SWEDISH NATIONAL AUDIT OFFICE

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The Government's accounting for tax expenditures – as the Riksdag wants it?

Summary and recommendations

Background

Tax expenditures mainly consist of subsidies arising from special regulations in tax legislation. To determine the existence of a tax expenditure and the amount, there must be a benchmark for the tax system. The tax expenditure arises in the deviation between the benchmark and tax rules. For example, the benchmark for value added tax is that all commercial supply of goods and services must be taxed at a rate of 25 per cent. If the VAT rate on some goods or services is lower than the general tax rate, a tax expenditure exists, since the tax rate deviates from the benchmark. This tax expenditure provides tax relief that benefits households and companies. A fundamental idea in tax expenditure accounting is that tax expenditures are subsidies through tax relief, that these subsidies can be compared with expenditure reported on the expenditure side of the national budget and that tax expenditures should therefore be made visible through being accounted for.

Accounting for tax expenditures was started when a new budget process was introduced in the mid-1990s. In order to make subsidies to households and companies that take the form of tax expenditures visible, the Government has published separate accounts for them since 1996. To start with, the Government published these accounts in an appendix to the Spring Fiscal Policy Bill, but since 2008 tax expenditures are reported in a Communication that is submitted to the Riksdag at the same time as the Spring Fiscal Policy Bill. A formal provision was introduced in 2011 after the Riksdag decided that the Budget Act must stipulate that the Government is obliged to report tax expenditures annually to the Riksdag.

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Reason and purpose of the audit

The reason for the audit is that tax expenditures constitute large amounts and the Riksdag has stated that accounting for tax expenditures must be directed towards enabling review in the same way as expenditures via appropriations. The purpose of the audit is therefore to assess whether the Government's reporting of tax expenditures is in line with the statements made by the Riksdag to the effect that tax expenditures should be possible to review in the same way as expenditures via appropriations. The audit is based on two audit questions.

- Is reporting of tax expenditures based on a clear benchmark?
- Are tax expenditures accounted for so that they can be reviewed in the budget process in the same way as subsidies on the expenditure side of the budget?

Grounds for assessment

The Budget Act stipulates that the Government must report tax expenditures annually to the Riksdag without specifying how the reporting should be formulated. The grounds for assessment in the audit have therefore been drawn up using statements by the Government and the Riksdag in connection with the 2011 reform of the Budget Act and the guidelines for tax policy adopted by the Riksdag. The three main grounds for assessment are as follows.

- The benchmark is based on the principle of uniform taxation.
- Similar requirements can be made of preparation and accounting for tax expenditures and expenditures via appropriations.
- Special accounting requirements can be made when introducing new tax expenditures.

Implementation

The audit investigated the Government's accounting for new and existing tax expenditures in the period 2006–2016. The examination of tax expenditures was limited to a sample consisting of the 15 tax expenditures that constituted the highest amounts in 2015. All in all these accounted for 70 per cent of the amount for all quantified tax expenditures in the same year.

The investigations focus on how the Government has described the benchmark, reported tax expenditure forecasts, reported new tax expenditures and reported tax expenditures by expenditure area. The main method used was studying documents. The sources mainly consist of the Government's communications, expenditure area annexes to the Budget Bill and bills in which the Government has proposed new tax expenditures. Document studies were supplemented by interviews with officials at the Ministry of Finance in autumn 2016.

The Swedish National Audit Office's conclusions

The Swedish NAO draws three overall conclusions from the audit. The first is that accounting for new tax expenditures is mainly in line with the grounds for assessment of the audit. The second is that there is scope for clarifying the benchmark. In addition, the Swedish NAO draws the conclusion that accounting for tax expenditures does not live up to the statements made by the Riksdag and the Government that tax expenditure should be possible to review in the same way as expenditures via appropriations.

The benchmark

In the tax expenditure accounting, the Government describes the benchmark on which the reporting is based. The Swedish NAO's examination of how the benchmark is described in the Government's tax expenditure accounting shows that the benchmark is based on the principle of uniform taxation. The examination also shows that the description of the benchmark has been changed without it being clearly stated whether the amended text is to express a change in the benchmark, and in that case what a change implies for tax expenditure accounting. Moreover, it can be noted that the benchmark could be clearer if the Government reported its interpretation of the benchmark in relation to amended tax rules that are not recognised as tax expenditures.

Forecasts

Furthermore, the audit found that the Government's forecasts for individual tax expenditures have changed between Communications without this being reported and explained in a similar way as for expenditures via appropriations. The audit shows that the Government has revised the tax expenditure forecasts both for individual years and for the trend in the forecast period. Some changes have meant that the forecast tax expenditures were revised upwards by relatively large amounts in relation to earlier forecasts. Moreover, the audit shows that a third of the tax expenditures were not quantified at all.

If the revisions mentioned above had referred to expenditures via appropriations, they would have been reported and explained by the Government in accordance with the Budget Act. In this way, amended expenditure forecasts for expenditure via appropriations are subject to the Riksdag's attention and treatment in a way that is not the case for revised forecasts for tax expenditures.

Reporting by expenditure area

The tax expenditure forecasts in the Government Communication are reported in the tax expenditure accounting presented in the expenditure area annexes to the Budget Bill. Accounting for tax expenditures by expenditure area is warranted because tax expenditures, like expenditures via appropriations, may have been introduced as a measure within a specific expenditure area and because they affect the budget balance.

The reporting in the expenditure area annexes differentiates, however, between tax expenditures and expenditures via appropriations. The audit found that all but one of the tax expenditures examined were accounted for in the expenditure area they had been referred to in the Government Communication. For the tax expenditures reported by expenditure area, however, the corresponding information on expenditure growth is not shown as it is for expenditure via appropriations. With the exception of the tax expenditure due to subsidies to new start jobs the tax expenditures are not included in performance reporting, and with the exception of the tax expenditure due to a reduced value added tax rate on food, no reasons are given for placing a tax expenditure in a specific expenditure area.

The Swedish NAO's conclusion is therefore that accounting for tax expenditures by expenditure area is done without the tax expenditures being clearly linked to the objectives for the expenditure area. The fact that the tax expenditures are not included in the performance reporting means that it is not possible to determine how tax expenditures contribute to the objectives for the expenditure area set by the Riksdag in the same way as for expenditures via appropriations.

New tax expenditures

The audit of how the Government has handled new tax expenditures shows that as stipulated in the Riksdag Act, it has specified reasons for the measures that entailed new tax expenditures. Moreover, the examination shows that the budget effects of the measures have been calculated and that they are presented in "reform tables". In that sense new tax expenditures are reported in the same way as expenditures via appropriations.

On the other hand, the reporting of new tax expenditures does not meet the special accounting requirement set up by the Swedish NAO, taking into account the guidelines adopted by the Riksdag for tax policy. The requirement is that the

Government gives reasons for the introduction of a measure that entails tax expenditures. Consequently, it is not shown why the Government deviates from the principle of general tax rules that is expressed in the guidelines for tax policy.

Recommendations

Taking into account the findings of the audit, the Swedish NAO makes the following recommendations to the Government.

- Reporting of existing tax expenditures should present and explain material changes in tax expenditure forecasts in relation to previous forecasts
- Reporting of tax expenditures by expenditure area should be developed so that tax expenditures are included in the presentation of how the activity has developed in relation to the objectives set up by the Riksdag
- Bills that entail tax expenditures should give reasons for the choice of tax expenditures instead of subsidies on the expenditure side of the budget.