- ◆ It may not necessarily follow that abolition of a tax expenditure or concession would produce a commensurate increase in the State's revenue. Activity making use of the tax expenditure or concession may contract if the tax expenditure or concession was abolished; or there may be increased use of other concessionally-taxed or charged activities, which would reduce revenue elsewhere.
- ◆ Since some tax expenditures and concessions overlap, the elimination of one exemption may not increase a taxpayer's liability to pay tax or a client's liability to pay charges or fees. As a result, the revenue forgone under a number of tax expenditures and concessions may be considerably less than the total obtained by adding each individual item.
- ◆ Inter-jurisdictional comparisons of tax expenditures and concessions can be rendered difficult by different judgements made in defining which elements of the tax and charging system constitute tax expenditures and concessions, and which elements represent structural features.

6.3 TAX EXPENDITURES

The estimates of tax expenditures in this statement are for the years 2001-02, 2002-03 and 2003-04 except for the estimates for land tax, which are for the 2002, 2003 and 2004 land tax years.

Table 6.1 provides a summary of major (i.e. \$1 million or greater) tax expenditures for each type of tax.

Table 6.1: Major Tax Expenditures by Type of Tax

Tax	2001-02		2002-03		2003-04	
	\$m	% of tax revenue	\$m	% of tax revenue	\$m	% of tax revenue
Transfer Duty	806	25.8	744	21.0	719	21.3
General and Life Insurance Duty	583	119.8	330	74.2	280	64.4
Mortgage Duty	66	22.4	81	22.5	99	26.6
Marketable Securities Duty ^(a)	8	16.1	...	...	...	...
Financial Institutions Duty ^(b)	3	4.5	...	...	...	...
Payroll Tax	659	16.4	581	14.1	594	13.5
Land Tax	364	36.3	387	34.1	408	32.6
Debits Tax ^(c)	11	5.6	...	...	...	...
Taxes on Motor Vehicles	210	13.6	226	13.7	243	14.2
Parking Space Levy	7	17.0	8	16.7	9	19.6
Gambling and Betting Taxes	431	35.6	444	35.2	458	35.0
Total	3,147	23.8	2,800	20.1	2,810	19.8

(a) Stamp duty on the transfer of listed marketable securities was abolished from 1 July 2001.

(b) Financial institutions duty was abolished from 1 July 2001.

(c) Debits tax was abolished from 1 January 2002.

Quantifiable tax expenditures (valued at more than \$1 million) are estimated at \$2,800 million in 2002-03, representing 20.1 percent of total tax revenue. Tax expenditures should increase to \$2,810 million, or 19.8 percent of tax revenue, in 2003-04. The modest increase chiefly reflects:

- ◆ tax expenditures associated with insurance stamp duty declining by \$50 million in 2003-04, chiefly due to the full year effect of the reduction in the general insurance duty rate to 5 percent from 1 August 2002; and
- ◆ the anticipated decline in transfer duty revenue in 2003-04 reducing tax expenditures associated with transfer duty.

Tax expenditures are spread across all major tax bases. By value, tax expenditures in 2003-04 are highest in transfer duty, payroll tax, gambling and betting taxes and land tax, which account for around three quarters of total measurable expenditures. Reduction of the benchmark rate of general insurance duty from 1 August 2002 reduces the relative importance of tax expenditures for insurance stamp duty. The gambling and betting tax expenditure relates to the lower taxation of gaming machines in registered clubs compared to those in hotels.

Tax expenditures for transfer duty vary markedly from year to year mainly due to large and irregular tax expenditures associated with corporate reconstructions. The decline in 2002-03 and 2003-04 also reflects the reduction in forgone revenue under the First Home Plus scheme with the decline in the first home buyer market following the cessation of the Commonwealth's extra First Home Owners Scheme grants for new houses from 1 July 2002.

As a percentage of tax revenue by type of tax, tax expenditures in 2003-04 are largest for insurance duty (despite reductions in the tax rate), gambling and betting taxes and land tax.

Table 6.2: Tax Expenditures by Function ^(a)

<i>Function</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>
	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>
Public Order and Safety	2	2	2
Education	68	73	78
Health	320	333	351
Social Security and Welfare	235	251	274
Housing and Associated Amenities	205	139	138
Environmental Protection	...	...	...
Recreation and Culture	436	449	463
Agriculture, Forestry, Fishing and Hunting	273	290	308
Transport	11	7	6
Other Economic Activities	1,421	1,085	1,009
Other Purposes	176	172	181
Total	3,147	2,800	2,810
<i>Percent of Expenses</i>	9.8	8.3	8.0

(a) In past budgets, this table compared the functional classification of tax expenditures with that of direct expenses. However, with administrative arrangements in some restructured government departments not fully in place, detailed program statements and a functional classification of expenses are not available. Therefore, calculation of tax expenditures by function as a percentage of expenses by function is not possible in this Budget.

Table 6.2 provides a functional classification of tax expenditures. The largest categories of tax expenditures are Other Economic Activities (which constitutes assistance to industry generally rather than to a particular type of economic activity), Recreation and Culture (reflecting the gambling and betting tax expenditure) and Health (mainly reflecting payroll tax exemptions for hospitals and nursing homes).

The distribution of tax expenditures by function is broadly similar over the three years covered by this statement, with the exception of a decline in Other Economic Activities. That decline reflects reduced tax expenditures related to general insurance and payroll tax due to lower tax rates, as well as the abolition of stamp duty on the transfer of listed marketable securities.

6.4 CONCESSIONS

Table 6.3 classifies the major concessions provided by the NSW Government by function. The estimated total value of major concessions in 2002-03 is \$686 million, representing 2 percent of expenses. Concessions are anticipated to amount to around the same proportion of expenses in 2003-04.

Table 6.3: Concessions by Function ^(a)

<i>Function</i>	<i>2001-02</i>	<i>2002-03</i>	<i>2003-04</i>
	<i>\$m</i>	<i>\$m</i>	<i>\$m</i>
Public Order and Safety	...	...	...
Education	98	100	105
Health	80	84	85
Social Security and Welfare	251	256	262
Housing and Associated Amenities	256	242	253
Environmental Protection	...	...	...
Recreation and Culture	...	...	...
Agriculture, Forestry, Fishing and Hunting	4	4	4
Transport	...	...	...
Other Economic Activities	...	...	...
Other Purposes	...	...	...
Total	689	686	709
<i>Percent of Expenses</i>	2.1	2.0	2.0

(a) In past budgets, this table compared the functional classification of concessions with that of direct expenses. However, with administrative arrangements in some restructured government departments not fully in place, detailed program statements and a functional classification of expenses are not available. Therefore, calculation of concessions by function as a percentage of expenses by function is not possible in this Budget.

The vast majority of concessions are concentrated in the social security and welfare, and housing and associated amenities functions, mainly comprising concessional charges to pensioner concession card holders for transport, water and energy.