

## Definition

### Definition of "Tax Expenditures"

[Stanley Surrey](#) introduced the concept of tax expenditures on the basis that many provisions in tax laws had (and were intended to have) similar effects to normal budgetary expenditures. Given this similarity, he argued, that these provisions should be subject to the same budgetary analysis using budgetary (not tax policy) criteria. Since the introduction of the concept, there has been a great deal of commentary advocating, criticizing, and/or modifying tax expenditure concepts and analysis.

The [Organization for Economic Co-operation and Development \(OECD\)](#) defined "tax expenditures" as reductions in tax liabilities in comparison with a benchmark tax system that can take a number of forms.

Tax expenditures can take the form of:

- Exemption - exclusions from the tax base
- Allowances - deductions from the tax base before application of the tax rates(s)
- Credits - deductions from tax liability
- Rate relief - reductions in tax rates
- Tax deferral - delays in paying taxes (equivalent to interest free loan from government)

Tax expenditures are provisions that don't have anything to do with defining the basic elements of the tax system. Technical tax provisions, in comparison, are those provisions that establish the basic structural elements of a country's tax system. A tax system has six vital components:

- A definition of the "tax base"
- Establishment of "tax rates" and "tax brackets"
- Definition of the "taxable unit"
- Determination of the accounting rules applicable
- Establishment of an international tax system
- Adoption of administrative procedures

Tax expenditure analysis itself has little contribute when looking at the choices between alternatives when setting up the structure of a tax system. After a country has developed a benchmark, tax expenditures are those provisions of the tax laws that deviate from this chosen benchmark. Another method of identifying tax expenditures is by labelling those provisions that are justified by reference to government spending programs, but used as an alternative to them, as tax expenditures. Both methods rely on assumptions.

The idea of tax expenditures appears to be simple and straight forward - look to what is equivalent to a spending program found within the tax laws OR what is a deviation from the benchmark - however, there are several sources of difficulty. One problem comes from the difficulty in defining the benchmark against which comparisons are made. The difficulty in

choosing a benchmark has led some critics to argue that the selection of the benchmark is arbitrary, and therefore that the concept of tax expenditures is not valid.

Stanley Surrey himself argued that the benchmark ought to be the [Haig-Simmons definition of comprehensive income](#):

"the algebraic sum of (1) the market value of rights exercised in consumption and (2) the change in the value of the store of property rights between the beginning and the end of the period in question"

Thus, inclusion of all accretions to net wealth plus consumption within a period of time.

No country, however, uses the Haig-Simmons comprehensive income as the benchmark, and most use a standard that closely resembles that country's tax system. There are other possible benchmarks, including an expenditure benchmark, but they are not considered here.

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