Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Budget Estimates

1 June – 3 June 2010

Question: BET 129

Topic: Gross Operating Surplus

Hansard Page: E113-114 (03/06/2010)

Senator JOYCE asked:

Senator JOYCE—Is there any appreciable difference between the ABS projections of Australia's population and those produced in the *Intergenerational report* either in results or methodology?

Mr Farrell—The *Intergenerational report* was prepared some time after the projections done by the ABS. The assumptions were taken independently. There are some differences—they are not substantial—around the three main series. They fall somewhere between the middle assumption and the higher assumption that the ABS uses as the three main series that we produce.

Senator JOYCE—I want to go to some questions about the Treasury paper that was released last Monday entitled *Disparities in average rates of company tax across industries*. On page 5 of the Treasury paper, it says about gross operating surplus—GOS:

GOS is a measure of the surplus from the production of goods and services available for distribution to those that hold a claim to corporations (ABS 2000). However, GOS is not the most appropriate measure of a corporate income tax base as it excludes income unrelated to production — such as property income, land and natural resource rents, net interest receipts, and capital gains or losses — which rightly forms part of company income and profits.

Emphasis added. But when I go to the *Australian National Accounts: Concepts, Sources and Methods*, paragraph 11.48, the ABS defines the gross operating surplus as follows:

Both gross operating surplus (GOS) and gross mixed income (GMI) measure the surplus accruing from processes of production before deducting any explicit or implicit interest charges, land rent or other property incomes payable on the financial assets, land or other tangible non-produced assets required to carry on the production.

So the Treasury seems to be saying that the gross operating surplus includes things like interest rates and land rents whereas your definition seems to suggest it does not. Can you clear up the definition of gross operating surplus for me? Please do not say, 'Repeat the question.' But I can if you need me to.

Mr Pink—I am looking at the definition of gross operating surplus as we include it in the quarterly national accounts. There it says that we are calculating gross operating surplus before deduction of consumption of fixed capital dividends, interest, royalties and land rent and direct taxes payable but after deducting the inventory valuation adjustments; so gross operating surplus does include most of those elements.

Senator JOYCE—So you are saying that the two definitions are the same?

Mr Pink—Well, I believe I am, if I understood as you were going through reading out the Treasury one.

Senator JOYCE—I will read out the Treasury one. On page 5 of the Treasury paper, it says:

GOS is a measure of the surplus from the production of goods and services available for distribution to those that hold a claim to corporations (ABS 2000). However, GOS is not the most appropriate measure of a corporate income tax base as it excludes income unrelated to production — such as property income, land and natural resource rents, net interest receipts, and capital gains or losses — which rightly forms part of company income and profits.

Treasury are saying they exclude those amounts. You are including them.

Mr Pink—Yes. We are.

Senator JOYCE—You are. So there is a difference?

Mr Pink—We will take that on notice and come back because I do not know what is in the Treasury document, but we will certainly reference it and clarify it for you.

Answer:

All accounting systems include a concept of the surplus generated by subtracting costs of production from income. These are loosely called "profits".

In the System of National Accounts (SNA), the nearest concept to profits is that of operating surplus.

To understand operating surplus, it is necessary to describe the intermediate step of the derivation of value added.

Value added in the Australian National Accounts is derived from income that is earned from production activities within the Australian economic territory minus expenses incurred in production. Value added is used to pay:

- compensation of employees which is the return to labour
- taxes on production which is the return to government
- operating surplus which is the return to capital.

Gross Operating Surplus is adjusted for inventory valuation changes, which can be quite high when the prices for output move by large amounts, as in the case of mining in recent periods.

Gross Operating Surplus is operating surplus prior to the deduction of consumption of fixed capital (cf. depreciation). Net Operating Surplus is operating surplus after the deduction of consumption of fixed capital.

Operating surplus is one source of income for a company. It is added to other sources of income (such as interest and dividends received) to form the total income of the company. The total income is used for a variety of purposes, one of which is the payment of taxes on income.

Table 1 below illustrates a hypothetical company and the contribution it would make to GOS.

Table 1.
SOURCES OF GOS

	SNA Gross Operating Surplus Derivation
Income from Production	1,000,000
less Production Expenses (including inventory changes and taxes on production)	200,000
less Inventory Valuation Adjustment	5,000
less Compensation of Employees (including wages and superannuation)	300,000
Equals Gross Operating Surplus	495,000

Table 2 shows the use of income from all sources, including GOS.

Table 2.
SOURCES AND USES OF INCOME

SOURCES OF INCOME	
Gross Operating Surplus	495,000
Interest received	100,000
Dividends received	40,000
Land and Resource Rents received	20,000
Miscellaneous other income	40,000
TOTAL INCOME	695,000
USES OF INCOME	
Consumption of fixed Capital (Depreciation)	-70,000
Interest paid	-60,000
Dividends paid	-20,000
Income Taxes	-200,000
Land and Resource rents paid	-50,000
Miscellaneous other uses	-5,000
SAVING (Balance)	290,000

Both the statement from the Treasury paper *Disparities in average rates of company tax across industries* and the ABS definition in *Australian National Accounts: Concepts, Sources and Methods (ABS Cat. No. 5216.0)* are correct. As the above example shows, a business can also earn income from sources (such as dividends on investments) that are not related to its production. The income tax paid by a company is levied on all its income, not just that earned from production. This was expressed by Treasury in the observation “Gross Operating Surplus is not the appropriate measure of a corporate income tax base as it excludes income unrelated to production.”

The ABS definition lists outlays which are not included in the expenses which are deducted from income to calculate GOS. These outlays are met from all sources of income, of which GOS is one component as illustrated in Table 2.