PROMOTING BUDGET TRANSPARENCY THROUGH TAX EXPENDITURE MANAGEMENT

A Report on Country Experience for Civil Society Advocates

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Contents

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Executive Summary

The primary function of tax laws is to raise revenue for government spending. Government spending is usually authorized by a decision of the executive or legislature to appropriate funds for a purpose that is administered by a government department or agency. However, government spending may also take place through targeted concessions or subsidies in the tax law.

Tax expenditures are rules and practices which reduce the amount of tax revenue collected, compared with a benchmark tax system. Tax expenditures usually provide tax concessions to deliver a government subsidy to a class of taxpayer or activity. Tax expenditures are widespread in country tax systems and can cost significant government revenue. However, the concept of tax expenditures is not widely understood, even among concerned citizens and commentators who take an interest in budget transparency. In particular, tax expenditure analysis is not well known in many developing countries.

This report aims to provide an accessible source of information about tax expenditure reporting, including definitions, explanations of different approaches to measurement and calculation, and examples and analysis of country experiences. Politicians, journalists, think tanks and researchers, government department officers and Treasury and Finance officials may find the information and experiences in this report helpful in analyzing their own country government's decisions about taxing and spending.

Tax expenditures include tax exemptions; special tax deductions; tax offsets (or credits); concessional tax rates; or timing rules, which enable a taxpayer to defer their tax liability. Typically, tax expenditures undergo less scrutiny than direct spending. This is because, once they have been passed into law, typically tax expenditures are classified as revenue rules and so pass into a government's annual budget with less scrutiny than applies to spending rules. For example, unlike many spending programs, tax expenditures are not usually subject to a vote in the legislature every year.

For budget transparency, governments should report key tax expenditures so that the legislature and civil society groups are aware of them and can ensure accountability of the government for all aspects of its budget.

It is important to identify and report on tax expenditures because:

- like direct expenditures, they have an impact on the budget;
- tax expenditures frequently are significant compared to total tax revenues collected and to total government expenditure; and
- tax expenditures can alter the distribution of a nation's tax burden, often to the advantage of those with high income or substantial wealth.

This report discusses tax expenditure management, with reference to current practices in a range of developing and developed countries. The report provides information, with many country examples, about the definition of a tax expenditure, why tax expenditure reporting is important, what are country practices and how tax expenditure reporting can improve budget transparency. This report has value for both civil society groups and governments, as tax expenditure management can improve government management of its own functions and budget goals.

Tax expenditure management must be tailored to each country's own needs and circumstances. A significant number of countries report some information about tax expenditures in their annual budgets, or another form of regular report. However, a large number of countries do not report any information on tax expenditures. Those countries that do report tax expenditures demonstrate a wide range of approaches, from a very basic conceptual report to detailed estimated revenue foregone over a period of years. There may be many challenges in establishing a detailed tax expenditure report, however even a basic report that highlights key tax expenditures and provides rough estimates of revenue cost will be very useful in enhancing budget transparency.

As well as giving a large number of specific country examples, this report focuses on case studies of tax expenditure reporting in four countries:

(1) India
(2) South Africa
(3) Chile
(4) Brazil.

This report seeks to strike a balance between global norms or goals of tax expenditure reporting and the particular context of each country. This report identifies some 'best practices' as a guide to establishing good tax expenditure management in the particular context of each country.

All countries face challenges in implementing a fair, efficient and transparent tax system as part of the country's budget process. Tax expenditure reporting and management is one way in which countries can seek to improve their budget process and tax system, so as to ensure that they can raise adequate revenues for public spending on infrastructure, education, health and other needs, for economic development and for distributional goals.

Chapter 1 What is Tax Expenditure Reporting?

SUMMARY

In this chapter we define a tax expenditure and explain what we mean by tax expenditure reporting. We also explain why a tax expenditure report is valuable for civil society groups and others who scrutinize the budget, and for governments seeking to improve budget practices.

Tax expenditures often cost significant government revenue. Close attention to tax expenditures is desirable if government is to be open, transparent and accountable.

To enable public scrutiny, a government ought to publish a tax expenditure report as part of its budget cycle. We list key requirements for a tax expenditure report.

1.1 What is a tax expenditure?

A tax expenditure is usually defined as the estimated revenue loss to a government that results from a tax concession or tax preference allowed to a particular class of taxpayer or activity.

The existence of a tax expenditure is established by comparing the actual tax system of a country with a benchmark tax law (which identifies what tax structure should normally apply to taxpayers). Often, tax expenditures are concessions in the tax law that the government applies instead of direct spending to deliver a government subsidy to a particular person or activity. The amount of a tax expenditure is estimated as the revenue that would have been collected if the tax concession did not exist in the tax system.

Ideally, governments would define their benchmark tax system, so that it can be debated. However, even if the benchmark is not specifically defined by a government, major tax expenditures can be listed and described. More detail about the definition and measurement of tax expenditures, and some country examples, are in Chapter 2.

1.2 The main principle: A consistent approach to direct spending and tax expenditures

The concept of a tax expenditure is based upon a simple proposition – there is no difference between a government providing a direct subsidy to an entity, and the government deciding not to collect tax from that entity when it otherwise would have collected that tax.

A government's budget sets out how a government will deploy the resources available to it to pursue the government's policy goals. One resource available to government is its capacity to generate taxation revenue. A government can raise revenue to fund direct expenditures. Alternatively, a government can choose not to raise revenue, with the object of achieving a particular policy objective by enacting a tax concession or preference (a tax expenditure). In this situation, the government can be said to have revenue foregone because of the specific tax concession it enacted.

This point is illustrated by considering two scenarios:

- A government collects $100 in tax from a taxpayer and then pays a direct subsidy of $100 to that taxpayer (a direct government expenditure); or

- A government decides not to tax the same taxpayer to the extent of $100 in circumstances where the government otherwise would collect that tax (a tax expenditure).

In both scenarios, the economic effect on the taxpayer is the same.

If the similarity between a direct subsidy and a tax expenditure is accepted, it follows that the consideration of each form of government spending ought receive comparable critical examination as part of the budgetary process.

One basis of a government's legitimacy and authority to govern is the rationality with which it makes laws. In the budget context, this requires that the government take a rational and consistent approach to all budget items. The application of the consistency principle in the budget context is important for two reasons.

1. A consistent budget approach demands that both policy tools (taxing and spending) ought to be subject to the same level of scrutiny to ensure that openness, transparency and accountability are achieved for all budget measures. Taxing and spending are dealt with separately in most national budgets, and this contributes to the different levels of scrutiny they may undergo. Usually, a direct government expenditure will be exposed to greater political scrutiny than a tax expenditure, even though both produce the same outcome for the taxpayer.

   Achieving consistent scrutiny of both direct spending and tax expenditures is promoted by governments providing comprehensive reporting of tax expenditures. This can help the legislature and observers to be aware of tax expenditures and their respective impacts upon public policy. With this information, the legislature and civil society groups can advocate so as to hold government accountable for all aspects of its budget.

2. Consistency also demands that a government's various programs operate consistently. For example, government programs should treat a person uniformly across both direct spending and tax expenditure programs. If there is no tax expenditure reporting or inadequate tax expenditure reporting and analysis, it is possible for a government to favour a particular group of taxpayers

with a tax expenditure, but to take a contradictory approach in a direct spending program.

1.3 Examples of tax expenditures

Tax expenditures take many forms, including tax exemptions; tax deductions; tax offsets (or credits); concessional tax rates; or special timing rules, which enable a taxpayer to defer their tax liability.

A tax expenditure can arise with respect to any type of tax law. A personal income tax, company income tax, commodity tax (such as tariffs and excise), sales tax (or Value Added Tax), property tax, wealth tax or inheritance tax may all contain tax expenditures. A tax expenditure can also arise with respect to any of the fundamental elements of a tax. To illustrate the variety of tax expenditures, in the following paragraphs some examples of different types of tax expenditures are given.

- **What is subject to tax** – some parts of the tax base might be exempted or only partially subject to tax.

Example 1.1 - Exclusion of capital gains from an income tax

In South Africa, capital gains generally are included in a taxpayer's assessable income for a year. However, individuals can exclude up to R20,000 of capital gains from assessable income for each tax year. Individuals conducting small businesses may also exclude capital gains arising from the sale of property used in the business of up to R900,000 from assessable income.[1] The exclusion of these capital gains from tax has the effect of a subsidy for individuals who invest in assets, or small businesses.

In a tax on goods, such as a tariffs or sales tax, a particular product may be exempt, or be taxed at a lower rate than the benchmark tax law, or it may be taxed at a higher rate (sometimes called a *negative* tax expenditure).

Example 1.2 - Ghana Energy and Environmental Measures

In Ghana, the tariff code provides an exemption for energy saving compact fluorescent lamps. To further promote energy savings and reduce power consumption, the Ghana government added LED Lamps to the exemption list in its 2011 Budget. Local companies producing energy saving bulbs will have the same treatment for their primary raw materials.[2]

The benchmark for tariffs would usually provide for all products of a similar type to be taxed at the same rate. As a result, this tariff exemption is a tax expenditure.

[1] Income Tax Act 1962 (South Africa), Sch 8 Part VIII.
[2] Ghana, 2011 Budget, para 167.

The 2011 Ghana Budget also proposes to enact a 20 percent excise duty on plastic packaging materials and products at the importation and any production or collection points. The purpose is to reduce use of plastic packaging for environmental purposes.

A benchmark for taxation of goods would usually tax all similar materials and products at the same rate. Against this benchmark, this packaging tax would be a negative tax expenditure because it taxes a particular product at a higher rate.

There may be good policy reasons for both of these measures proposed by the Ghana government. It is important to report them and estimate the cost in the tax expenditure report, so that a debate can occur in the legislature and public forums, such as the media, about whether this is a good policy.

- **Who must pay the tax –** a tax rule might exclude particular individual taxpayers from taxation or might allow a particular taxpayer favorable tax treatment because of a characteristic that taxpayer possesses (such as their age, or family status).

Example 1.3 - Deduction for spouse or housekeeper

In Samoa, the income tax law provides that the primary income earner of a household is allowed a deduction where the income earner's husband or wife has limited income. A widow, widower or a divorcee is also allowed a deduction for amounts paid to a housekeeper.[3]

If the individual is considered the appropriate taxation unit for the purpose of defining the income tax benchmark, deductions for a dependant spouse would be a tax expenditure because it offsets a gain to the taxpayer that would otherwise be subject to income tax. This can provide useful information about the revenue cost of rules about the family in the tax law.

On the other hand, the government may decide that the benchmark tax law should allow for deductions for spouses and other dependents. In this case, the deduction for a spouse would not be reported as a tax expenditure.

[3] Income Tax Act 1974 (Samoa) sections 56-58.

In the business context, a tax rule might exclude particular corporate taxpayers from paying tax on business profits if they establish in a region, or if they operate an export business. The tax holiday may be for a limited time, or may be indefinite at the discretion of the government.

Example 1.4 - Jordan corporate tax incentive

As an incentive for investment, Jordan offers a reduced corporate tax rate for periods of between 2-12 years for companies engaged in particular industries, and a tax holiday that exempts from tax their business profits derived from exports.[4]

- **The time that tax is payable** - a taxpayer may be allowed to pay tax at a later time by comparison to the benchmark. Such a 'tax deferral' is like an interest-free loan from the government to the taxpayer, which is a subsidy that costs revenue.

Example 1.5 - Retirement savings concessions

Many countries use their tax system to promote retirement savings by individuals. In general, these tax expenditures comprise income tax concessions for savings which are preserved until a person's retirement from work. Commonly, amounts contributed to retirement savings funds on behalf of individuals respectively are exempt from income tax or subject to a lower income tax rate than would apply if the individual received the sum as wage or salary.

A benchmark income tax would usually tax all wages and benefits for an employee. The benefits of a retirement fund deposit, or of deferral of tax on it, are tax expenditures. These tax expenditures often cost significant government revenue and may only benefit a small percentage of the working population (or the bulk of the benefit may pass to only a small proportion of the beneficiaries). By contrast, a benchmark consumption tax would not tax savings and so retirement savings exemptions would not comprise a tax expenditure if a consumption benchmark were adopted.

The contrasting treatment of retirement savings concessions under alternate income and consumption tax benchmarks illustrates a hotly contested issue in tax expenditure reporting. As those with higher incomes/wealth generally have a greater capacity to save, savings concessions generally favour this economic group within society. Advocates of a 'fair' society, conceived as one which redistributes social wealth to those with less income/wealth, often will prefer an income tax benchmark so that savings concessions will be transparent and hence open to scrutiny.

[4] MENA-OECD Investment program, *Tax Incentives for Investment – A Global Perspective: experiences in Middle East and North African (MENA) and non-MENA countries* (2007) Table 3 (2004 data), p. 8.

(a) In Samoa an employer is entitled to a deduction with respect to a contribution to a retirement fund on behalf of an employee.[5] Although the employee will benefit from this sum in the future (upon retirement), this benefit, or addition to the individual employee's wealth, is not recognized for income tax purposes.

(b) In the US, individual workers can choose to deposit a part of their salary into an individual retirement savings account. They only pay tax on this amount, and on earnings in the account, later when the funds are withdrawn to support them in retirement.[6]

(c) In Australia, retirement funds are taxed at a concessional tax rate of 15 percent on all contributions to the fund by employers and individuals, and on all earnings within the fund. Payouts on retirement are usually tax-exempt.[7] This is an even more generous tax expenditure than a 'tax deferral', as for high income earners, it produces a much lower rate of tax on their retirement savings.

- **Rate of tax** - The rate of tax may vary for particular categories of taxpayers or transactions; for instance, small business income or income comprising capital gains might be taxed at a lower rate than otherwise applies.

Example 1.6 - Small business tax rate

Small business companies in South Africa are subject to a concessional tax rate scale relative to other companies. Rather than paying tax on taxable income at the usual corporate tax rate of 28%, small business companies pay tax under a progressive tax rate scale ranging from 0% (up to R150,000) to 28% (for income exceeding R300,000).

- **The country or local jurisdiction in which tax is payable** - a taxpayer may be excluded from tax with respect to activities undertaken in a particular jurisdiction or upon the basis of their residence in a particular jurisdiction (i.e., where a foreign resident is excluded from taxation in the country where the source of income exists);

Example 1.7 - Exclusion of foreign source dividends

In Australia the corporate recipient of dividends from a foreign company does not include those dividends in assessable income provided that the Australian company holds a substantial controlling interest in the foreign company.

[5] Income Tax Act 1974 (Samoa) section 26
[6] Internal Revenue Code, Title 26 USA, section 401(k).
[7] Income Tax Assessment Act 1997 (Cth of Australia), Division 295, 301.

- **How the tax is administered –** the administration of the tax law may vary for different taxpayers. For example, small business taxpayers might be allowed to file tax returns on the basis of less detailed information than is required otherwise for the purposes of the taxation law. Alternatively, taxpayers may be subject to presumptive tax rules which adopt a proxy for a taxpayers true income where measuring that true income could prove problematic. As a result of either departure from the benchmark rules for administering the tax, the revenue agency may not have enough information to collect the correct tax in accordance with the relevant tax benchmark.

Example 1.8 - Presumptive income taxation

In South Africa, since 2009, small businesses that satisfy specific legislative conditions may elect to be taxed on a presumptive basis.[8] The tax is calculated based on business turnover, instead of business net income. This may help small businesses to calculate their tax liability more easily.

Against a benchmark of an ordinary income tax, the difference between the tax collected under the presumptive tax regime and the tax that would have been collected under an income tax constitutes a tax expenditure.

For small businesses with high profit margins the turnover tax method may provide a significant tax saving. This opportunity to be taxed upon the basis of turnover rather than income is claimed to be justified because small business income tax compliance costs can be excessive relative to the amount of tax payable. However, if this tax concession means that some small businesses pay a lot less tax, it may be difficult to quantify the public benefit of this tax concession.

1.4 Fiscal Significance of tax expenditures

Total tax expenditures may be very large in terms of revenue foregone for a government. As noted by the IMF in its *Manual on Fiscal Transparency* (2007, [187]) "in many tax systems, tax expenditures can be significant relative to the total tax revenue". Tax expenditures may also be large relative to direct expenditures of a government.

A study of tax systems in central America found that the tax base of many central American countries is narrow and there are many exemptions from taxation (Gallagher, 2004: p. 7). It was found that in Guatemala:

> "tax expenditures", i.e., exemptions, exonerations, deductions, and other special privileges … were equal in value, in terms of foregone revenues, to the entire total of tax receipts.

[8] South Africa Revenue Authority, see http://www.sars.gov.za/home.asp?pid=43122.

Similarly, many country tax laws in Africa contain large numbers of tax exemptions and other tax expenditures, "representing a staggering opportunity cost … in terms of revenue forgone. These typically favour the wealthy and should be greatly reduced or preferably abolished." (North-South Institute, 2010: p. 1). For example:

- In 2006 in Burundi, 60 percent of imports were exempted partly or fully from paying tax or duties, which amounted to a loss in tax revenue equivalent to 10.7 percent of GDP and 65.5 percent of revenues.

- In 2006/7 in Tanzania, tax exemptions amounted to 32 percent of total revenue and 5 percent of GDP.

- In 2007 in Ethiopia customs exemptions amounted to 4.5 percent of GDP.

Table 1.1 presents some examples of the fiscal significance of tax expenditures in some developed and developing countries. The statistics are taken from each country's own estimates of the total level of its tax expenditures, either as a proportion of Gross Domestic Product (GDP), direct government spending, or total tax revenue collected.[9]

The definition of tax expenditure and calculation of tax revenues varies significantly across countries, so that it is difficult to make direct comparisons. The size of aggregate tax expenditures as a proportion of tax collected will differ depending on a country's definition of its tax expenditure benchmark and its overall tax system. However, the examples show how significant tax expenditures can be, relative to the size of a country's economy (its GDP), its government spending, and overall tax revenues.

For example, Table 1.1 shows that in Korea, tax expenditures across all taxes comprise more than 14 percent of all central government tax and non-tax revenue. In the UK and Canada, tax expenditures are respectively 46% and 64% of total tax and non-tax revenues of the central government.

The scale of aggregate tax expenditures relative to direct spending or tax revenues suggests that close attention to this form of government spending is warranted. The methodology to estimate and measure the tax revenue foregone because of tax expenditures is discussed in chapter 3. Some challenges in measurement are discussed in chapter 5.

[9] Issues and challenges of measurement of tax expenditures are discussed in Chapter 5. Estimates of total tax expenditures provide a useful overall picture, but are very rough and must be treated with caution.

Table 1.1 Fiscal Significance of Tax Expenditures

Country	Significance of tax expenditures	Sources
Brazil	Central government tax expenditures comprise 2.98% of GDP and 17.84% of total central government revenue.	2010: Chile, 2011 Report on Tax Expenditures p. 94.
Canada	Central government tax expenditures comprise 10.16% of GDP and 64.96% of central government total tax and non-tax receipts.	2004: OECD (2010), Table II.1 p. 173 and Table II.2, p. 176.
Chile	Central government income tax expenditures comprise 3.5% of GDP and 20.95% of direct central government expenditures.	2010: Chile, National Budget 2011, Table VII.4 (see further Table 4.4 below).
Germany	Central government tax expenditures comprise 0.74% of GDP, 8.81% of direct central government expenditure and 8.48% of central government total tax revenue.	2006: OECD (2010) Table II.5 p. 182 and Table II.6 p. 184.
India	The government estimates that corporate tax expenditures comprise 30% of total corporate tax revenues collected, while excise tax expenditures comprise 164% of total excise revenue collected (see further Table 4.1 below).	2009-10: India Ministry of Finance, Statement of Revenue Foregone 2010-11, Budget annex 12, Table 12 p. 33
Korea	Central government tax expenditures comprise 2.52% of GDP and 14.52% of central government total tax and non-tax receipts.	2006: OECD (2010) Table II.9 p. 188, Table II.10 p. 190.
South Africa	Central government tax expenditures comprise 3.4% of GDP and 12.5% of total tax revenue collected.	2008-09: South Africa National Budget 2011, Budget Review p. 64.
United Kingdom	Central government tax expenditures comprise 17.03% of GDP and 46.84% of total tax receipts.	2006-07: OECD (2010) Table II.21 p. 204, Table II.22 p. 206

1.5 Purpose of Tax Expenditure Report

Tax expenditure reporting can serve several important functions:

1. It exposes all forms of government spending, both direct spending and tax spending, to the same level of scrutiny in the budget process. This enables informed decision-making by the legislature and facilitates public understanding and advocacy.

2. It enhances the government's fiscal management. If major tax expenditures are not properly identified and reported, the Treasury may overestimate revenues in the budget. This leads to an inaccurate budget and may mean that sharp expenditure cuts have to be made late by the government when it is executing the budget.[10]

[10] Shah (2007) p. 242.

3. It promotes public consideration of how the government should act to achieve its various policy goals (e.g., through public ownership of resources, regulation, direct spending, taxation or tax expenditures). Tax expenditure analysis is no different from public policy analysis more generally as it entails consideration of the best means of achieving a government's objectives.

4. It promotes analysis of tax policy principles and potential improvements to the tax system for a particular community. Discussion of how to define tax expenditures and set the tax benchmark promotes closer consideration of a community's aspirations for its taxation system and what the government *ought* to tax for a fair, efficient and simple tax system. Tax expenditure advocacy is one avenue by which citizens, opposition parliamentarians and other commentators can make arguments about the fairness and effectiveness of the tax system.

The purpose of the tax expenditure report is central in determining what information should be provided in it. A government may wish to estimate the overall revenue cost of a policy that is delivered through tax expenditures in order to decide whether the use of the tax system is appropriate. Civil society organizations are likely to be interested in a broad range of information about tax expenditures including the distributional impact of a tax expenditure (who benefits most or who does not benefit at all) and whether particular tax expenditures are effective in achieving public policy goals.

1.6 Main information in a Tax Expenditure Report

A tax expenditure report may range from a minimal identification and basic costing of tax expenditures, to a detailed description and analysis of tax expenditures, the benchmark tax system, and revenue foregone over a period of years.

We set out below a full list of information that ideally should be included in a tax expenditure report. What can be achieved in a tax expenditure report is subject to resource and data constraints of governments. No government achieves all of the following elements of a tax expenditure report. However, even a basic tax expenditure report that identifies, costs and explains the most important tax expenditures, is better than no report at all. It will enhance transparency of the budget and help generate public debate.

1. **Definition of a 'tax expenditure' –** the definition of a tax expenditure for each type of tax should be clearly stated and defended within the tax expenditure report.

2. **Comprehensive identification of all types of tax expenditures –** a tax expenditure report ought to comprehensively report upon all tax expenditures. More detail on different types of tax expenditure is in Chapter 2. At a minimum the tax expenditure report should identify the most expensive tax expenditures (say, the top 10 most expensive provisions) and report in detail on those tax expenditures.

3. **A definition of the 'benchmark tax law'** that is the basis for the 'tax expenditure' definition. Ideally, the report ought to set out the reasons for the choice of a particular benchmark for each type of tax and why it is appropriate.

4. **Method for estimating revenue foregone (a credible measurement framework) –** the method used for estimating individual tax expenditures should be clearly set out in the report. A significant factor affecting the usefulness of a tax expenditure statement is the accuracy with which the cost of a particular tax expenditure is determined. The degree to which each tax expenditure estimate is reliable ought to be clearly indicated.

5. **Break outs in the reporting of tax expenditures**
   (a) Tax expenditures should be organized and reported by government function (e.g., health, social security, environment, industry assistance) and the revenue foregone should be estimated individually, and in the aggregate, for each function. This shows what government functions or payments are being funded through tax expenditures, compared to direct spending.
   (b) Time series data over a period of years (such as a 3 or 5 year period), briefly noting any variations to the tax law or benchmark in that time, should be presented.
   (c) Tax expenditures should be defined for different taxes at different levels of government and also aggregated across all levels of government, if possible.
   (d) Aggregate (total) tax expenditure estimates should be provided, to give an overall picture of spending in the country's tax system. However, readers should be cautioned that this is a very rough estimate that should not be relied upon for detailed analysis.

6. **Information for each tax expenditure**
   (a) The estimated cost of the tax expenditure, with an indication of the reliability of the estimate, including the quality of the data upon which the estimate is based.
   (b) The source of the tax expenditure (is it a tax law provision, administrative practice, or tax treaty?).
   (c) The duration of the tax expenditure (is it subject to a 'sunset clause' or is it ongoing?).
   (d) The type of tax expenditure (is it, for instance, a tax exemption, a tax credit, or a reduced tax rate?).
   (e) Policy justification for each tax expenditure (what is the policy objective of the tax expenditure and why is the tax expenditure the best means of achieving that objective?). Note that this is the kind of analysis that independent academic commentators, think tanks or civil society groups may wish to do for particular tax expenditures. See further in chapter 6, below.
   (f) Distributional impact of major tax expenditures, to the extent that data is available.
   (g) For the most significant tax expenditures, the report should explain when the government last reviewed the tax expenditure to determine if it is good tax policy (the relative significance of tax expenditures might be determined by cost or other criterion such as potential impact upon social justice).

Chapter 2 Key ingredients for good tax expenditure management

SUMMARY

This chapter examines in more detail the key ingredients for good tax expenditure management, including the definition of a tax expenditure, measurement methods, critical analysis of tax expenditures and also measures to assure the integrity of tax expenditure management.

2.1 Tax Expenditure Management: More than Just Reporting

The concept of tax expenditure management emphasizes that merely reporting tax expenditures does not fully enable critical scrutiny of tax expenditures by the media, think tanks and members of parliament and opposition parties. Active tax expenditure management, of which reporting and costing are two important elements, forms an integral part of government budget processes and of civil society engagement with government budgets.

Tax expenditure management requires the establishment of a framework for identifying, measuring and critically assessing the merits of tax expenditures, before they are legislated and on an ongoing basis over time.

Key elements of tax expenditure management include:

- A publicly accessible analysis of proposed tax expenditures before they take effect. Often tax expenditures are developed in the pressured context of preparing a budget and therefore escape critical analysis;
- Reporting of tax expenditures, as explained in Chapter 1 of this report;
- Regular updating of tax expenditure analysis for each tax expenditure, which takes account of the changing legal and social context; and
- Regular, independent review of the process by which tax expenditures are measured and assessed. This might be undertaken, for example, by the government auditor.

For example, in addition to its annual published tax expenditure report, a government could periodically examine the cost and justification for its main tax expenditures in detail, with the goal of determining its distributional impact, if the cost is increasing or decreasing over time, whether there continues to be a good policy justification for the tax expenditure compared to other policy goals and instruments.

A government, from time to time, could also do a detailed examination of its own definition of tax expenditure and methods of analysis. For example, the government of Chile has established a review committee to carry out this analysis in 2011 (see chapter 4 below).

The framework under which tax expenditures are identified, measured and assessed should be assured for quality and accuracy. One way that this can be done is by subjecting it to independent examination by a government Audit Office. A civil society organization could also examine the tax expenditure management framework, if the information is publicly available, to decide if it is suitable for transparency and accountability and how it could be improved.

2.2 Definition of Tax Expenditures: Some More Detail

The definition of the tax expenditure concept is fundamental to systematic tax expenditure management. For this reason, the tax expenditure report should set out the definition of "tax expenditure" that is applied by the government in the report.

There is no globally agreed definition of a tax expenditure. However, as noted in Section 1.1 above, a tax expenditure is usually defined as the estimated revenue loss to a government that results from a tax concession or tax preference allowed to a particular class of taxpayer or activity. For example, the International Public Sector Accounting Standards Board defines tax expenditures as follows (IPSA 23, 2006: Cl. 7 p. 5):

> Tax expenditures are preferential provisions of the tax law that provide certain taxpayers with concessions that are not available to others.

Country examples

Different countries have developed some quite different language and approaches to the definition of a tax expenditure.

In South Africa, tax expenditures are defined in this way:[11]

Example 2.1 - South Africa: Definition of Tax Expenditure

Tax expenditures are indirect government expenditures that are not reported in the normal budget process. They are tax provisions that reduce the amount of tax revenue that could otherwise have been collected.

Tax expenditures can be defined as deviations from the benchmark of a current standard tax legislative framework. A benchmark is a reference point against which the nature and extent of a concession can be identified – it is the standard taxation treatment that should apply to similar taxpayers or types of economic activities. Tax expenditures deviate from this benchmark of a good tax system that adheres to the basic principles of neutrality and equity.

A less robust but more practical approach is to define tax expenditures merely as a deviation from the basic tax structure, without reference to an

[11] Republic of South Africa, *National Budget 2011*, Annexure C, p 179, available at: http://www.treasury.gov.za/documents/national%20budget/2011/review/Annexure%20c.pdf

ideal benchmark. For example, the United States Treasury's definition of a tax expenditure states that a tax expenditure must: (a) be special in that it applies to a narrow class of transactions or taxpayers; and (b) have a general provision and a specific provision that provides an exemption.

In Korea, a tax expenditure is defined by the Ministry of Finance as follows:[12]

Example 2.2 - Korea: Definition of Tax Expenditure

Tax expenditures are the tax-subsidy counterpart to fiscal expenditures: they are the reduction of national tax revenues that result from the application of special provisions, as exceptions to the normal taxation system, for reducing the tax burden of [a specific target subgroup of] taxpayers.

A government may wish to distinguish between a tax expenditure that is a subsidy or concession, and a tax expenditure that the government sees as an important structural relief in the tax law. This is done, for example, in the United Kingdom.[13]

Example 2.3 - United Kingdom: Tax expenditures and Structural Reliefs

The UK distinguishes between 'reliefs' that are 'tax expenditures' and 'structural reliefs'. The estimated revenue foregone from both kinds of tax 'relief' is reported in the UK budget, but it is separated out to make it clear to the reader that each type of tax 'relief' is viewed differently by the government.

In 2010, New Zealand started reporting on tax expenditures after not having reported on tax expenditures since 1984. The New Zealand Treasury is taking a cautious approach towards improving budget transparency. New Zealand defines a tax expenditure as:[14]

Example 2.4 - New Zealand: Definition of Tax Expenditure

Tax expenditures are individual features of the tax system that reduce an entity's tax obligation in a way that is designed to give effect to policy other than to raise revenue in the most efficient and economically neutral way.

[12] Korea, Ministry of Finance, Tax Expenditure Report; National Fiscal Act 2005; see Kim (2008).
[13] United Kingdom, *Revenue-based Taxes and Benefits: Tax expenditures and structural reliefs*, http://www.hmrc.gov.uk/stats/tax_expenditures/table1-5.pdf available for download from http://data.gov.uk viewed 14 May 2011.
[14] New Zealand, 2010 Tax Expenditure Statement, Budget 2010, http://purl.oclc.org/nzt/b-1296 p. 1.

Positive and negative tax expenditures

Governments and civil society groups will typically report on or scrutinize tax expenditures which provide preferential tax treatment for a class of taxpayer or activity, resulting in tax revenue foregone.

This kind of tax expenditure is called a *positive tax expenditure* and is the main focus of tax expenditure analysis. This is because it costs revenue for the government and is similar to budgetary spending or a subsidy for the taxpayer. Positive tax expenditures may also be called tax subsidies, tax preferences, tax reliefs, or tax breaks.

A *negative tax expenditure* arises where a taxpayer is treated disadvantageously by comparison to the benchmark tax law. This is analogous to imposing a higher tax on an activity or taxpayer than the normal tax system would apply.

Negative tax expenditures may reflect a specific policy goal of the government to tax some activities or commodities higher than others, but they also may disadvantage particular segments of the community. Like all taxes (and spending), they should be published, understood and open to scrutiny.

Example 2.5 - Australia: Negative tax expenditure

Australia imposes a luxury car tax on the purchase of a car with a price above a certain threshold. The benchmark for taxes on commodities is a general Goods and Services Tax that applies equally to all goods. As this luxury car tax imposes tax at a rate above the benchmark rate, the luxury car tax creates a negative tax expenditure in Australia's tax expenditure report.

Example 2.6 - Ghana: Positive and Negative Expenditures

Chapter 1, Example 1.2, gives examples of positive and negative tax expenditures in Ghana. The exemption from tariffs for energy efficient light bulbs is a positive tax expenditure. The additional excise on plastic packaging is a negative tax expenditure.

Express and non-express tax expenditures

A tax expenditure may result from an express provision in the tax law (an *express tax expenditure*). Most governments only report express tax expenditures. However, tax preferences against a specified benchmark might also arise in various non-legislated ways.

For example, administrative practice such as a consistent failure to enforce an existing tax law would be a *non-express tax expenditure*. Similarly, a failure to introduce a law which imposes a tax could be an implied tax expenditure. In effect, there is no difference between a government having an express rule exempting a particular item from taxation, and a government failing to introduce a law which imposes the tax, or failing to enforce the existing tax law. In all these cases, revenue is not collected in circumstances where the benchmark indicates that tax ought to be imposed.

Civil society groups may wish to identify non-express tax expenditures in lobbying the government to provide a comprehensive report of its tax expenditures measured against a recommended benchmark.

Example 2.7 - Non-express tax expenditure

New Zealand does not impose taxation on capital gains. If a comprehensive income tax benchmark was used, this would require capital gains to be included in income. The failure to enact a capital gains tax law can be considered a non-express tax expenditure. However, currently, New Zealand does not treat capital gains as taxable under its benchmark, and so does not identify this exemption as a tax expenditure.

2.3 Benchmark tax law

In section 2.2 it was noted that the definition of tax expenditure relies on departures from a benchmark or normative tax system. Tax expenditures are ultimately identified, measured and critically analyzed by comparison (implicitly or explicitly) with a benchmark.

For each different type of tax imposed in a country, the tax expenditure report will ideally define the benchmark tax law. The report should set out clearly its definition of the benchmark so that it is possible for the reader to assess the tax expenditures identified.

Defining the benchmark for tax expenditures can be controversial. For example, in section 1.3 when considering retirement savings concessions, we noted the alternative treatment of these concessions under an income tax benchmark, compared to a consumption tax benchmark. The deeply political nature of benchmark definition was noted there.

A civil society organization may disagree with the government's definition of the benchmark. The organization could respond by defining its own benchmark or by criticizing the government's definition of the benchmark. The challenges in defining a benchmark are discussed in more detail in Chapter 5 below.

Guidelines for an income tax benchmark[15]

As an example, we set out here some key components or structural features of an income tax law, which should be specified as part of the benchmark:

- The tax base – for an income tax, presumably the general tax base is income (see the discussion below);
- The tax unit (individual, spouse or family), or enterprise (company);
- The time for imposition of the tax;
- The tax rate structure;
- A minimum tax-free threshold or standard exemption or deduction for a taxpayer;
- Jurisdictional rules which define the country's claim to tax. For example, in the context of an income tax, many countries frame their claim to impose tax upon incomes around the concepts of residence of taxable entities and/or the source of income for tax purposes; and
- Rules governing the administration of the tax.

With respect to the definition of a benchmark **income tax base**, government and civil society groups would need to consider whether, and if so to what extent a broad concept of gain forms the base for this benchmark. The concept of gain can be difficult to apply in practice. However, a broad concept of gain would form the basis for inclusion of the following benefits within a benchmark income tax base:

- All current income from salaries and business, and from investments, such as dividends, interest, rents, royalties should be included in income. This means that any exemptions or exclusions from income, or any exclusions of particular types of taxpayer, will be tax expenditures.
- Employment related benefits provided by an employer to an employee and where the employer is allowed to deduct the cost of the benefit against its income. This means that any employment related benefits that are exempt from tax, or not effectively taxed, will be tax expenditures;
- Net realised gains (eg on the sale of assets) are included in income in full, and subject to the generally applicable tax rates. A transfer of an asset by gift is treated as a realization event. This means that any reduced tax rate or exemption from tax of gains on sale of assets will be a tax expenditure.
- Deductions are allowed for all costs of producing income and for losses incurred in respect of income producing assets, or assets held for investment. This means that any restriction or prohibition on a deduction for business expenses, will be a *negative* tax expenditure.
- No deduction is allowed for personal consumption expenses, such as the cost of food, housing or cars, or for medical expenses. This means that any deduction, or tax credit, for such personal expenses is a tax expenditure.

[15] Surry and McDaniel (1985) were the first to propose a comparative analysis of tax expenditures across countries and to set out some basic guidelines about the benchmark tax system. These brief guidelines draw from their survey, and from more recent analysis and country experience. Detailed guidelines about how to establish a benchmark income tax and value added tax law are set out in that book.

- Capital expenditure on business assets can be deducted over the estimated useful life of the asset on a straight line or diminishing value (declining balance) method. This means that any immediate tax write-off for the cost of a business asset, or accelerated depreciation, will be a tax expenditure.

2.4 Justification of tax expenditures from a policy perspective

Aside from the fiscal significance of total tax expenditures in respective countries, the practical significance of tax expenditures in terms of their impact upon public policy means that close attention to them is warranted.

A democratic government ought to aspire to openness, accountability and transparency with respect to all of its policy measures, including tax expenditures. For this reason, it is important that a government states clearly why it has chosen to advance a particular policy through enacting a tax expenditure instead of using some other policy tool. However, as noted above, many governments will not provide this analysis. This is the kind of critique or examination that could be done by independent scholars, think tanks or civil society groups about particular tax expenditures. An example of this analysis is in chapter 6 below.

This section identifies some of the key advantages and disadvantages of the tax expenditure mechanism, to help in an examination as to whether this is the right policy solution in a particular case. An understanding of these pros and cons can strengthen a civil society's assessment of tax expenditures.

Disadvantages of tax expenditures

There are several reasons why tax expenditures may be less effective as a policy tool than another mechanism, such as direct spending or a regulation. The IMF describes tax expenditures as being, in general, a "second best" policy. That is, if the government decides that a subsidy or government support is needed for an activity or certain persons, direct spending should be the first option considered (IMF, 2010, p. 13).

- **It is more difficult to subject tax expenditures to legislative control**

It is difficult for the government to estimate and control costs through a tax expenditure that is a permanent part of the tax law. This is usually more difficult than estimating and controlling the costs of a direct spending program, which is budgeted (and thereby scrutinized) annually. It is also difficult for a government to implement a spending cap for a tax expenditure, in contrast to direct expenditures.

It is often the case that no particular functional agency is responsible for a tax expenditure even if it is directly relevant to the functions of that agency. This is because tax expenditures are usually administered by the revenue agency or the Treasury. For example, a department of housing may have no control over an exemption from land tax of the home of a taxpayer. This lack of functional oversight can lead to less coherent policy-making or implementation when tax expenditures are used.

A tax expenditure may remain in the tax law after its usefulness as a policy tool has come to an end. One way that a legislature may seek to control this problem is to enact a 'sunset' clause for the tax expenditure. A 'sunset' clause prescribes a particular date, or period of time, after which the tax expenditure will cease to apply. Sunset provisions are used rarely and may add to tax law complexity.

Example 2.8 - Korea Sunset Clause for Tax Expenditures

Korea is an example of a country that, in the 1970s, actively used tax expenditures to provide incentives to industrial development.[16] However, more recently, Korea has aimed to reduce the number of industry incentives in its tax law.

In 1976, Korea enacted a law that subjects all tax expenditures to a 5 year sunset clause. Strictly speaking, this means that a tax expenditure has to be approved again by the Parliament, in a law, at the end of 5 years. There was some concern in Korea that this sunset law was not being enforced. However, in 2005, 7 tax expenditure provisions expired, so that they are not in the tax law any more. In 2006, 5 tax expenditure provisions expired. In 2007, 38 tax expenditure provisions expired. This experience indicates that a sunset law could be helpful in reducing the number of tax expenditures over time.

- **Tax expenditures may be subject to less administrative control**

Tax expenditures are usually administered by the revenue agency of a country because they are in the tax law. However, administration of a tax expenditure by the revenue agency may not be optimal. While the revenue agency has expertise in managing tax law and systems, it is likely to have less expertise in managing a particular policy field (such as the environment, housing, or research and development) that a tax expenditure is trying to influence. This can lead to a tax expenditure being applied in either a more or less generous way than was intended by policy makers.

One concern is that the costs of a tax expenditure may be inflated by illegitimate or erroneous claims. In general, a taxpayer does not need to apply for a tax expenditure and so their eligibility for it is not determined up front. Instead they claim it in their tax return (if one needs to be filed). This may not occur until after the end of the fiscal year. As a result, tax expenditures may be obtained by ineligible recipients (intentionally or not). Discovery of such illegitimate public funding depends on the efficacy of tax enforcement mechanisms used by the revenue agency, such as audit of tax returns. The error may not be identified, if at all, until several years later, when taxpayers can be faced with large bills for unpaid taxes plus interest.

Alternatively, officers in the revenue agency may interpret a tax expenditure rule narrowly in a way that cuts out some of the intended beneficiaries. Performance management indicators applied to the revenue agency may emphasize tax revenue

[16] OECD (2010) p. 99.

raised per unit of cost. The revenue agency may have little incentive to ensure that tax expenditures are obtained by all eligible taxpayers. Only taxpayers who can afford to pay for the advice of a tax lawyer or accountant may succeed in accessing all the tax expenditures applicable to them.

- **Tax expenditures may generate unfair distributional outcomes between taxpayers.**

Where a tax has a progressive (increasing) rate structure, such as a progressive income tax, some kinds of tax expenditures will benefit high income taxpayers more than low income taxpayers. This is sometimes called an 'upside down' effect of tax expenditures.

For example, a tax expenditure that provides a deduction from gross income can provide a greater advantage to those with higher incomes because the value of the tax deduction increases as the taxpayer's marginal tax rate rises.

Example 2.9 - Illustration of the 'upside down' effect of a tax expenditure

Assume that the government allows a deduction of $100 for certain private expenses of a taxpayer, which would qualify as a tax expenditure. Taxpayer A pays zero tax as he has a low income. Taxpayer B has medium income and has a 20% tax rate with respect to her marginal income (ie the last unit of income received by the taxpayer). Taxpayer C has a high income and has a marginal tax rate of 40%.

	Taxpayer A (low income)	**Taxpayer B (medium income)**	**Taxpayer C (high income)**
Marginal tax rate (tax rate imposed on last $100 of income)	0%	20%	40%
Deduction allowed	$100	$100	$100
Tax saved as a result of the deduction	$0	$20	$40
Effective subsidy received	$0	$20	$40

Tax expenditures can also have unfair distributional consequences when individuals or companies who can best afford tax advice are most likely to access them. Taxpayers on low incomes who do not have sufficient knowledge of the tax law may not understand that they are eligible for special tax concessions.

- **Tax expenditures usually benefit only those in the community who actually pay tax.**

In most cases, a tax expenditure will only be of benefit to a person if the person would otherwise be liable to pay tax. As shown in Example 2.9, above, a tax exemption or a tax deduction is only worth money to a person (and only costs the government in revenue foregone) if that person would otherwise have paid tax in respect of the particular income, good or activity.

One exception is a 'refundable' tax credit which can offset any tax payable and, if the credit exceeds tax payable the credit is paid as a cash grant to the relevant person. This is illustrated in Example 2.10.

Example 2.10 - Refundable Tax Credit

Looking again at Example 2.9, above, instead of a deduction of $100, the government allows a refundable tax credit of $40. In that event, Taxpayer A, who owes no income tax before the tax credit is considered, would receive a cash payment of $40. Taxpayer B would receive a $20 credit against their tax liability and a cash payment of $20. Taxpayer C would receive a $40 credit against their income tax liability. As a result, the refundable tax credit is worth an equal amount of cash to each taxpayer, in spite of their different levels of income.

	Taxpayer A (low income)	**Taxpayer B (medium income)**	**Taxpayer C (high income)**
Marginal tax rate (tax rate imposed on last $100 of income)	0%	20%	40%
Refundable tax credit allowed	$40	$40	$40
Tax saved as a result of the deduction	$0	$20	$40
Cash payment received	$40	$20	$0

While refundable tax credits have the advantage of being equally fair for all taxpayers, they are costly to administer, particularly where there are a large number of taxpayers benefiting from the tax expenditure. The government would need to have the administrative resources necessary to control and administer a refund system. This may be difficult for many tax administrations. A better solution may be to provide a direct grant, or publicly funded service, if the government aims to provide a particular policy benefit to everyone, regardless of income.

- **Governments may face large costs in enforcing the boundaries of tax expenditures**

If many taxpayers who can afford tax advice seek to take advantage of some tax expenditures, this can lead to widespread abuse of tax expenditures in the tax law. As a result, revenue agencies may spend significant funds policing the boundaries of tax expenditures. For example, tax concessions such as an exemption for income from agriculture activities could be abused in tax planning schemes by wealthy individual taxpayers seeking to minimize their tax.

Advantages of tax expenditures

Some characteristics of tax expenditures may give them an advantage as a policy tool in some circumstances, compared to direct spending or regulation.

- If the government wants to make a concession available to a broad range of taxpayers without identifying each recipient's particular characteristics, a tax concession may offer the least cost path both for the government to administer and for taxpayers to obtain the benefit (although note that low income individuals may not benefit from a concession delivered in this way).

- Enacting a tax expenditure may prevent churning of tax revenue collection and public spending, enabling the government to efficiently deliver public spending by avoiding the administrative cost of collecting tax from a taxpayer only to return it to the same taxpayer in the form of a government payment.

- The tax system might be the best means of advertising the availability of government assistance, especially when there is a large target group consisting of taxpayers required to lodge tax returns. By asking taxpayers to consider whether they fit the requirements for the government assistance as part of mandatory tax filing, a government might ensure that assistance reaches the target group.

2.5 Tax Expenditure Reporting and the Budget Cycle

Typically, tax expenditures are classified as 'revenue' rules and are subjected to less scrutiny in the budget process than applies for direct 'spending' rules. There is no public policy justification for this difference.

The goal of tax expenditure management (see features identified at section 2.1) is for tax expenditures to be subjected to the same scrutiny as direct expenditures. This also requires that information is reported to the legislature and the pubic in a timely, accessible and useful manner.

Timely and Current Reporting of Tax Expenditures

A tax expenditure report should be *timely***.** A tax expenditure report should also be *current and relevant* – it should be prepared annually, so that preparation of the national budget is informed by current information regarding a government's tax expenditures. For each tax expenditure, the report should be able to assist in answering the question: Does the government want to support this policy objective, and is a tax expenditure the best way of achieving it?

In many countries, tax expenditures are reported as part of the annual budget. This has the advantage that the tax expenditure report is a regular element of the budget.

For example, this is required in Mexico:

Example 2.11 - Mexico

Before 30 June each year, the Treasury Department and Public Credit (SHCP) is obliged to publish the Tax Expenditure Report on its web page and deliver it to the Treasury and Public Credit Commissions of Budget and Public Account, to the Public Finances Study Centre of the Chamber of Deputies and to the Treasury and Public Credit Commission of the Senate.[17]

A possible disadvantage of this timing is that it is difficult for civil society groups and parliamentarians to respond to the tax expenditure report by making proposals to change tax expenditures in the budget for the same year.

An alternative approach would require that a tax expenditure report be released in advance of the annual preparation of the national budget. This would assist in ensuring that consideration of the report can meaningfully inform consideration of revenue and spending measures.

Example 2.12 - Australia

In Australia, a detailed tax expenditures report is issued mid-financial year (December). This is well in advance of the annual budget which is published in the following May. It occurs before the process in which civil society groups and other stakeholders can make 'pre-budget submissions' to the government. This timing enables civil society groups and commentators to examine the cost of tax expenditures reported and to propose reforms during the course of budget negotiations.

Accessible tax expenditure reporting

A tax expenditure report should be *readily accessible to the public*. It should be available at no cost or at a low cost which does not preclude broad public access. The full tax

[17] Income Tax Law (Mexico Federation) (2010), Article 28.

expenditure report, including tables and all revenue estimates, should be available on the website of the government's central budget agency. A summary of the tax expenditure report, identifying key tax expenditures and the current year revenue estimate, should be prepared.

Note, above in Example 2.11, that the Mexican Treasury is required to publish its tax expenditure report on the website each year. The same approach is taken in Australia, and in most other OECD countries that publish tax expenditure reports.

At least, key tax expenditures should be reported in publicly accessible budget papers or summaries.

2.6 Tax expenditure reporting in federal systems

Ideally, tax expenditures should be reported by each level of government in a country, including central, provincial, regional and local governments. Each level of government is likely to impose some taxes and administer some tax expenditures. The State or local government tax expenditures may be significant in terms of tax revenue foregone, and may also have a big impact on local spending capacity of governments.

The central government is usually best placed to manage aggregated reporting of tax expenditures across all levels of government. This would assist each level of government with better management of their respective tax expenditures and would provide the public and civil society groups with a 'big picture' of the overall tax system in the country.

In practice, reporting of tax expenditures by sub-national levels of government is done much less, and is less well done, than reporting by national governments. This is the case even in wealthy countries with significant resources in the Treasury for tax expenditure management. The Centre for Budget and Policy Priorities in the US recently did a major analysis of US State reporting of tax expenditures, and concluded:[18]

> Some state tax expenditure reports are much better than others, but every state could improve its practices in this area. Oregon, Minnesota, and Connecticut publish relatively comprehensive and informative reports that could serve as a model for other states. Among the least useful reports are those issued by Arkansas, Maryland, and Rhode Island, because they omit major taxes, fail to provide cost estimates and other key information for many tax expenditures, and/or are not available online. Nine states fail to publish a tax expenditure report at all, meaning that citizens have no way of knowing on an ongoing basis what the state is spending or what policies it is pursuing through the tax code.

One way for governments to improve tax expenditure reporting in federal systems could be for the central government to identify the key state or local level taxes, and tax exemptions or subsidies in a general report. It could then seek to require that a minimum level of identification and tax expenditure estimating of only a few key items be done by the state or local government in its reporting to the central government.

[18] Levitis, Johnson & Koulish (2009), p. 2-3.

Chapter 3 History and global practice of tax expenditure reporting

Summary

This chapter briefly examines the history and development of the tax expenditure concept and sets out the main approaches adopted globally. It then surveys tax expenditure management in countries around the world.

The chapter also examines the views of the international financial institutions, including the IMF, World Bank, OECD, and the International Public Accounts Standards Institute, concerning why they support tax expenditure reporting.

This chapter surveys tax expenditure management in countries around the world, and in particular, in countries covered in the International Budget Project's Open Budget Index (OBI) 2010. Tax expenditure reporting is increasingly widespread, but it is still not applied or well understood in many countries. Out of 94 countries who participated in the OBI 2010 Index, only 36 provided any data on tax expenditure reporting. A summary of the tax expenditure reporting in those countries is in Appendix 1 to this report. Where available and accessible, links to government budget sites or tax expenditure reports for countries are set out in Appendix 2.

As well, a number of other countries which are not surveyed in OBI 2010 carry out tax expenditure reporting, including most OECD countries, in addition to other practices relevant to open budgets. Examples of countries that report tax expenditures and have reasonably good budget practices, but that are not surveyed in OBI 2010, are Australia, Canada, Japan and Denmark.

3.1 History of tax expenditure reporting

Tax expenditure reporting began in the late 1960s on opposite sides of the Atlantic Ocean at about the same time. In Germany, the Treasury has since 1967 published a report on tax subsidies and preferences (*1er Subventionsbericht*). In the United States, the first tax expenditure report was prepared by the US Treasury in 1968. In 1974, the US budget law required the US Treasury to report all federal tax expenditures annually in the budget.

During the 1970s, some international organizations including the International Fiscal Association, brought together tax experts from different countries to examine the concept of tax expenditure reporting. After this, tax expenditure reporting began to be adopted by a number of other countries, including Austria in 1978, Canada and France in 1979, Spain in 1979 and Australia in 1982. Some countries started reporting tax expenditures, for example New Zealand in 1984, and then stopped; New Zealand in 2010 recently began reporting tax expenditures again. One reason that New Zealand stopped reporting tax expenditures was because it carried out major tax reforms in the 1980s that removed many incentives from its tax law.

3.2 Views and recommendations of international financial institutions

The IMF (2007), World Bank (2004) and OECD (2002, 2010) all recommend that a government should estimate and report at least key tax expenditures.

International Monetary Fund

The IMF has recently emphasized that legislatures need to know about different kinds of "off-budget" spending, including tax expenditures. In its *Manual on the Role of the Legislature in the Budget Process*, the IMF states (2010, p. 13):

> Tax expenditures can be another form of off-budget spending. Tax expenditures are exemptions and other tax concessions that fall outside the usual benchmarks for taxes. They are adopted to provide a benefit to a specific activity or class of taxpayer. Although there is a debate on how to measure tax expenditures, given their quasi-budgetary nature, parliament needs to be informed as to their amplitude, so as to exercise control over their size.

The IMF states that if the government ultimately decides to introduce a new tax expenditure (tax exemption, credit or deduction), this should be done as part of the normal budget cycle, alongside regular budget spending. This will help the parliament scrutinize the proposal and decide if it is the best policy (2010, p. 13).

The IMF *Manual on Fiscal Transparency* also recommends that governments should report tax expenditures to ensure full budget transparency (2007, para. [187]):

> An important difference compared with expenditure programs is that tax expenditures do not require formal annual approval by the legislature (though some may be subject to sunset clauses); they remain in effect as long as the tax law is unchanged, and are therefore not subject to the same regular degree of scrutiny as actual expenditure. A proliferation of tax expenditures can therefore result in a serious loss of transparency.

Consequently, the IMF recommends that the government budget or other fiscal papers should include a statement of the main central government tax expenditures. The statement should set out the public policy purpose of each provision, its duration, and the intended beneficiaries. Fiscal estimates of the revenue foregone from major tax expenditures should be provided and compared with the estimated results of previous tax expenditures compared with their policy purposes. This helps in assessing the effectiveness of tax expenditures compared to expenditure provisions.

Example 3.1 - IMF Focus on Tax Expenditures in Eastern Europe

The IMF monitors country fiscal transparency in its fiscal Report on Standards and Codes (ROSC) process. Recently, the IMF has sought to encourage suitable tax expenditure reporting in a number of Eastern European countries, if this would suit the overall budget and tax situation of the country. Most country Fiscal ROSCs are available from www.imf.org .

(a) ESTONIA: Setting a good example

The Fiscal ROSC for Estonia (2009, p. 10) notes with approval that the Estonian Ministry of Finance has recently initiated a study of the major deductions and exemptions against tax liabilities. Although no estimates of the cost of tax expenditures are currently done by the Estonian government, the IMF notes that relative to international experience, the extent of deductions and exemptions is small in Estonia. The Estonian Ministry of Finance is beginning to establish a definition of tax expenditures that would include, in relation to personal income tax, the deductions for mortgage interest; child allowances; student loan interest deductions; and education deductions. In relation to VAT, tax expenditures would include a small number of items taxed at the concessional 5 percent rate (books, newspapers, and hotel accommodation).

(b) BULGARIA: A lack of transparency in tax expenditures

The Fiscal ROSC for Bulgaria (2005, p. 26) observed that Bulgaria did not do any tax expenditure reporting. The IMF recommended that a statement of tax expenditures should accompany the annual budget, including a list of all tax expenditures and any existing estimates of their fiscal impacts. To move toward international best practice, the statement should be progressively expanded over time to include the public policy purpose, duration, intended beneficiaries and fiscal impact of each tax expenditure. Bulgaria scored 56 in the OBI 2010 survey, and it provides some public budget reports. However, Bulgaria still does not provide tax expenditure reports.

(c) ALBANIA: Very poor budget transparency

The IMF was critical of Albania in its Fiscal ROSC for not releasing any information on tax expenditures to the parliament or the public (2003, paras [19], [44]). It said that "the costs of tax relief measures are thus not rigorously accounted for and not subject to scrutiny by parliament and the public, limiting transparency and accountability". Unfortunately, in the OBI 2010 survey, Albania scored very low, and it provides only minimal budget information to the public. Albania still does not publish a tax expenditure report.

World Bank

The World Bank emphasises good budget practices, with a particular goal of ensuring good public expenditure management and management of foreign aid and debt. In a recent volume on budgeting, the World Bank states that like other government lending and other items of fiscal policy, tax expenditures "should be transparent and included in the budget" (Shah, 2007: p. 80).

The World Bank is currently developing a Public Expenditure Diagnostic Toolkit which includes several questions about tax expenditures.[19] One important question that the Toolkit asks is "how significant are tax expenditures as a percentage of total budgeted expenditure?" (Qu 2.5.11). Some examples of the fiscal significance of tax expenditures as a proportion of total direct expenditure are in Table 1.1 above. The Toolkit also asks "do the estimates of new public policy proposals cover tax expenditures?" (Qu 2.6.4d).

The Public Expenditure Toolkit being developed by the World Bank includes a Table which may be a useful way for civil society organisations to track who knows about different kinds of off-budget fiscal operations, including off-budget funds, physical assets of the government, financial assets, and tax expenditures.

Table 3.1, below, extracts key questions from the World Bank table, and targets them to tax expenditures. A civil society group that is aiming for fiscal transparency about tax expenditures should try to specify for their country the details set out in Table 3.1. If they cannot answer these questions, it is clear that increased transparency and reporting is required by the government.

3.3 Current Practice in OECD countries

Most OECD member country governments conduct some form of tax expenditure reporting. A recent OECD report (2010) examines tax expenditure reporting in the countries of Canada, France, Germany, Japan, Korea, The Netherlands, Spain, Sweden, the United Kingdom and the United States.

The OECD has done an international comparison of tax expenditures in these countries, as a percentage of GDP. Table 3.2 presents the summary table compiled by the OECD comparing these tax expenditures.

[19] See http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPUBLICSECTORANDGOVERNANCE/EXTPUBLICFINANCE/EXTTPA/0,,contentMDK:20237087~menuPK:2090883~pagePK:148956~piPK:216618~theSitePK:390367~isCURL:Y,00.html

Table 3.1: Who Knows What About Tax Expenditures?

	Tax Expenditures	**Action taken**
Who keeps account of tax expenditures?	(specify agency)	If yes, what action is taken? How is accounting carried out?
Who manages financial control of tax expenditures?	(specify agency)	
To which government agency are tax expenditures reported?	(specify agency)	How is report done? What is content of report?
Who audits tax expenditure reporting and management?	(specify audit agency)	How is audit managed?
Are tax expenditures reported to Cabinet?	(Yes/No)	How is report done? What is content of report?
Are tax expenditures reported to Parliament?	(Yes/No)	How is report done? What is content of report?
Are tax expenditures reported to the public?	(Yes/No)	How is report done? What is content of report?
Are tax expenditures reviewed by the media and/or civil society organisations/ NGO's?	(Yes/No/Which organizations?)	How is review done? How does government hear views about tax expenditures?

Source: World Bank (with author variations)
http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPUBLICSECTORANDGOVERNANCE/EXTPUBLICFINANCE/EXTTPA/0,,contentMDK:20237087~menuPK:2090883~pagePK:148956~piPK:216618~theSitePK:390367~isCURL:Y,00.html

Table 3.2: Tax Expenditures in Selected OECD Countries

Table II.29. International comparison of tax expenditures (% of GDP) †

Latest actual year available

	Canada (2004)	Germany (2006)	Korea (2006)	Netherlands (2006)	Spain (2008)	United Kingdom (2006)	United States (2008)
*Purpose of tax expenditure, income tax**							
General tax relief	0.00	0.00	0.05	0.00	0.00	0.00	0.00
Low-income non-work related	0.02	0.00	0.03	0.00	0.04	0.09	0.11
Retirement	1.68	0.00	0.02	0.06	0.17	2.32	1.02
Work related	0.39	0.03	0.03	0.06	0.01	0.15	0.07
Education	0.12	0.00	0.12	0.06	0.00	0.00	0.13
Health	0.27	0.00	0.29	0.00	0.00	0.00	1.05
Housing	0.20	0.18	0.05	0.05	0.41	1.20	1.05
General business incentives	0.41	0.00	0.68	0.48	0.52	0.77	0.41
Research & development	0.24	0.00	0.15	0.07	0.03	0.04	0.09
Specific industry relief	0.05	0.01	0.18	0.18	0.04	0.11	0.23
Intergovernmental relations	1.55	0.03	0.00	0.00	0.00	0.00	0.63
Charity	0.21	0.00	0.13	0.09	0.02	0.09	0.33
Other	0.02	0.00	0.02	0.01	0.17	0.12	0.09
Total	5.16	0.26	1.75	1.06	1.41	4.90	5.21
Capital income taxation							
Accelerated depreciation	0.00	0.00	0.00	0.00	0.00	1.40	0.35
Interest	0.00	0.00	0.00	0.00	0.00	0.02	0.01
Dividends	0.27	0.04	0.00	0.00	0.00	0.00	0.02
Capital gains	0.35	0.00	0.00	0.00	0.16	1.65	0.33
Subtotal	0.62	0.04	0.00	0.00	0.16	3.07	0.70
Total	5.77	0.29	1.75	1.06	1.57	7.97	5.91
Make work pay provisions	0.01	0.00	0.01	0.04	0.74	0.35	0.06
Total	5.78	0.29	1.76	1.10	2.31	8.32	5.97
Non-income tax related	1.16	0.45	0.72	0.90	2.25	4.47	0.00
Total	6.94	0.74	2.48	2.00	4.55	12.79	5.97
Structural items	3.22	0.00	0.03	0.00	0.28	4.24	0.20
*Income tax expenditures by type**							
Credits	1.44	0.00	0.02	0.06	0.34	1.52	0.34
Deductions, exemptions & exclusions	2.64	0.28	1.70	0.80	1.61	4.92	4.63
Deferrals	1.50	0.00	0.00	0.05	0.00	1.47	0.80
Reduced rates	0.21	0.01	0.04	0.19	0.36	0.41	0.20

† For every country except for Canada and Spain, fiscal years rather than calendar years are used. For the United Kingdom, fiscal year 2006-07 is used (from 6 April 2006 to 5 April 2007).

* Classification of income tax expenditures by purpose and by type is to some degree arbitrary.

Source: OECD (2010).

Chapter 4 Country Case Studies

Summary

In this chapter, we examine in more detail the experience and processes of tax expenditure management in four countries: India, South Africa, Chile and Brazil.

The purpose of this chapter is to show how particular country approaches to tax expenditure management have developed over time, and the differences and similarities in approach.

Our research has identified that it is the emerging economies with democratic governments that have established increasingly strong tax expenditure reporting in the last decade. It is noteworthy that each of India, South Africa, Chile and Brazil have recently significantly strengthened their tax expenditure reports. Civil society advocates in these countries can draw on their government reports to help them participate in public debate about the budget, while also advocating for improvements in tax expenditure reporting.

Each of these countries applies a clearly expressed approach to tax expenditures which is consistent with the approach taken by other countries. However, each country also relies on its own unique legal framework and approach in presenting tax expenditures to the public. The countries also have some different priorities in tax expenditure reporting. These case studies provide some useful examples of how developing country governments could improve their tax expenditure management in different ways.

It is important to remember that detailed tax expenditure analysis requires significant governmental resources and expertise in the Treasury or Finance department. Civil society groups could push governments with fewer resources to prepare a minimal, basic tax expenditure report that sets out some key information and basic estimates. The goal could be to increase expertise over time if resources become available. Even a basic tax expenditure report can be very useful for budget transparency.

4.1 India

India is a good example of an emerging country with a significant, growing economy, adopting a transparent budget reporting scheme, including reporting on tax expenditures. India is a very large, democratic country (population 1.18 billion), with considerable pressure upon its resources and political processes but with significant economic growth. India has been quite successful in establishing a robust and transparent approach to fiscal measures.

India has a federal system of government and has significant taxing and spending at both provincial and federal levels. The federal nature of India has created a unique fiscal environment. Provinces are responsible for levying a Value Added Tax (VAT), whilst the national government imposes personal income and corporate taxes.

A tax expenditure analysis was first carried out for India by an independent scholar, thirty years ago (Gupta, 1981; and see an even earlier analysis by Bagchi, 1974). Today, the Indian government publishes annually in its budget papers the *Statement of Revenue Foregone under the Central Tax System*. The current approach to reporting tax expenditures was proposed in 2003, under the authority of the Fiscal Responsibility and Budget Management Act (2003) and Fiscal Responsibility and Budget Management Rules (2004). The Act was enacted as part of a widespread fiscal reform designed to tackle the growing budget deficit at that time. More generally, it requires statements of fiscal and economic strategy, and the medium-term economic framework, to be put before the legislature each year, including the monitoring of all taxes and expenditures.

The Minister for Finance first presented the *Statement of Revenue Foregone* in the 2006-07 Union Budget taking account of various tax exemptions. For the most recent *Statement,* published in both Hindi and English.[20] The contents of this Statement are regularly reviewed by the Ministry of Finance and the Standing Committee on Finance. The Indian government also established a Task Force to report on reforms to improve revenue collections.

The *Statement of Revenue Foregone* reveals some aspects of distributional effects of tax expenditures but does not explicitly analyse them. It demonstrates that tax expenditures preferring the corporate sector are significantly greater than tax expenditures in the non-corporate and individual sector. Some details extracted from the Indian *Statement of Revenue Foregone 2010-11* are below.

Goal of tax expenditure reporting in India

It is the goal of the *Statement of Revenue Foregone* to monitor and assess tax expenditures. A Fiscal Policy Strategy Statement of the Indian Government outlines the future direction the Indian Government intends to take regards some of these expenditures. It states:

> Government realizes that a number of tax incentives increase the deadweight costs, distort resource allocations and stunt productivity. On the other hand, keeping the need to promote the social and regional development goals of the Government and the need to provide special incentives to targeted groups, tax expenditures may still be justified and on that count some exemptions may be required to be retained for a longer period than others.[21]

[20] India, 2009-10 Union Budget, Statement of Revenue Foregone under the Central Tax System, available at http://www.indiabudget.nic.in/ub2009-10/statrevfor.htm
[21] India, 2009-10 Statement of Revenue Foregone, ibid, p 14.

In its *Statement of Revenue Foregone 2011-12*, the Indian government states:[22]

> The main objective of any tax system is to raise revenues to fund Government expenditures. The amount of revenue raised is determined to a large extent by tax bases and tax rates. It is also a function of a range of measures – special tax rates, exemption, deductions, rebates, deferrals and credits – that affect the level and distribution of tax. These measures are sometimes called 'tax preferences'. They have an impact on Government revenue (ie they have a cost) and reflect the policy choices of the Government.

Some have noted that the prevalence of tax exemptions has meant that in the past there have been substantial variations in the effective tax rate paid in different industries and sectors.[23] The proliferation of tax exemptions has been noted as distorting investment decisions and allocative efficiencies of the Indian economy.[24]

The Indian Task Force on Fiscal Reform considers that tax expenditures can be justified when they are more cost effective than a direct expenditure program, are appropriately targeted to pursue government policy, avoid economic disruptions, do not unduly compromise the vertical and horizontal equity principles of taxation, do not unnecessarily complicate the tax structure, and correct market failures.[25]

Definition and types of tax expenditures

The Indian *Statement on Revenue Foregone* defines tax expenditures as:[26]

> Tax preferences may be viewed as subsidy payments to preferred taxpayer such implicit payments are referred to as 'tax expenditures' and it is often argued that they should appear as expenditure items in the Budget. In this context, the basic issue is not one of tax policy but one of efficiency and transparency – programme planning requires that the policy objectives be addressed explicitly; and programme budgeting calls for the inclusion of such outlays under their respective programme headings. Tax expenditures are spending programmes embedded in the tax statute.

The Consultative Committee to the Indian Ministry of Finance defines tax expenditures further as reducing the amount of taxes to be paid by certain individuals or entities producing foregone tax revenues. In this sense, the fiscal effects of tax expenditure are just like those of direct government expenditure or grants.[27]

Data and Method used for estimating tax expenditures

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[22] India, 2011-12 Union Budget, Statement of Revenue Foregone under the Central Tax System, p. 1, available at http://indiabudget.nic.in/index.asp .
[23] Poirson, Helene '*The Tax System in India: Could Reform Spur Growth?*', IMF Working Paper 06/93, 2006.
[24] Poirson, ibid., p 15.
[25] India, 2009-10 Union Budget, Statement of Revenue Foregone, above n 20, p 3.
[26] India, 2010-11 Union Budget, Statement of Revenue Foregone under the Central Tax System, annex 12, p 1.
[27] India Ministry of Finance, 'A Note on Tax Expenditures', 4th Meeting of the Consultative Committee (2007).

The Indian government uses the revenue foregone method of estimating the cost of individual tax expenditures. The Union Budget provides a projection of the revenue foregone of existing tax expenditures in their present state for two years: the current year and an estimate for the next year. There is no forecast of revenue foregone from proposed future tax expenditures. Since 2009-10, the revenue foregone is estimated by indicating the potential revenue gain that would be realized by removing the relevant tax expenditure. This method, and its limitations, are explained in the 2011-12 Statement as follows (p. 1):

> The revenue foregone on account of such tax incentives has been estimated in respect of most items of tax preferences. The estimates are for financial year 2009-10, the most recent year for which data is available. However, an attempt has also been made to estimate the revenue loss during financial year 2010-11 on the basis of the revenue foregone figures of the financial year 2009-10 projected on the provisional collection figures for 2010-11. The estimates of the tax expenditures have been made on the basis of the following assumptions:
>
> (a) The estimates and projections are intended to indicate the potential revenue gain that would be realized by removing exemptions, deductions, weighted deductions and similar measures. The estimates are based on a short-term impact analysis. They are developed assuming that the underlying tax base would not be affected by removal of such measures. As the behaviour of economic agents, overall economic activity or other Government policies could change along with the elimination of the specific tax preferences, the revenue implications could be different to that extent.
>
> (b) The cost of each tax concession is determined separately, assuming that all other tax provisions remain unchanged. Many of the tax concessions do, however, interact with each other. Therefore, the interactive impact of tax incentives could turn out to be different from the revenue foregone calculated by adding up the estimates and projections for each provision.

In the Statement of Revenue Foregone, the Indian Ministry of Finance also estimates the *effective tax rate* of various types of corporate tax payer, compared to the nominal tax rate for companies of 30%. The effective tax rate is the result of the definition of the tax base, including all tax exemptions, preferences and so on, which would be counted as tax expenditures.

The Indian government estimates its total revenue foregone from tax expenditures in relation to corporate income tax, personal income tax, excise duty and customs duty, relative to the tax collections for these taxes. This is presented in Table 4.1 below.

Table 4.1 Indian Total Revenue Foregone from Tax Expenditures, Estimates 2009-10.
(Crore rupees) (a)

	Revenue foregone in 2009-10	Actual tax collection in 2009-10	% relevant tax collection 2009-10 (*author calculation, rounded*)	Revenue foregone in 2010-11	Estimated tax collection in 2010-11
Corporate income tax	72881	244725	30%	88263	296377
Personal income tax	45142	132832	34%	50658	149066
Excise duty	169121	102858	164%	198291	133300
Customs duty	195288	85847	227%	174418	131800

Source: Statement of Revenue Foregone 2010-11, Budget annex 12, Table 12, p. 33
(a) 1 Crore = 10 million

Tax expenditures: Income tax

The main express tax expenditures in India include:

- exemptions for income and exemptions from long-term capital gains
- incentives for regional/industrial development to encourage industrial growth
- incentives for foreign exchange earnings/export of goods and services
- exemptions for promotion of charitable, religious organizations and other non-profit organizations
- incentives for promotion of scientific research and development
- exemption for income of funds on the basis of their being pass-through entities
- exemptions for promotion of welfare of armed services personnel and
- accelerated depreciation for capital investment.

The *Statement of Revenue Foregone* 2011-12 identifies and estimates the revenue cost of 39 major tax expenditures of corporate taxpayers (p. 22 Table 5). The aggregate cost of corporate tax expenditures is estimated for the 2009-10 year to be 72,881 Crore[28] rupees and projected estimate for the 2010-11 year is 88,263 Crore rupees.

Some examples and estimates for the larger tax expenditures are extracted in Table 4.2 below. The largest corporate tax expenditure is identified as accelerated depreciation, at a revenue cost of 29,308 Crore rupees in 2009-10.

[28] A crore (often abbreviated cr) is a unit in the Indian numbering system equal to ten million (10,000,000), or 100 lakh. It is widely used in India, Bangladesh, Nepal, and Pakistan. Large money amounts in India are often written in the form " 23 cr", that is, 23,00,00,000 rupees (230,000,000 or 230 million in Western notation). (see, eg, http://www.kosmix.com/topic/crore#ixzz1FmelC8VV)

Table 4.2 Examples of Indian Corporate Tax Expenditure Estimates
(Crore rupees) (a)

Item No.	Nature of Incentive	Revenue foregone 2009-10	Projected revenue foregone 2010-11
3	Deduction of export profits of units located in Special Economic Zones (sections 10A and 10AA)	4233	5126
8	Accelerated Depreciation (section 32)	29,308	35,494
11	Deduction on account of donations to charitable trusts and institutions (section 80G)	554	671
17	Deduction of profits of undertakings engaged in providing telecommunications services (section 80-IA)	3510	4251
18	Deduction of profits of undertakings engaged in generation, transmission and distribution of power (section 80-IA)	7236	8763
22	Deduction of profits of industrial undertakings located in Jammu and Kashmir (section 80-IB)	217	263
28	Deduction of profits of industrial undertakings derived from housing projects (Section 80-IB)	986	1194
36	Deduction of profits of undertakings set-up in Himachal Pradesh (section 80-IC)	2127	2576
38	Deduction in respect of employment of new workmen (section 80JJAA)	29	35

Source: Indian Ministry of Finance, Statement of Revenue Foregone 2011-12, Table 5 p. 22.
(a) 1 Crore = 10 million

Table 4.2 provides a lot of useful information about tax expenditures, even though the revenue foregone estimates must be treated with caution. Information that can be useful to civil society groups in this Table includes:

- The Table reveals the relative revenue cost of different tax preferences or tax breaks. In particular, it reveals the largest tax expenditures, such as accelerated depreciation. This may indicate some questions that could be asked of the government about this tax expenditure. For example, how many large businesses, compared to small businesses, benefit from this tax relief?
- The Table identifies the brief title and legislative section under which the tax expenditure is provided. It does not, however, contain a summary explanation of what the tax expenditure does, which would be useful for civil society groups.

- The Table reveals that many Indian tax expenditures relate to targeted concessions for special economic zones, or particular geographic areas that the central government targets to assist in economic development.
- The Table reveals that particular industrial sectors, such as telecommunications, power or mining, benefit from large tax expenditures.

The Indian government also provides further information about the benefit derived from particular industries from tax expenditures, through a lower effective tax rate. For example, IT agencies have only a 15% effective tax rate and Software development agencies have only an 18% effective tax rate.

The Statement of Revenue Foregone also estimates major tax expenditures for individuals. Some examples are extracted in Table 4.3. The estimates are based on a sample of about 35.3 Crore (353 million) individual tax returns. The total estimated revenue foregone from major individual tax expenditures is 40,297 Crore in 2009-10.

Table 4.3 Examples of Indian Individual Tax Expenditure Estimates
(Crore rupees) (a)

Item No.	**Nature of Incentive**	**Revenue foregone 2009-10**	**Projected revenue foregone 2010-11**
1	Deduction on account of certain investments and payments (section 80C)	33,348	37,424
2	Deduction on account of contribution to certain pension funds (section 80CCC)	227	255
4	Deduction on account of health insurance premium (section 80D)	1080	1212
5	Deduction on account of expenditure for medical treatment of a dependent who is disabled (section 80DD)	107	120
9	Deduction on account of rent paid for housing accommodation	74	83
11	Deduction on account of contributions given to political parties (section 80GGC)	170	191
13	Deduction of profits of undertakings engaged in development of Special Economic Zones in pursuance to SEZ Act, 2005 (section 80-IAB)	215	241
21	Higher exemption limit for senior citizens	1376	1544
22	Higher exemption limit for women	2272	2550

Source: Indian Ministry of Finance, Statement of Revenue Foregone 2011-12, Table 7 p. 22
(a) One Crore = 10 million

The tax expenditure in Item 1 of Table 4.3 is by far the largest single tax expenditure in the individual federal income tax. The description of this tax expenditure is not very informative, but in a Note to Table 7, the Statement provides that this covers "investments in various savings instruments, repayment of principal of housing loan and payment of tuition fees for children".

Indirect Taxation (customs, excise and service tax)

The bulk of Indian indirect tax expenditures are area-based exemptions, which are seen as exemptions used to promote regional development.

Excise tax expenditures include subsidies for:

- area-based exemptions
- health and family welfare
- defence and strategic sector
- goods for educational purposes
- goods for research and development and exhibitions
- supplies to UN projects
- diplomatic concessions
- export promotion, power generation, and environmental protection subsidies

Customs duty exemptions include exemptions for:

- inputs and intermediates for the Information Technology sector
- research and educational material
- computer literacy items
- items for sports
- export promotion related exemptions
- defence, security related imports
- machinery, equipment, parts for specified public transport projects
- petroleum exploration, research and development and
- exemptions for goods imported by United Nations, international organizations and diplomatic missions.

In 2005, the Indian government did a substantial reform of tax expenditures in customs duties. The Minister for Finance stated:

> Exemptions have revenue implications. But they do serve a number of objectives by ensuring that the imported goods are not only available but also at lesser cost. Exemptions also serve to stimulate domestic economic activity by creating a level-playing field. However, it is also true that exemptions once granted tend to continue even if the objective has since been met and even if alternative and more transparent mechanism is available for achieving the desired objective.[29]

For excise and customs tariffs, revenue foregone is calculated as the difference between duty that would have been payable but for the issue of an exemption notification, and the actual duty paid in terms of the relevant notification (the effective rate of duty. For example, if tariffs and effective rates of duty are levied in ad valorem rates:[30]

[29] cited in Standing Committee on Finance (2005-06) Fourteenth Lok Sabha, Ministry of Finance, *Widening the Tax Base and Evasion of Tax*, 33rd Report (February 2006), p. 18 para 29.
[30] 2010-11 Union Budget, Statement of Revenue Foregone under the Central Tax System, annex 12, p. 28.

Revenue foregone = Value of goods * (Tariff rate of duty – Effective rate of duty)

In 2009-10, the largest tax expenditures for customs duty was the exemption for animal or vegetable fats, estimated as 25,503 Crore rupees for 2009-10.[31]

The *Statement of Revenue Foregone* is useful in identifying that many customs and excise tax expenditures arise from specific export and regional incentive schemes (a total of 43,375 Crore rupees in 2009-10).

As customs reform takes place, this affects estimates of tax expenditures. For example, the government took advantage of a decision to reduce overall rates of duty, to review a number of exemptions in the 2005 Budget. As a result, 34 exemptions were removed from the customs duties law. The revenue foregone from customs tax expenditures reduces as the overall customs rates reduces.

Service tax exemptions include services provided to United Nations or other international organizations, as well as those on diplomatic missions on a reciprocal basis. Other specific exemptions include the interest component of specified banking and financial services, business auxiliary services in diamonds, gemstones and jewellery sectors, commercial or industrial construction service in relation to construction of ports and in relation to construction of roads, airports, ports and railways.

The *Statement* reveals that exemptions in customs and excise significantly exceed the tax base (see Table 4.1 above).

Successes, and limitations of the Indian Tax Expenditures Statement

The Indian *Statement of Revenue Foregone* contains significant useful information and data analysis of the direct and indirect tax systems levied by the central government. It is published annually to the legislature and the broader public as part of the annual Budget papers and this greatly enhances budget transparency.

A few ways in which the *Statement* could be further improved are set out below.

- The *Statement* currently estimates revenue foregone for the current Budget year and projected for the next year. Ideally, the *Statement* would be expanded in the future to deal with estimates over a period of 3 to 5 years, enabling comparison of importance of different tax expenditures over time.
- The *Statement* should identify in more detail each tax expenditure provision, and what it does (not merely by title and section reference). For example, the largest individual income tax expenditure is not well defined.
- The *Statement* should set out tax expenditure as a percentage of GDP and of total tax collection.
- The *Statement* should, ideally, set out the government's justification or reason why the tax expenditure exists in the tax law, and why this is the best policy solution. This could be done for just a few different tax expenditures in each year.

[31] Ibid., Table 10 Item 15.

- The *Statement* does not explicitly define the benchmark tax system for all of the taxes that it analyses. An explicit explanation of the benchmark would assist in tax policy analysis of the tax expenditures.
- The *Statement* contains some useful information about the distributional effect of tax expenditures, but does not discuss this directly. A distributional analysis of some key tax expenditures would be helpful.
- The *Statement* deals only with central government tax expenditures. However, India is a highly decentralized federation, and many of the States levy significant taxes and also provide significant tax incentives and exemptions. It is important to identify the provincial tax expenditures in those taxes.

4.2 South Africa

South Africa has made a significant effort in budget transparency in the last few years, and this is shown by South Africa's overall ranking of first place in the International Budget Partnership Open Budget Index of 2010. South Africa's transition to democracy has come with substantial efforts to emphasise fiscal transparency in the budget process.[32] As part of this effort, South Africa has succeeded in a moderate attempt at transparency in reporting on tax expenditures. As a leader in the region, South Africa has also influenced the activities of other countries to conduct significant fiscal reform in recent years.

As early as 1994, the *Katz Commission* argued that tax expenditure analysis would be useful in South Africa, but the commission was unable to quantify the cost of tax incentives "due to the lack of useful and accurate data and a serious manpower shortage in revenue offices." It concluded that the revenue cost of tax expenditures seemed to be substantial, and the inability to cost tax expenditures was "a most unfortunate development which must be changed if South Africa is to develop a rational tax policy".[33]

In 2002, an IMF delegation visited South Africa and issued a fiscal ROSC (Report on Observance of Standards and Codes: Fiscal Transparency). Following this visit, South Africa gave an undertaking to introduce a basic tax expenditure statement in its budget reporting. In 2003, for the first time, the South African government identified some major tax expenditures within its annual Budget Review, with intended further development towards a comprehensive quantitative statement on revenues foregone.[34] A list of tax expenditures was also included in the 2006 Budget. In the 2011 *Budget Review* paper, the objectives of a Tax Expenditure Statement are stated as follows:

- Increases fiscal transparency and accountability
- Creates comparability between direct and indirect government expenditures
- Assists in the design of tax policy by promoting and informing public debate.

[32] African Fiscal Transparency, South Africa, http://www.internationalbudget.org/resources/SAFRICA.pdf.
[33] Katz Report, par. 13.5.2, cited in Republic of South Africa, National Budget 2011, Budget Review Annex C, pp. 179ff available at: http://www.treasury.gov.za/documents/national%20budget/2011/review/Annexure%20c.pdf
[34] South Africa, Budget Review 2003, Summary of Tax Proposals, Annex C, p. 228.

In the 2011 Budget the Ministry of Finance included for the first time, a tax expenditure statement in the *Budget Review*. It also included a table of aggregate tax expenditures. The Ministry noted that tax expenditures, conservatively estimated, amounted to 3.4% of GDP and 12.5% of total tax revenue collected for the 2008/2009 year.[35]

Definition and measurement of tax expenditures

The detailed, current definition of tax expenditure in the South African Budget statement is extracted in Chapter 2 above. In general, tax expenditures have been defined in the annual South African Budget Reviews as any tax preference, including exemptions that exclude income from the tax base or allowances that are deductible from gross income, or a reduction in a tax rate, or a tax deferral that delays the payment of tax.[36]

Up until the 2009 Budget Review, tax expenditures were listed individually under the categories of personal income, corporate, estate duties and value-added taxes. The policy rationale for each exemption is listed alongside each one, enabling considerable transparency in the reporting process.

The *Tax Expenditure Statement 2011* states that it applies the revenue foregone method, but does not set out details about how revenue foregone is estimated.

In 2011, South Africa presents time series data for 4 years regarding tax exemptions (3 prior financial years and the current financial year). It does not do any forecasting of the future value that such tax expenditures will reflect in foregone revenue. The Budget Review refers only to existing tax expenditures, not future tax expenditures.

An extract from the South African Tax Expenditure estimates is in Table 4.4 below. Table 4.4 sets out some specific tax expenditures in the personal income tax, corporate income tax and VAT.

Personal income tax expenditures in South Africa include:

- deductibility of donations to public benefit organizations
- exemptions of scholarships, war and disability pensions
- reduced capital gains tax rate
- exemption on interest income
- deductions for contributions to pension funds and superannuation schemes
- exemptions for certain foreign dividends.

The rationale for justifying these tax expenditures was set out in the review. For example, the rationale for the contributions to pension funds is to provide long term budget relief for retiring employees.

[35] Republic of South Africa, National Budget 2011, *Budget Review* p. 64 and Annexure C, 179ff; available at: http://www.treasury.gov.za/documents/national%20budget/2011/review/Annexure%20c.pdf
[36] South Africa, Budget Review 2005, Summary of Tax Proposals, Annexure C, p 213.

Table 4.4 South Africa Tax Expenditure Estimates 2011 - Extract

Table C.1 Tax expenditure estimates - R million

	2005/06	2006/07	2007/08	2008/09
Personal income tax				
Pension and retirement annuity[1]	12 722	13 538	15 464	18 349
-pension contributions employees	*4 711*	*4 911*	*5 495*	*6 567*
-pension contributions employers	*5 298*	*5 523*	*6 180*	*7 386*
-retirement annuity	*2 713*	*3 105*	*3 790*	*4 397*
Medical	9 155	12 841	5 753	6 742
-medical contributions & deductions employees	*3 521*	*4 939*	*5 753*	*6 742*
- medical contributions - employers [2]	*5 634*	*7 902*	*n/a*	*n/a*
Interest exemptions	1 290	1 715	2 283	3 033
Secondary rebate (65 years and older)	739	739	769	828
Donations	141	178	230	282
Capital gains tax (annual exclusion)	74	98	121	69
Total: Personal income tax	**24 122**	**29 109**	**24 620**	**29 303**
Corporate income tax				
Small business corporation tax savings	178	627	747	675
Research and development (R &D)	183	313	286	219
Learnership allow ances	179	221	324	193
Strategic Industrial Policy[3]	513	281	228	61
Film incentive	186	194	319	n/a
Urban development zones (UDZ)	28	65	90	85
Total: Corporate income tax	**1 267**	**1 701**	**1 995**	**1 233**
Value-added tax				
Zero-rated supplies				
19 Basic Food items[4]	10 036	11 376	13 107	13 907
Petrol[5]	6 837	7 763	9 176	10 524
Diesel[5]	586	736	948	1 249
Paraffin[5]	430	454	516	520
Municipal property rates	–	2 618	3 008	3 774
Reduced rates for "commercial" accommodation	80	85	95	113
Subtotal: zero-rated supplies	**17 969**	**23 032**	**26 849**	**30 086**
Exempt supplies (Public transport & education)	**604**	**682**	**785**	**832**

Source: Republic of South Africa, National Budget 2011, *Budget Review* Annexure C, p. 181, Table 12, http://www.treasury.gov.za/documents/national%20budget/2011/review/Annexure%20c.pdf

Corporate income tax expenditures listed in Table 4.4 above include incentives for films; special urban development zones; small business concessions; and research and development. Some additional corporate income tax expenditures listed in the South African Budget review carried out in 2006 include:

- tax deductions for mining corporations
- deduction of insurance premiums
- capital allowances for strategic industrial projects
- accelerated depreciation for research and development buildings.

Most of the policy rationales for corporate income tax expenditures refer to stimulating industrial investment in particular areas or sectors, for example to encourage film production in South Africa, aid small business development, encourage research and development, or create employment and encouraging investment in general.[37]

[37] South Africa, Budget Review 2005, Annexure B, Table C.6, p215.

However, as noted in the *Tax Expenditure Statement 2011*, the most recent Statement misses some important tax expenditures. In particular, accelerated depreciation of business assets (especially mining assets) is not included in the Table, but is noted as being a potentially significant tax expenditure item.[38] It is stated that at present, data is not available to estimate this tax expenditure.

The **VAT law** in South Africa exempts certain services and goods from taxation. These are listed as including financial services, road and rail transport, education services and the supply of after school care or crèche. The reasons behind such exemptions are reported as being provided for administrative as well as relief-based purposes.[39]

Distributional Effects of Tax Expenditures

Some of the tax proposals named in the 2011-12 South African budget will have a clear distributional impact, for example:

- A change in personal income tax rates favouring lower income earners,
- Increased luxury car tax, which will impose a higher tax on higher income earners (a *negative* tax expenditure) and
- small business incentives that are of benefit to them relative to larger corporations.
- There is also a distributional benefit afforded to those entering retirement with deductions for contributions made to superannuation and pensions schemes.

An overall change in personal income tax rates would usually be defined as 'structural' in the income tax law and not a tax expenditure. However, the other measures listed above are tax expenditures for particular categories of taxpayer, or expenditure.

The *Tax Expenditure Statement 2011* also makes some comments on the distributional impact of tax expenditures. For example, it states in respect of the VAT exemption of food:[40]

> Estimates from the 2005/06 Income and Expenditure Survey by Statistics South Africa (StatsSA) suggest that the poorest 20 per cent of households accounted for about 7.9 per cent of total expenditure on food and non-alcoholic beverages, and the top 20 per cent of households accounted for 39.9 per cent. Assuming that the poorer households' share of expenditure that is VAT zero rated on the list of "basic food items" is slightly higher (about 10 per cent), the monetary benefit that accrued to them was about R1.4 billion (10 per cent of R13.9 billion) in 2008/09, while the upper 20 per cent of households received a benefit of R5 billion (about 36 per cent of R13.9 billion).This is not the most effective form of relief for the poor.

[38] Republic of South Africa, National Budget 2011, *Budget Review* Annexure C, p. 182, http://www.treasury.gov.za/documents/national%20budget/2011/review/Annexure%20c.pdf .
[39] South Africa, Budget Review 2005, Annexure B, Table C.8, p 216.
[40] Republic of South Africa, National Budget 2011, *Budget Review* Annexure C, p. 182, http://www.treasury.gov.za/documents/national%20budget/2011/review/Annexure%20c.pdf

In this statement, the government suggests that an exemption from VAT is not the most effective form of relief or subsidy for the poor. Alternatives, such as direct grants or transfer payments, or a reduction in other kinds of tax, may be more effective.

On the other hand, in many countries (including Australia and most European countries), basic foods are exempt from VAT for political and fairness reasons. Even if it is not expected that the government would reform the tax law so as to include VAT on food, it is still useful to estimate the revenue foregone from this major tax exemption from VAT. It shows that the tax base is not, ultimately, as broad as it could be, as a result of a structural tax policy decision by the government.

4.3 Chile

In Chile, there is a Constitutional reporting obligation for tax expenditures. This is similar to several other Latin American countries. The Constitution of the Republic of Chile, Article 19, para 22 requires that all the fiscal benefits provided through tax laws must be set out in the Budget Law every year:

> **Article 19 of the Constitution of the Republic of Chile**
> The Constitution guarantees every person:
> 22. No arbitrary discrimination by the State and its Agencies in economic matters. Only by virtue of law, and provided it does not produce such discrimination, may particular direct or indirect benefits in favour of some sector, activity or geographical zone be authorized, or special levies that affect one or another established. In the case of tax expenditures or indirect benefits, the assessment of the cost of such expenditures shall be annually included in the Budget Law. [41]

In keeping with this mandate, the Chilean Tax Administration (SII) conducts an annual estimate of tax expenditures. The annual tax expenditure report is included in the *Budget of Public Finances* published each year by the government. The Budget of Public Finances for 2011 was issued on October 2010 and it presents the estimate made by the Chilean Tax Administration for 2009 tax expenditures in the Income tax and VAT, and projections for 2010 and 2011.

Benchmark, definition and measurement of tax expenditures

Chile defines tax expenditures as a transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by a direct expenditure.

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[41] Republic of Chile Constitution, http://www.leychile.cl/Navegar?idNorma=242302 [Unofficial translation, Manuel Cardenas]: La Constitución asegura a todas las personas: …Para 22.- La no discriminación arbitraria en el trato que deben dar el Estado y sus organismos en materia económica. Sólo en virtud de una ley, y siempre que no signifique tal discriminación, se podrán autorizar determinados beneficios directos o indirectos en favor de algún sector, actividad o zona geográfica, o establecer gravámenes especiales que afecten a uno u otras. En el caso de las franquicias o beneficios indirectos, la estimación del costo de éstos deberá incluirse anualmente en la Ley de Presupuestos; …

The Chilean Finance Ministry sees the definition of a suitable benchmark for measuring tax expenditures as very important. For this reason, during the year 2011, the Finance Ministry will establish a Commission of Experts that will review the definition and assessment of the tax expenditures, analysing both the estimated amounts and the items included. The tax expenditure report which will be presented in 2011 will include the methodological recommendations made by the Commission, showing an historical sequence updated with the new methodology. A further discussion of the benchmark for tax expenditures in Chile is in chapter 5.

- **Income Tax (Personal Income Tax and Income Tax of Enterprises)**

Methodologically, the assessment of each tax expenditure is conducted independently; that is assuming that the other tax reliefs remain unchanged. However, the final totals incorporate the combined effect that is equivalent to the simultaneous repeal of the tax reliefs.

First, revenue foregone from each individual tax expenditure is estimated based on a simulation that redoes every taxpayer's income tax return declaration, adding to the taxable base the exempt income or deduction, or reversing the effect of a deferral of income.

Second, based on the aggregated data of the tax returns or income statistics, the basic data about cost of tax expenditure is obtained directly from the aggregated declarations or the tax revenue estimate and then adjustments are made to simulate the repeal of the tax relief.

- **Value Added Tax (VAT)**

In estimating the revenue foregone from tax reliefs in the VAT, the method incorporates a supposed change in behaviour by taxpayers: the repeal of a tax relief produces less income available to taxpayers, thereby also decreases their consumption subject to VAT (under the assumption that the total gross disbursement of the agents remains constant). Thus, the assessment calculates the VAT that would not be collected in the event of the repeal of each tax relief.

In the case of VAT, to estimate most of the exemptions, a 1996 model of non-deductible VAT based on the Input-Output Matrix (MIP) of the Central Bank of Chile, is used. This model operates based on the intersectoral sales and purchases associated to the 75 products comprising the MIP. The tax expenditure of each exemption is estimated recalculating the non-deductible VAT of the model and then extending the result to the universe of the tax collection.

Sample tax expenditure reports by Chile

Table 4.5 below is based on Table VII.4, drawn directly from Chile's 2011 Budget. It shows the projection of revenue foregone for tax expenditures for 2011, estimated in 2010, differentiating the tax expenditures by type of tax and type of tax relief.

Table 4.5 shows that for income tax, the revenue forgone from tax expenditures represents 3.5% of GDP, and this revenue is foregone mainly as a result of the preferential treatment in the form of tax deferrals. This is precisely the kind of tax expenditure which is not identified under a benchmark in which it was decided to treat consumption (expenses) as the benchmark instead of income. The next most important tax expenditures in terms of revenue foregone are deductions from the tax base, tax credits and exemptions and untaxed items.

The tax expenditures related to VAT are estimated at 0.77% of GDP, and arise from exemptions, untaxed items and tax credits.

Table 4.5 Total 2010 Tax Expenditures for Chile

2010 Tax Expenditure Report, Chile		
	2011 Millions US$	**% GDP**
Income Tax	**4.069.010**	**3,5%**
Special Regimes	179.215	0,15%
Exemptions	230.933	0,20%
Deductions	346.560	0,30%
Credits	277.382	0,24%
Tax deferrals	3.034.232	0,61%
Reduced rates	689	0,00%
VAT	**889.641**	**0,77%**
Exemptions and untaxed	469.133	0,40%
Credits	420.509	0,36%
Tax deferrals	0	0,00%
TOTAL	**4.958.652**	**4,27%**

Source: Chile, *Budget of Public Finances 2011*, Table VII.4

Table 4.6 below is based on Table VII.5 from the 2011 Budget, which shows the tax expenditure estimates for 2011, aggregated by sector or objective that each provision seeks to benefit.

It shows that 63.92% of the tax expenditures come from preferential treatments that aim to stimulate saving and investment. In second place are incentives to the Real Estate sector, which account for 9.96% of total tax expenditures, followed by Health with 6.92% and Education with 5.56%.

Table 4.7 below is based on Table VII.6 of the 2011 Budget. It shows Chile's estimated tax expenditures for the period 2009 to 2011, aggregated by type of tax. It shows that tax expenditures are concentrated mainly in the Personal Income Tax, reaching 2.33% of GDP in the estimate for 2011. The next most costly are in the Income Tax of Enterprises, with 1.17% of GDP and, finally, the tax expenditures related to VAT, estimated at 0.77% of the GDP.

Table 4.6 2011 Tax Expenditures for Chile by Sector

2011 Tax Expenditure (Sorted by sector or benefiting objective)			
Sector/Objective	**2011 Millions US$**	**% PIB**	**% TOTAL**
Savings & Investment	3.169.671	2,73%	63,92%
Real Estate	493.911	0,43%	9,96%
Health	343.289	0,30%	6,92%
Education	275.571	0,24%	5,56%
Promotion of MSEs	227.717	0,20%	4,59%
Sectors Remaining	212.089	0,18%	4,28%
Regional	86.410	0,07%	1,74%
Combined effects unallocated	62.762	0,05%	1,27%
Transportation	62.154	0,05%	1,25%
Insurance	22.025	0,02%	0,44%
Exporters	3.053	0,00%	0,06%
TOTAL	**4.958.652**	**4,27%**	**100,00%**

Source: Chile, Budget of Public Finances 2011, Table VII.5

Table 4.7 Chile estimated tax expenditures 2009-2011

Tax Expenditure 2009-2011						
	2009		**2010**		**2011**	
	Mill. US$	**% GDP**	**Mill. US$**	**% GDP**	**Mill. US$**	**% GDP**
(I) Income Tax	6.901	4,22%	9.375	4,65%	8.272	3,50%
A) Enterprises	1.722	1,05%	1.881	0,93%	2.771	1,17%
B) Persons	5.179	3,16%	7.494	3,72%	5.501	2,33%
(II) VAT	1.415	0,86%	1.543	0,77%	1.809	0,77%
TOTAL	**8.316**	**5,08%**	**10.918**	**5,42%**	**10.081**	**4,27%**

Source: Chile, Budget of Public Finances 2011, Table VII.6

Table 4.7 shows that over the period from 2009 to 2011, there was a significant decrease in tax expenditures in the Personal Income Tax, which in 2009 were estimated at 3.72% of GDP but in 2011 were estimated at only 2.33% of GDP. At the same time, we see a small increase in tax expenditures in the Income Tax on Enterprises, which in 2009 was estimated as 1.05% of GDP and in 2011 was estimated as 1.17% of GDP. These changes are explained mainly by an increase in the enterprise income tax rate from 17% to 20% at this time. This increase had the effect of reducing the difference between the enterprise income tax rate and the personal income tax rate. This caused a decrease in the personal tax expenditure from the deferral of business income in the hands of individuals.

Successes, and limitations of the Chile Tax Expenditures Statement

Chile has a well-established tax expenditure reporting process. It provides useful overall estimates and comparisons as well as analysis by government function and by industry. The Constitutional requirement for equality of treatment in economic revenues and expenditures provides a strong legal basis for tax expenditure reporting.

The Chile tax expenditure report is available on the web with other aspects of the budget papers each year. The report provides useful overall comparisons by industry sector. The Chilean tax expenditure report provides an overall analysis of tax expenditures across 3 years, which enables a comparison over time. However, it does not provide details of each tax law provision that establishes the exemption or other tax incentive, and its individual revenue cost. The report also does not provide a policy justification of all tax expenditures.

The Chilean government could improve its ongoing management of tax expenditures. For example, in respect of new tax expenditures, the law is subject to evaluation and justification only in the discussion of the Bill which creates the tax expenditure, and not on an ongoing basis. There do not appear to be any sunset clauses or other restrictions on new or existing tax expenditures.

4.4 Brazil

The Brazilian Federal Constitution of 1988 marks the settlement of the democratic regime in Brazil. The Constitution sets out the framework for the Brazilian tax system and the general rules concerning the federal budget and so it is the cornerstone of fiscal transparency in Brazil. As in Chile, there is an explicit obligation to present a public statement on tax expenditures in the annual federal budget. This obligation is in article 165, paragraph 6 of the Constitution, which states:

> **Brazil Constitution, article 165**
> 6. The draft budget bill shall be accompanied by a regional report on the effect on revenues and expenditures due to exemptions; amnesties; write offsets; subsidies; and benefits of financial, tax, and credit nature.

In 2000, the Law of Fiscal Responsibility (Complementary Law 101, of 4/May/2000), in its articles 5 and 14,[42] extended to the States and Municipalities the obligation of

[42] Brazil, Constitution [unofficial translation Livia Gonzaga] "Art. 5. The annual draft budget bill, drafted along with the pluriannual plan and with budgetary guidelines and regulations of this Complementary Law in a compatible way: (...)
II – shall be accompanied by the document referred to in §6 of Article 165 of the Constitution, as well as by the measures to compensate revenue waivers and the increase in compulsory expenditures that are continuous;"

presenting tax expenditure statements. Currently, the Secretariat of the Federal Revenues of Brazil (Receita Federal do Brasil, or RFB) is the administrative body responsible for issuing the annual statement on tax expenditures, which is entitled as "Report on Tax Expenditures" (Demonstrativo de Gastos Tributários – DGT) and is available for public consultation at the Secretariat's website.[43]

Definition of Tax Expenditures

In 2004, the RFB published an in-depth study on the concept of tax expenditures,[44] which included analysis of the reports presented by OECD member countries. This study showed that there were two important requirements that were similar in both the OECD and the Brazilian concepts:

(i) tax expenditures (being indirect government expenditure), and direct government expenditures, must have the same objectives, and as a result, both must have a budgetary justification and rationale; and

(ii) tax expenditures (in the broadest sense, meaning tax reliefs) are presented as a deviation from the regular tax system, therefore they must always be treated as specific in nature.

For the second requirement, the RFB considered that the three main principles for a good tax system are expressed in the principles of horizontal equity (taxpayers in comparable economic positions must be subject to comparable tax obligations), vertical equity or proportionality (taxpayers with higher incomes must be more heavily taxed than taxpayers with lower income) and neutrality (taxation must not imply changes in the allocation of resources in the economy).

The RFB considers that any tax reduction, concession or benefit that represents a deviation from these principles and, at the same time, had been set with the clear intention of promoting a governmental policy should be considered a tax expenditure. The only way to identify such deviations (and, therefore, identify a tax expenditure) is to

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"Art. 14. The concession or expansion of the tax incentive or benefit which results in a revenue waiver must be accompanied by the estimate of the budgetary-financial impact in the fiscal year when its validity must begin and the following two years, and it must comply with what is outlined in the LDO and meet at least one of the following conditions:
I – the proponent must prove that the waiver was taken into account in the revenue estimate of the budget bill, in the form of Article 12, and that it will not adversely affect the fiscal goals outlined in the same annex of the LDO;
II – it must be accompanied by compensation measures, in the period mentioned in the main article, by means of an increase in revenues stemming from an increase in rates, the broadening of the base for the estimate, and the increase in or creation of the tax or contribution." See Carvalho (2010).

[43] Brazil Secretariat of Federal Revenue (Demonstrativo de Gastos Tributários) *2011 Report on Tax Expenditures*, http://www.receita.fazenda.gov.br/publico/EstudoTributario/BensTributarios/2011/DGT2011.pdf. For previous reports see: http://www.receita.fazenda.gov.br/Arrecadacao/BenTributarios/default.htm .

[44] Brazil Secretariat of Federal Revenue, *Estudos Tributários n. 12 - Gastos Governamentais Indiretos, de Natureza Tributária – Conceituação*: http://www.receita.fazenda.gov.br/Publico/estudotributarios/estatisticas/25GastosTributarios.pdf .

clearly set out the structure and characteristics of a referential, or *benchmark,* tax system.

The RFB set out two steps to be followed in the identification of a tax expenditure: first, determine all tax reliefs based on a referential tax system, and second, using specifically designed criteria, evaluate which reliefs are true indirect exenditures and which could be successfully replaced by direct expenditures. These criteria have the purpose of providing more transparency to the qualification of tax expenditures, This analysis led to the elaboration of the new Brazilian concept of tax expenditure, that is described as follows:

> Tax expenditures are indirect government expenditures incurred through the tax system in order to achieve social and economic goals. They must be explicit in the rule that refers to the tax, constituting an exception to the referential tax system, thus reducing the potential tax collection and, consequently, increasing the taxpayer's economic availability. They are of compensatory nature when the government does not adequately provide the population with the services for which it is responsible, or may have an incentive nature when the government intends to develop certain economic sectors or regions.[45]

Measurement and Identification of Tax Expenditures

The main source of information for the assessment and calculation of the amount of tax expenditures in Brazil comes from individual and company annual tax returns. Brazilian annual tax returns have the requirement that each taxpayer declares and substantiates any tax benefits to which he receives or is entitled to, including regular fiscal benefits (such as exemptions, reductions and offsets established by the infra-constitutional tax rules) and tax immunities (a special sort of exemption that is constitutionally determined and can not be modified by infra-constitutional rules).

Some examples of tax expenditures in Brazil are:

- Tax exemption for paper used for printing of books;
- Exemptions and reductions applicable to companies that are established and operate in the Northern regions of the country (as an incentive for the development of these regions);
- Deductions applicable to the income tax due by companies that support or sponsor cultural and audiovisual activities;
- Deductions of medical, educational, pharmaceutical and study expenses (to a certain limit) incurred by the taxpayer for himself or any dependants, and deductions of the same nature for companies regarding the expenses with providing these benefits to its employees;

[45] Brazil Secretariat of Federal Revenue. *Estudos Tributários n. 12 - Gastos Governamentais Indiretos, de Natureza Tributária – Conceituação.* [Unofficial translation by Livia Gonzaga]: http://www.receita.fazenda.gov.br/Publico/estudotributarios/estatisticas/25GastosTributarios.pdf

- Tax exemptions applicable to the Manaus Tax-Free Zone, the Processing and Exports Zones, among others.

All these tax benefits have the common characteristic of being an incentive for the development of individuals or regions, which is part of the governmental policy as a whole.

The analysis of tax expenditures in Brazil is made based on the type of tax and the type of benefit. Brazil has three classes of taxes, namely "taxes", "fees" and "social contributions".

- A "tax" is a financial obligation that the taxpayer must pay, and the revenue from its collection may be applied according to the government's political discretion.
- A "fee" is an obligation imposed by the government in association with the rendering of a public service specifically determined.
- "social contributions" are the amounts that a taxpayer needs to pay in relation to compulsory social insurance.

As a result of fiscal federalism, these three categories of tax obligations may be imposed by each of the federal entities (Union, States and Municipalities). For example, the income tax (both on individuals and companies) is a federal tax. The Brazilian sales tax is divided into three different taxes imposed by the States and Municipalities.[46] The federal government is responsible for collecting most of the social contributions, and there are fees that may be charged by any level of government.

Tax expenditures may arise for each of these types of tax or charge. This complex structure is the reason why the assessment of the tax expenditure in Brazil is extremely detailed and involves different methods and calculations for each tax considered. The Brazilian tax authorities make a considerable effort in this regard towards the objective of fiscal transparency.

The general guidelines for the assessment of tax expenditure in Brazil may be summarized in the following items:

a) a list by type of taxes is drafted along with each type of benefit, which according to the concept used, will generate a tax expenditure;
b) the most adequate source of information is selected for this specific item;
c) the necessary information for the specific case is extracted; and
d) the estimate is made.[47]

In this assessment, the RFB also considers other variables, such as changes in the taxpayers behavior in face of the new situation introduced by the tax relief, and also the economic impact of such behavioral changes.

[46] IPI (Imposto sobre Produtos Industrializados – Tax on Industrialized Goods) – imposed by the federal government; ICMS (Imposto sobre a Circulação de Mercadorias e Serviços – Brazilian Excise Tax); and ISS (Imposto sobre Serviços – Tax on Services) – Imposed by Municipalities.
[47] Carvalho (2010), p. 8.

The 2011 *Report on Tax Expenditures* (RBF, 2011) contains detailed tables and charts which demonstrate the tax expenditures under a classification by tax and by each tax relief provided by the Brazilian Federal Tax Legislation. Not all Brazilian States have in their government's website a consolidated report on their own individual tax expenditure. The example Tables below relate to the federal tax expenditures based on the 2011 Report provided by the RFB, which is part of the Brazilian Annual Budget Act.

The total federal tax expenditures for Brazil in the fiscal year 2011 are estimated as R$116,082,902,877, representing 2.98% of GDP and 17.84% of total revenue managed by the RFB.[48]

According to the 2011 Report, the amount estimated for 2011 represents, in absolute numbers, an increase of 1.94% in comparison to 2010. This is due to some alterations made to the tax legislation and the introduction of new forms of tax reliefs, especially for digital inclusion incentives and stimulation of the civil construction sector. Of the total amount estimated for the country, the most representative regions were the Southeast region, known for its very well established industrial and services sectors, and the North region, a new industrial focus in Brazil.

From the perspective of budgetary functions, the tax expenditure estimates indicate a concentration of 76% in five specific budgetary governmental functions:

- trade and services: 27.3%
- industry: 17.4%
- health: 11.6%
- employment: 11.4%
- agriculture: 8.2%
- a little less than 24% is spread among other budgetary functions.

The tax expenditures in relation to Social Contributions for health and social insurance programs are assessed separately. For 2011, it is estimated as R$21,156,224,144, representing 0.54% of GDP and 8.30% of the social contributions revenue.[49]

The tables below present a summary of the federal tax expenditure in Brazil for the year 2011. Table 4.8 presents the tax expenditure estimates for 2011 sorted by tax. Table 4.9 presents the tax expenditure estimates for the goods and services tax. Table 4.10 presents the tax expenditures sorted by budgetary or departmental function.

[48] Brazil, 2011 Report on Tax Expenditures, p. 94.
[49] Brazil, 2011 Report on Tax Expenditures, pp. 94-95.

Table 4.8 Brazil Federal Tax Expenditure Estimates 2011 – by Tax

2011 TAX EXPENDITURE (SORTED BY TAX)			
Tax	**Estimated Amount (2011 – R$)**	**%**	
		GDP	**Total Expenditure**
Tax on Imports	2,363,084,053	0.06	2.04
Income Tax	45,682,508,680	1.17	39.35
Individuals	*16,831,945,877*	*0.43*	*14.50*
Business	*28,143,772,720*	*0.72*	*24.24*
Withholding Tax	*706,790,083*	*0.02*	*0.61*
Tax on Industrialized Products (federal GST)	19,607,536,166	0.50	16.89
Domestic Operations	*17,417,754,578*	*0.45*	*15.00*
Imports Operations	*2,189,781,588*	*0.06*	*1.89*
Tax on Financial Operations	1,297,010,864	0.03	1.12
Tax on Rural Properties	25,245,661	0.00	0.02
Social Contribution for PIS-PASEP	6,542,567,981	0.17	5.64
Social Contribution on Business Net Income	5,830,436,706	0.15	5.02
Social Security Contribution	34,617,996,829	0.89	29.82
Contribution for Intervening on Economic Dominance	116,515,937	0.00	0.10
TOTAL	**116,082,902,877**	**2,98**	**100**
GDP	**3,892,476,264,150**	**100**	

Source: 2011 Brazil Report on Tax Expenditures (Demonstrativo de Gastos Tributários – 2011).

Table 4.9 Brazil Federal Tax Expenditure Estimates 2011 – Goods and Services Tax[50]

TAX EXPENDITURE 2009 – 2010 - 2011					
2009		**2010**		**2011**	
Estimated Amount (R$)	**% of GDP**	**4.4.1.1.1 Estimated Amount (R$)**	**% of GDP**	**Estimated Amount (R$)**	**% of GDP**
101,956,496,783	3.20	113,875,428,613	3.42	116,082,902,877	2.98
GDP/2009: R$ 3,186,644,994,468		**GDP/2010:** R$ 3,326,524,958,625		**GDP/2011:** R$ 3,892,476,264,150	

Source: 2011 Brazil Report on Tax Expenditures (Demonstrativo de Gastos Tributários – 2011).

[50] The information in this table is a compilation of the data extracted from the 2009, 2010 and 2011 Reports on Tax Expenditure. Available at: http://www.receita.fazenda.gov.br/Arrecadacao/BenTributarios/default.htm

Table 4.10 Brazil Federal Tax Expenditure Estimates 2011 – by Budget Function

2011 TAX EXPENDITURE (BY BUDGETARY FUNCTION – BENEFITING OBJECTIVE)		
Budgetary Function	**Estimated Amount (2011 – R$)**	**Participation in Total Expenditure (%)**
Trade and Services	31,722,770,413	27.33
Industry	20,238,900,119	17.43
Health	13,500,748,169	11.63
Employment	13,241,278,172	11.41
Agriculture	9,590,050,857	8.26
Social Assistance	5,604,482,838	4.83
Science and Technology	5,179,965,119	4.46
Education	4,988,540,502	4.30
Energy	3,646,154,216	3.14
Habitation	3,078,526,500	2.65
Transport	2,315,358,144	1.99
Culture	1,724,405,936	1.49
Citizenship Rights	633,138,058	0.55
Sports and Leisure	403,700,678	0.35
Communications	180,693,271	0.16
Agricultural Organization	25,245,661	0.02
Public Sanitation	8,944,224	0.01
TOTAL	**116,082,902,877**	**100**

Source: 2011 Brazil Report on Tax Expenditures (Demonstrativo de Gastos Tributários – 2011).

Successes, and limitations of the Brazil tax expenditure report

The past two decades have seen a significant increase in fiscal transparency in Brazil, especially in respect of reports of tax expenditures. The constitutional obligation to disclose such data has proven to be effective. Annual reports on tax expenditures by the federal tax administration may be easily accessed at the RFB website, and the annual budget act is also available online, at the federal government website. These reports present a detailed picture of the Brazilian government's efforts towards economic and social development by explaining and quantifying the indirect investment represented by tax expenditures.

Unfortunately, the same level of transparency is not always applicable for the state and municipal authorities. The good example set by the federal tax administration by providing in its website the reports on tax expenditure, as well as research and studies on tax issues, should be followed by states and local administrations in order to help achieve the goal of fiscal transparency.

Brazil is well placed to increase the policy scrutiny on its tax system and to establish ongoing oversight and justification of existing tax expenditures, for example introduction of a sunset clause for some special regional concessions, while establishing a process to enable new tax provisions to be properly costed and scrutinised.

Chapter 5 Challenges in tax expenditure reporting

Summary

In this chapter we discuss some challenges and controversies regarding the definition, measurement and reporting of tax expenditures.

The purpose of this chapter is help readers gain a fuller appreciation of different approaches and views about the tax expenditure concept and its application. This chapter also aims to alert civil society groups and other commentators to the types of arguments they might confront when advocating a more robust tax expenditure management framework in their country.

5.1 Controversy about tax expenditures

This report shows that the tax expenditure concept is adopted by many governments and as explained above, has significant advantages especially because it has contributed significantly to discussion of budget transparency. On the other hand, the tax expenditure concept has also attracted considerable criticism. In all fields of public policy there are debates regarding objectives of public policy and also debates regarding the best approach to pursuing any particular public policy objective. Tax expenditures are no different.

Civil society advocates need to be aware of potential criticisms of the tax expenditure concept, and possible responses to those criticisms. Criticism of tax expenditure reporting may be self-interested, for example, when beneficiaries of tax expenditures resist exposure of such 'hidden' tax welfare. Criticism of the tax expenditure concept may also be motivated by a 'small state' political philosophy. Some argue that the adoption of a tax benchmark amounts to a claim that the government ought to raise more tax than it is raising under legislation created by a democratically elected legislature.

There are also some specific issues and problems with defining and measuring tax expenditures that need to be acknowledged. This chapter identifies some of the potential criticisms and limitations of the tax expenditure method when identifying the criteria for an adequate tax expenditure report by a government. No method for analysis or estimating of government expenditures is perfect, and it is important to understand the limits of any method of analysis, including tax expenditures.

Civil society organizations can expect to encounter criticisms with respect to:

- Definition of the benchmark tax law used for identifying tax expenditures;
- The method of measuring the revenue loss that results from tax expenditures; and
- Lack of comparability of tax expenditures with direct spending.

5.2 Defining the benchmark

As explained above, the tax expenditure concept involves an assessment that a tax rule or practice departs from the treatment that should apply under a benchmark tax system.

In practice, identifying the benchmark tax law can be problematic. Any tax law embodies tradeoffs between competing policy objectives and each trade off reflects a potentially controversial set of principles. It is unlikely that any benchmark will be accepted universally. It must be remembered that the absence of a universally accepted tax benchmark does not prevent the tax expenditure concept from being useful in enabling critical consideration of tax policy. In this regard, tax policy is no different from other types of government policies, which also involve tradeoffs and disagreements over ideals.

In defining the benchmark tax law, a tax expenditure report should explicitly identify the tax policy principles to which it aspires and the relative weight of those principles when framing the policy tradeoffs which underpin the benchmark tax law. The preparation of a tax expenditure report which clearly sets out the defined benchmark can prompt broader and ongoing dialogue regarding a community's aspirations for its tax system. This is an important political task in which civil society groups can play a significant role.

A variety of approaches have been adopted to define the benchmark tax law used in tax expenditure reports.

An 'external' or 'ideal' benchmark

This approach defines the benchmark based on tax policy principles irrespective of whether those principles are embodied in the existing tax law. This approach helps to identify where the existing tax law departs from a policy ideal. It may have the result that more tax expenditures are identified as compared with the 'internal' approach explained below.

- **Economic or "comprehensive" income tax benchmark:** The tax base may be defined to be a comprehensive income tax, which includes all economic gains in the control of a taxpayer in the tax year with only limited modifications to take account of policy tradeoffs or practical tax administration. The comprehensive income tax base may be defined to include imputed rent from living in your own home and all accrued capital gains (adjusted for inflation) and may require that all income be taxed at the basic defined rate structure, ignoring aspects such as concessions for family members or low income taxpayers.

- **Broad-based consumption tax benchmark:** The tax base may be defined to cover consumption of all goods and services in the country, whether purchased with cash or property or self-provided. The benchmark may require that all consumption be taxed at the same flat rate.

- **Neutral land tax benchmark:** The tax base may be defined to include all land, whether or not privately owned, developed or vacant, urban or rural, agricultural or industrial. The benchmark may require that all land be taxed at the same rate without any concessions for small holdings, homes, or low income landowners.

An 'internal' or 'normal' benchmark

This is sometimes called a 'normal', 'reference' or 'baseline' benchmark. This approach adopts a benchmark that is based on the general policy expressed in the existing tax law. Departures from these policy principles are defined as tax expenditures.

Usually, the difference between an 'internal' or 'normal' benchmark and the existing tax law will be smaller than if an 'external' benchmark is adopted. Thus, fewer tax expenditures will be identified. This benchmark may be seen as more pragmatic but it is less useful as a means to assess the policy of the tax law because it is not set independently with reference to objective tax principles.

A combination of external and internal benchmarks

This approach takes an external benchmark as a starting point but modifies that benchmark by adopting certain internal features of a tax that may be of long standing or that are otherwise considered to be entrenched systemic features. Most countries take this approach.

For example, an ideal Value Added Tax would apply to all supplies of goods or services by any business entity in a country. However, for simplicity, the imputed rent from living in your own home and the sale of a home are usually excluded from the tax base as 'private' assets. A tax expenditure report may treat this exclusion as part of the benchmark.

Example 5.1: Debate about the Benchmark in Chile

Tax expenditure reporting in Chile is explained in Section 4.3 above. For both the identification and measuring of tax expenditures, historically it has been assumed that the Chile income tax aims to tax a broad notion of income which is close to the economic or "comprehensive" definition of income, set out above.

Notwithstanding this basic concept, the Chilean income tax law has over time had various modifications, which aim to give tax relief on savings and investments, in such a way that it has been turning into a hybrid income-consumption tax. The tax relief provides deductions for saving, or a reduced tax rate or exemption for capital gains. The real tax base of the income tax law is closer to a consumption tax (which does not tax savings or business investment) or, in general, an intermediate amount between income and consumption. As a result, it appears that it is the intention of the lawmaker to tax either consumption or only partially to tax income.

This raises issues for how to define the tax expenditure benchmark in Chile. If it was assumed that the taxing of consumption is the correct benchmark, some tax expenditures that are currently reported as such would cease to be so. The most significant example is the deferral of personal tax on business income, which is the biggest item in terms of cost to revenue. There also would not be recognized as tax expenditures either a deduction for contributions to pension funds or voluntary pension fund payments.

On the other hand, if a consumption tax benchmark was used, a negative tax expenditure would be recognized whenever the income is taxed instead of consumption.

5.3 Measurement and estimating the revenue loss from tax expenditures

There are different methods of measuring the revenue loss from tax expenditures and each method has advantages and disadvantages.

A general problem with estimating the revenue cost of tax expenditures, using any method, is the need for adequate data in tax returns, overall tax revenues and taxpayers. Some methods may be more accurate but require higher quality data.

1. **Revenue foregone method** – This is the most common method. It measures the cost of a tax expenditure by comparing the amount of tax revenue raised under the existing tax law (including the tax expenditure) with the amount of revenue that *would have been* raised under the existing tax law, *excluding* the tax expenditure.

   This method assumes that all other tax provisions, and other laws remain the same and that taxpayer behavior is unchanged in response to the hypothetical abolition of the tax expenditure. Ignoring behavioral effects can be problematic, and cause substantial inaccuracy, because taxpayers do, of course, modify their behaviour depending on the particular legal framework and opportunities available to them. However, this method is relatively simple for a government department to apply and for observers to understand and analyze.

2. **Revenue gain method**. – This measures the anticipated revenue gain that would arise from abolition of a tax expenditure. It aims to take into account likely taxpayer responses to that hypothetical abolition of the tax expenditure. It also aims to take into account other 'second order' effects such as interaction of tax laws with other laws.

   The revenue gain method is potentially more accurate than the revenue foregone approach. However, it requires considerable amounts of high quality data to estimate the behavioral response of taxpayers to the abolition of a tax expenditure. It is more time consuming and expensive to apply. The United States applies this method, as well as the revenue foregone method, in its tax expenditure analysis. However, it is not applied by most other countries.

3. **Outlay equivalence method** – This measures how much it would cost to deliver the same after-tax benefit to the beneficiaries of the tax expenditure by way of a cash grant. It assumes that the cash grant would be subject to the normal application of the existing tax law without the tax expenditure. This method

offers the opportunity of assessing the merits of alternative means of delivering the government benefit. However, measuring the actual benefit in the hands of the beneficiaries requires high quality data about the taxpayer.

Because of the difficulties of measuring the cost of tax expenditures accurately, tax expenditure reports provide estimates rather than precise budget allocations. As a result, they cannot be directly compared with direct budget spending. That is, tax expenditures cannot be "summed" or added up in the same way as direct expenditures. Concerns about tax expenditure estimates are compounded when these estimates are added together to produce a total estimate for government tax expenditures. A total tax expenditure estimate may usefully indicate, very roughly, what proportion tax expenditures comprise of government revenues or direct expenditures (see Table 1.1 above). However, it must be remembered that this is only a rough estimate and used cautiously in debates about public policy.

Users of a tax expenditure report should also be aware that the abolition of a tax expenditure will not necessarily generate additional revenue to the extent implied by the tax expenditure report. This is likely because, for instance, the report might not consider behavioral responses to abolition of the tax expenditure.

For example, assume that a government decided to abolish all tax expenditures for retirement saving by individual taxpayers. Taxpayers may choose, instead, to put some of their savings into another concessionally taxed, or exempt, savings vehicle. A possibility is that taxpayers might put more money into buying a family home, which is frequently exempt from tax. As a result, the savings in tax revenue would be lower than expected.

Ideally, a tax expenditure report should indicate the reliability of each estimate, noting the available data, method and behavioral modeling upon which the estimate is based. Such a statement about reliability could prompt discussion about how to enhance the reliability of particularly significant estimates. As for other aspects of measurement, however, preparing an estimate with proper reliability statements requires government resources.

5.4 Identifying the beneficiaries of tax expenditures and distributional impact

Some critics of tax expenditure reports argue that identifying the beneficiaries of tax expenditures can be difficult.

For example, it has been suggested that tax credits provided to low income workers may benefit the employers of those workers to some extent (as they may mean that the employers can pay the workers lower wages). Indeed, it can be difficult to identify who benefits from some tax expenditures and behavioral responses to tax expenditures. This can add to problems in assessing the distributional impact of tax expenditures.

The difficulties in identifying beneficiaries do not mean such analysis should be forsaken altogether. Here as well, such information in a tax expenditure report must be used with caution but remains useful in critically analyzing government policy.

Chapter 6 Using the tax expenditure report in budget advocacy

Summary

This chapter summarises how civil society groups and other commentators could use a tax expenditure report in budget advocacy and in participating in debates about reform of tax systems.

6.1 Objectives of Civil Society Consultation

Good governance and democratic principles suggest that direct spending ought be subject to a rigorous cost benefit analysis, carried out before the money is appropriated, which considers the merits of the policy and whether spending is the most appropriate government action. It should also be subject to ongoing annual review.

Similar scrutiny of tax expenditures should be conducted. By providing sufficient information, a tax expenditure report can:

- Expose 'hidden' public welfare to more robust scrutiny;
- Identify inconsistent spending and tax programs – government might be promoting inconsistent policy outcomes by adopting contradictory spending and tax measures;
- Strengthen the operation of budgetary fiscal rules, which may, for example, cap direct expenditure at a particular level of GDP, but may not refer at all to tax expenditures which are similarly large;
- Identify areas where the tax system is not operating in accordance with legislative intention (because, for example, the tax administration has insufficient resources to enforce the law or because it has allocated enforcement resources to other matters);
- Provide information regarding a government's ongoing management of tax expenditures. Reviews of tax expenditures are highly desirable in assisting governments and civil society groups to analyze critically whether the tax expenditure is the best policy tool to achieve a particular objective. For each tax expenditure, a tax expenditure report should indicate when a review was last undertaken and the result of that review.
- Identify the best means of delivering a particular policy outcome (that is, direct spending may be a better alternative to a tax expenditure); and
- Identify aspects of the tax law that ought to be improved if the community's aspirations for its tax system are to be carried into effect.

Politicians, journalists, think tanks and researchers, concerned citizens, the media and civil society or non-government organizations will all find a tax expenditure report useful in increasing their capacity to analyse their government's decisions about taxing and spending, and to participate in budget and tax reform debates.

For example, members of the media, or parliamentarians, who are interested in decisions about government spending on targeted tax concessions for particular industries, or regions, will be assisted in understanding the government provisions (and their cost to government) as a result of the tax expenditure report.

A non-government organization that seeks a fairer distribution of spending on housing by the government might be interested in finding out what tax concessions exist for housing in the tax system, and the estimated revenue cost of those tax concessions. It is often the case that the estimated revenue cost of housing tax expenditures is very large, and may exceed government direct spending on housing.

6.2 Civil society consultation can be improved by effective tax expenditure management

There are several key elements of tax expenditure management which enable civil society consultation with government upon reform of tax expenditures:

- **Identification of tax expenditures** – the definition of tax expenditures is discussed in this report in chapters 1, 2, and 5;
- **Reporting of tax expenditures** - providing information regarding the nature, operation and cost of each tax expenditure – information that should be available for each tax expenditure is noted in paragraph 1.6 of this report;
- **Critical analysis and policy justification of each tax expenditure** – the advantages and disadvantages of tax expenditures relative to other policy mechanisms available to government (ie regulation, subsidy) are considered at paragraph 2.4 of this report;
- **Regular review of tax expenditures** – this repeats the critical analysis of tax expenditures, but taking account of data collected with respect to the operation of the tax expenditure over time; and
- **Independent assurance** of the integrity of the process by which tax expenditures are identified, reported and analysed, for example, by an independent national audit agency.

6.3 What tax expenditure management can achieve

Effective tax expenditure management can help in improving the fairness and the efficiency of the tax law and transparency of the budget process. It contributes to democratic oversight of taxing and spending.

Fiscal reform

Tax expenditure management can help government, parliaments and commentators or observers to identify tax concessions that are particularly costly to revenue. If these tax concessions are able to be removed from the tax system, overall tax rates can be lowered, which may produce a better outcome for everybody as well as a simpler tax system.

As explained above in Chapter 1, tax incentives frequently cost significant revenue foregone (see examples in Table 1.1). This revenue cost is often greater than expected by the government when incentives are put in place:[51]

> Revenues foregone by tax incentives for investment – such as tax holidays, partial profit exemptions, free trade zones, etc. – tend to exceed by a wide margin the revenue costs expected before the concession is put in place. In particular, countries frequently under-estimate tax planning opportunities for multinationals to extend the coverage of tax relief to shelter non-targeted activities and profits. Increased reliance on other taxes and the need for tax base protection measures place additional strains on the tax system.

Full reporting of revenue foregone from tax incentives has prompted tax reform in Morocco.

Example 6.1 - Morocco and tax expenditures

In Morocco, reporting of tax expenditures prompted critical review of the country's tax rules. The goal of critics was to increase tax revenue without introducing new taxes or increasing headline tax rates (see material on the African Economic Outlook web site at: http://www.africaneconomicoutlook.org/en/in-depth/public-resource-mobilisation-and-aid/policy-options/deepening-the-tax-base/)

Tax expenditure analysis may also provide a useful impetus for fundamental tax reform in OECD countries. In the US, a research institution, the Tax Policy Centre of the Urban and Brookings Research Institute, has researched tax expenditures, with the goal of encouraging major tax reform.[52]

Example 6.2 - Calls for reform of US tax expenditures

Politicians in the US have recently called for tax expenditure reform as part of fundamental tax reform. See the following news item:

Friday, March 11, 2011 - 16:58 US Conrad: Must Cut Back $1 Trillion In Annual Tax Expenditures (By John Shaw) (Washington DC)[53]
Senate Budget Committee Chairman Kent Conrad said Wednesday the effort to assemble a comprehensive deficit reduction plan must include tax reform, adding that the "heart" of tax reform must be an effort to cut back the so-called tax expenditures.
In comments during a Budget Committee hearing on tax expenditures, Conrad repeated his view that controls of discretionary and entitlement spending are critical to deficit reduction efforts as is an effort to overhaul the

[51] African Economic Outlook, "Deepening the Tax Base", http://www.africaneconomicoutlook.org/en/in-depth/public-resource-mobilisation-and-aid/policy-options/deepening-the-tax-base/
[52] See http://www.taxpolicycenter.org/briefing-book/background/expenditures/largest.cfm
[53] See http://imarketnews.com/node/2763 viewed 14 March 2011.

tax code to make it more efficient and more structured to encourage economic growth.

"Both sides of the ledger are part of the problem," Conrad said. "Tax reform is essential," he added. Conrad said that overhauling the nation's tax cut code must include an aggressive effort to scale-back the $1 trillion in annual tax expenditures. Conrad said tax expenditures have "received far too little scrutiny" as policymakers examine ways to reduce the federal budget. "They have become a backdoor way of spending federal money," Conrad said.

The largest tax expenditures are the exclusion of employer contributions for health care (2010 cost: $262 billion), exclusion of retirement contributions and earnings (2010 cost: $123 billion), and the mortgage interest deduction for owner-occupied homes (2010 cost: $92 billion).

Conrad has been one of the leaders of a bipartisan group of senators that is trying to assemble a deficit reduction plan that uses the Simpson-Bowles package as its template. That plan calls for about $4 trillion in deficit reduction over a decade.

It is important to be aware that reform to remove tax concessions from the tax law can be very difficult to achieve. However, tax expenditure reporting assists in identifying who benefits from what in the tax system.

Distributional analysis – Who benefits from tax expenditures?

Of key importance to civil society groups, in addition to the overall revenue cost of tax expenditures, will be the distributional impact of tax expenditures. Who benefits? Are taxes and benefits of government distributed fairly?

Good tax expenditure management should aim to answer these questions, to the extent possible using available data. This can contribute significantly to civil society engagement with the budget process that aims to increase the social justice of taxing and spending.

A distributional analysis may identify significant gaps in the impact of the budget on different groups. For example:

- **Income/wealth analysis:** How do low income individuals or individuals with little wealth benefit from the tax expenditure compared to high income or wealth individuals?
- **Gender analysis**: Differential impact on women and men. For example, if only men work in the manufacturing industry in a particular country, a tax expenditure that reduces the tax burden on workers in manufacturing will benefit men more than women. An analysis of this expenditure may also identify policy reasons for the focus on manufacturing.
- **Minority analysis:** a regional tax investment credit may have the goal of benefiting a minority group that lives in a particular region. The tax

expenditure analysis may be able to identify if the credit is, in fact, benefiting that group.

Example 6.3 - Gender equity and tax expenditures in India[54]

In Section 4.1, we summarized some Indian tax expenditures based on the Indian Budget Statement of Revenue Foregone. One example of an Indian tax expenditure is a higher exemption for women (see Table 4.3). This is a positive tax discrimination in the income tax law, which is intended to assist gender equity.

However, a study has examined the effects of this provision on gender equity and it was concluded that, while this appears to be a positive measure, its effect is very small. This is because only a very tiny proportion of women pay income tax and so would benefit from this higher income tax exemption.

More generally, it is concluded that tax expenditures in the income tax are an ineffective way to reduce poverty or assist low income individuals in India. The study concludes that "the total number of individual taxpayers is about 27 million out of a total population of about 1 billion, so approximately 2.7 per cent of the population falls within the income tax net … Women likely constitute less than 3 per cent of this small number. … tax-paying women are only about 0.00001 per cent of all women and 0.27 per cent of working-age women. In other words, the use of income tax as a means to further gender equality seems limited."

Another example of distributional analysis could involve reporting on the environmental impact of tax expenditures. Owing to the less transparent oversight of tax expenditures to promote investment in particular sectors, the environmental impacts of industries benefiting from tax expenditures can be overlooked. Identification and reporting of tax expenditures could enable environmental groups to highlight the otherwise hidden environmental impacts of tax expenditures.

Example 6.4 - Environmental action and tax expenditures

Over many years, the environmental organization *Friends of the Earth* has highlighted the detrimental environmental impacts of tax expenditures. See http://www.foe.org/sites/default/files/179c%20%20fact%20sheet.pdf

[54] Chakraborty et al (2010, p. 94). It is understood that a tax reform may be forthcoming in India to repeal this gender-specific provision and replace it with a higher tax-free threshold for all individuals.

APPENDICES

Appendix 1: Tax expenditures in Countries assessed in the 2010 OBI.

Appendix 2: Where are Tax Expenditure Reports?

Appendix 3: What questions should a budget advocacy group ask the government about tax expenditures?

APPENDIX 1 TAX EXPENDITURE REPORTING IN OBI 2010 COUNTRIES – KEY ELEMENTS

This Table provides summary information about the 36 countries included in the OBI 2010, in respect of which some tax expenditure reporting is found. It has not been possible to find details about tax expenditure reporting in all of these countries. The IMF Fiscal Reports on Statements and Codes (ROSCs), available at www.imf.org, provide some useful additional information about these countries, and also other countries that were either surveyed for OBI 2010. Most, but not all Fiscal ROSCs are publicly available (this is a country decision). Many, but not all, fiscal ROSCs refer, at least briefly, to tax expenditure reporting.

Sources: OBI 2010 report and data available at www.internationalbudget.org ; OECD (2010); IMF Fiscal Reports on Standards and Codes (ROSCs) for countries, where available; own research into tax expenditure reports of countries.
Note: A higher OBI 2010 score indicates greater overall fiscal transparency reported for the country (scale of 1 to 100); 30 is very low transparency; 90 is high transparency.

Country	2010 OBI Score	Taxes Covered	Tax Expenditure Definition	Frequency of Tax Expenditure Report	Data for one or multiple years (time series)	Aggregated or Itemised Tax Expenditures estimated?	Tax expenditures discussed in public IMF or other report?
Argentina	56	Income tax, value added tax and specific taxes on consumption	"gasto tributario", defined as the amount of income the Treasury gives up when granting a different tax treatment from the general rule of the tax legislation, which aims to benefit either set activities, zones, taxpayers or particular types of consumption.	Annual in the Budget	Two prior years and current year (eg 2011 Budget has data for 2009, 2010 and 2011).	Individual tax expenditures are itemised and cost is estimated.	No
Brazil	71	Central government tax and social security taxes	Granted predominantly in area of regional development	Annual in the budget	Current year only.	Estimated for individual tax expenditures, report across each tax separately; aggregate revenues reported net of tax expenditures.	Fiscal ROSC (2001) states budget by law includes a table detailing federal tax expenditures.
Chile	72	Personal income tax, enterprise income tax, value added tax.	"gasto tributario", Chile defines tax expenditures relying on an OECD (2004) definition, as a transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by a direct expenditure	Annual; required by Constitution in the Budget, report itself states that the reporting is required by the	Current year only.	Estimates for individual tax expenditures, but reported only in aggregate (across types of tax expenditure, or	Fiscal ROSC (2003) found in 2001, first study of tax expenditures completed by SII, intended to be regularly reported in enhanced budget Public Sector Financial Report. Recommended legal provision to update and report annually. Fiscal ROSC (2005) reports

Country	2010 OBI Score	Taxes Covered	Tax Expenditure Definition	Frequency of Tax Expenditure Report	Data for one or multiple years (time series)	Aggregated or Itemised Tax Expenditures estimated?	Tax expenditures discussed in public IMF or other report?
				Constitution.		government function).	this is now clearly done.
Colombia	61	Income tax, value added tax.	"beneficio tributario", tax expenditures are those deductions, exemptions or special tax treatments existing in the legislation and imply a decrease in the tax obligation, producing less revenue collection for the State that grants them.		Two years: current and one prior year.	Estimated for main itemised tax expenditures. Percentage difference between years calculated. Reported by industry sector.	Fiscal ROSC (2003) indicated that at that time there was no reporting or estimating of tax expenditures.
El Salvador	37						Fiscal ROSC (2005) recommended including tax expenditure report in budget but finds tax expenditures are negligible in tax system
France	87	Income tax, Value Added Tax, other…	"depenses fiscales". Legal or statutory measures which induce a lower tax revenue for the state in comparison with application of the benchmark or "norm" ie the basic calculation principle of the tax.	Annual in the Budget Act	3 years. Current year and 2 prior years.	Both aggregate (total estimated cost and number of tax expenditures) and individual tax expenditure estimates.	No
Germany	68	Income tax, Value Added Tax, other.	No explicit legal definition. The law makes reference to "aid to enterprises and business sectors of the economy"; private or household tax expenditures are not reported.	Biannually in federal government's Subsidy Report plus 20 largest tax expenditures included in draft Budget annually.	4 years. Current year, 2 preceding years and 1 future year.	Itemised and evaluated individually.	No
Ghana	54		No definition	Annual.	No. Estimates are based on the current year budget only.	Tax expenditures are reported at a departmental and aggregated level.	Fiscal ROSC (2004) states no tax expenditures are estimated
Guatemala	50	Income tax, VAT, excises.		Annual in budget.	One year only.	Reported in aggregate only on public website.	Fiscal ROSC (2005) finds tax exemptions are substantial and tax expenditures are estimated rigorously

Country	2010 OBI Score	Taxes Covered	Tax Expenditure Definition	Frequency of Tax Expenditure Report	Data for one or multiple years (time series)	Aggregated or Itemised Tax Expenditures estimated?	Tax expenditures discussed in public IMF or other report?
							and reported since 2004.
India	65	Income tax, tariffs, customs	Tax preferences are defined as subsidy payments to preferred taxpayers, or spending programmes embedded in the tax statute.	Annual, commenced as an Appendix to 2006-07 Budget	2 years. The 2009-10 Budget was the first attempt to forecast tax expenditure revenue foregone for the subsequent financial year.	Each tax expenditure is individually identified with the estimated revenue foregone and projected to be foregone in the next year.	Fiscal ROSC (2001) recommended reporting tax expenditures
Indonesia	51	Income tax deductions, VAT exemptions for State owned companies	Defined as tax subsidies				Fiscal ROSC (2006) states that tax expenditures have been included in budgets since 2003 but reporting is incomplete.
Italy	58						Fiscal ROSC (2002) finds no comprehensive tax expenditure report but some tax expenditures are listed and estimate of revenue cost of new measures is required.
Kazakhstan	38			None.			Fiscal ROSC (2003) finds no estimates of tax expenditures but sporadic reporting of revenue cost of investment tax concessions.
Kenya	49	Customs, tax exemptions	No definition in the Budget Speech.	Annual	No. Annual only in the 2010 Budget Speech.	There are no costings provided for the few tax expenditures identified in the Budget Speech.	Fiscal ROSC (2008) refers to tightening control on tax expenditures but states that estimates are incomplete and not published

Country	2010 OBI Score	Taxes Covered	Tax Expenditure Definition	Frequency of Tax Expenditure Report	Data for one or multiple years (time series)	Aggregated or Itemised Tax Expenditures estimated?	Tax expenditures discussed in public IMF or other report?
Malaysia	39						No
Mexico	52	Income Tax for enterprises and individuals, Corporate Tax at Unique Rate (IETU), Value Added Tax, Special Taxes on Goods and Services, Tax on New Automobiles, and Tax on Possession or Use of Vehicles.	*"gasto fiscal".* Treatments with a tax character that cause a decrease in the tax collection. Exemptions, reductions and relief of a tax burden that deviate from the normal structure of any tax, constituting a favourable taxable regime to certain kind of incomes or sectors of activities and that have objectives other than fiscal or economic policy. May also include other measures, such as differentiated rates, tax credits and more favourable deductions, schemes that allow deferral of tax payments or grant a administrative facility, among others. Refers to document "Tax Expenditures in OECD countries".	Annual in Budget.	2 years. Current year and future year.	Itemised estimates for individual tax expenditures, also reported as a percentage of GDP.	Fiscal ROSC (2002) recommended full and regular publication of tax expenditure report, done for the first time in 2002, to help annual debate on the budget in Congress.
Morocco	28						Fiscal ROSC (2005) stated no estimate existed but tax expenditure report currently being prepared by study group for exemptions in tax and tariffs, to be completed by 2006.
New Zealand	90		TEs reduce revenue and like spending are equivalent to a flow from the government back to individuals; reduce an individual's tax burden and usually take the form of an exemption, allowance, credit, preferential tax rate, deferral, or tax offset. "... a tax provision significantly motivated by a policy objective other than to raise revenue that: reduces revenue by lowering tax		Limited time series data across current and forthcoming year is in the NZ Budget papers. The forecast for the upcoming	Tax expenditure estimates reported at both an individual and aggregate level. For example, paid parental leave is estimated to cost $149 million in 2010 while research and development tax credits are costed to	NZ government reports in 2010 that it will increase tax expenditure reporting that was reinstated in 2010 after ceasing in early 1990s.

Country	2010 OBI Score	Taxes Covered	Tax Expenditure Definition	Frequency of Tax Expenditure Report	Data for one or multiple years (time series)	Aggregated or Itemised Tax Expenditures estimated?	Tax expenditures discussed in public IMF or other report?
			for a limited or select group of taxable entities; is able to be replaced by a direct expenditure programme; and is neither administrative in nature or motivated by a domestic double taxation objective"		budget is provided as is the forecast and actual cost from the last financial year.	reach $7 million.	
Norway	83	Income tax, social security tax	For the computation of tax expenditures, the benchmark is based on the general tax rules and on persons, activities, and goods being taxable according to the same principles and rates.	Annual in Budget.		Itemised figures only presented as authorities consider that aggregated figures would mislead because of interactions between measures.	Fiscal ROSC (2009) states that budget provides extensive tax expenditure reporting.
Papua New Guinea	57		No.		No time series data is provided in the 2010 PNG Budget.	No individual or aggregate estimates. Tax expenditures are noted at a broad policy level without costings.	No
Peru	65	General Tax of Sales, Selective Tax on Consumption, Income Tax of Enterprises and Individuals, Ad Valorem, Special Right and Over Rate	"gasto tributario". No definition. Some conceptual analysis in Multi-annual Macroeconomic Frame 2006-2008.	Annual in Budget.	No. On 28 May 2010, Multi-annual Macroeconomic Frame approved, which includes the tax expenditure report for the year 2011.	Main individual tax expenditures estimated individually and reported by function.	Fiscal ROSC (2004) identifies tax expenditure estimating from 2003 as part of overall effort to improve budget transparency.

Country	2010 OBI Score	Taxes Covered	Tax Expenditure Definition	Frequency of Tax Expenditure Report	Data for one or multiple years (time series)	Aggregated or Itemised Tax Expenditures estimated?	Tax expenditures discussed in public IMF or other report?
Philippines	55						Fiscal ROSC (2002) finds no publicly available tax expenditure estimates.
Portugal	58	Income tax, other.		Annual in Budget.	Past 3 years; one year forecast by Article 34 of Budget finance law and Law No. 26/94.	Reported by category and all tax expenditures for individuals are reported plus revenue cost of new measures estimated.	Fiscal ROSC (2003) finds budget provides fairly detailed information on tax expenditures.
Russia	60		"Tax expenditures" relate to the revenue foregone by provisions in the tax code (for example, from exemptions, deductions, incentives, etc) that allow a tax payer to pay a reduced amount of taxes from the normal taxes that would be applicable for a given tax base			Estimate of cost of tax new or changing tax expenditures during the year. In 2004, govt monitored cost of tax expenditures but does not report publicly in detail.	Fiscal ROSC (2004) finds partial tax expenditure reporting and recommends including list of all tax expenditures by tax type and including special economic zones.
Serbia	54	Corporate income tax, excise, VAT	No definition is provided in the budget papers.	Not in budget documents. Some disclosed in reports on State Aid but not systematic.	No time series data is available in the Serbian Budget.	Each tax expenditure is estimated individually.	Fiscal ROSC (2009) finds tax exemptions numerous, major tax expenditure estimates calculated but only partially disclosed.
Slovakia	57			Occasional reports on State Aid; not in budget			Fiscal ROSC (2002) found no tax expenditure reporting but State Aid reports provided some information. Fiscal ROSC (2004) reports progress in State Aid reporting (tax and customs). Fiscal ROSC (2005) finds no further progress on this.
South Africa	92	Personal income tax, corporate	A tax expenditure is defined as any tax preference, including exemptions that exclude income from the tax base or	Annual	Reference to the expenditure	Historically South Africa provided individual tax	No.

Country	2010 OBI Score	Taxes Covered	Tax Expenditure Definition	Frequency of Tax Expenditure Report	Data for one or multiple years (time series)	Aggregated or Itemised Tax Expenditures estimated?	Tax expenditures discussed in public IMF or other report?
		income tax, estate duties and value-added tax (up until 2009).	allowances that are deductible from gross income or a reduction in a rate of tax or tax deferrals that delay the payment of tax.		in the immediate prior year in Budget 2009 but no explicit reference to TE time series.	expenditure estimates. The Budget 2009 reports only aggregate cost of tax expenditure.	
Spain	63	Central government only, personal and corporate income tax, VAT, excise, insurance tax and fees. Some *comunidades autonomas* produce tax expenditure reports.	A tax expenditure is administratively defined (no legal definition) as an intended departure from the basic tax structure (benchmark), intended to achieve some economic or social policy goal, that provides support only to a certain segment of the tax population or to certain economic sectors, not to the population generally.	Annual Budget on Tax Expenditures, mandated by Article 134 of the Constitution.	Current year only.	Itemised tax expenditures are estimated individually; by type of tax; by functional classification; total aggregate as percentage of GDP is also reported.	Fiscal ROSC (2005) confirms constitutional requirement for annual budget including tax expenditures, finds estimates "rigorous".
Sweden	83	Income tax, value added tax, excise on energy and Carbon dioxide, tax credits and surtaxes.	Informal administrative definition: tax expenditures are provisions that reduce revenue relative to a defined norm, either to pursue a specific policy objective or to facilitate the efficient operation of the tax system.	Spring Fiscal Policy Bill appendices and since 1998 in annual Budget Bills.	3 years: current, prior year and future year, plus retrospective data for period 1992-2008.	Each tax expenditure is estimated and evaluated independently.	Fiscal ROSC (2000) confirms tax expenditure estimates published annually since 1996
Trinidad & Tobago	33						No
Turkey	57	Personal and corporate		Public Financial Management and			Fiscal ROSC (2000) found no tax expenditure reporting and

Country	2010 OBI Score	Taxes Covered	Tax Expenditure Definition	Frequency of Tax Expenditure Report	Data for one or multiple years (time series)	Aggregated or Itemised Tax Expenditures estimated?	Tax expenditures discussed in public IMF or other report?
		income tax		Control Law 2003 requires tax expenditure report, intended to be fully implemented by 2006.			recommends it. Fiscal ROSC (2006) finds tax administration has done some study of cost of tax expenditures but not finalised but tax expenditures especially for special economic zones, regions and pension savings are large.
Uganda	55						Fiscal ROSCs (1999) and (2003) find no tax expenditure report.
Ukraine	62	Personal and corporate income tax, VAT; not import dutes or social security, not small business and agriculture simplified taxes.	Tax expenditures are separated from core tax features. No clear published definition yet.	Annual budget Explanatory notes, required by Article 38 of Budget Code since 2002.	Two prior years; plus forecast for budget year.	Individual cost estimates, reliability of estimates improved progressively.	Fiscal ROSC (1999) finds no tax expenditure report. But Fiscal ROSC (2004) finds significant tax expenditure reporting.
United Kingdom	87	Personal income tax, corporation tax, capital gains tax, inheritance tax, national insurance duty, petroleum revenue tax, stamp duty land tax, value added tax	Tax expenditures "are designed to help or encourage particular individuals, activities or products. … Such reliefs are often an alternative to corresponding public expenditure payments that would generate similar effects – i.e. there could be a choice between giving a tax relief as an allowance or deduction against tax, or by an offsetting cash payment.	Annual	Individual time series for the previous financial year and current budget year.	Each tax expenditure is costed individually and includes the current annual cost as well as one previous financial year.	Fiscal ROSC (1999) notes that tax expenditures are reported though not in annual budget.

Country	2010 OBI Score	Taxes Covered	Tax Expenditure Definition	Frequency of Tax Expenditure Report	Data for one or multiple years (time series)	Aggregated or Itemised Tax Expenditures estimated?	Tax expenditures discussed in public IMF or other report?
United States	82	Federal income tax; some States report tax expenditures.	Revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of liability.	Annual, reported in the Budget *Analytical Perspectives* and also reported by Congressional Joint Committee on Taxation.	Time series estimates for the two prior financial years, the current financial year and 4 future years plus aggregate estimate for 5 years (current and future).	Each tax expenditure is costed individually and reported both by rank (estimated cost) and by function.	Fiscal ROSC (2003) discusses US approach to tax expenditure reporting.
Zambia	36						No

Appendix 2: Where are Tax Expenditure Reports?

- *Argentina*

http://www.mecon.gov.ar/onp/html/presutexto/proy2009/mensaje/mensaje2009.pdf

http://www.mecon.gov.ar/onp/html/presutexto/proy2011/mensadosonce.html

- *Australia*

http://www.treasury.gov.au/contentitem.asp?NavId=035&ContentID=1719

- *Brazil*

http://www.planejamento.gov.br/secretarias/upload/Arquivos/sof/pldo09/Pldo_2009_anexo_4_11.pdf

http://www.planejamento.gov.br/secretarias/upload/Arquivos/sof/LDO09/ldo_2009_anexo_4_10.pdf

- *Chile*

http://www.dipres.cl/572/articles-3689_ifp2008.pdf

- *Colombia*

http://www.minhacienda.gov.co/MinHacienda/MinistryFinance/elministerio/prensa/materialdeapoyo/DOCUMENTOMFMP%202010.pdf

http://www.minhacienda.gov.co/portal/page/portal/MinHacienda/haciendapublica/politicafiscal/informacionfiscal/marcofiscalmedianoplazo/MFMP%20Version%20Imprenta.pdf

http://www.minhacienda.gov.co/portal/page/portal/MinHacienda/haciendapublica/presupuesto/programacion/proyecto/ProyectodePresupuesto2010/8%20Mensaje%20Beneficios%20Tributarios.pdf

- *El Salvador*

http://www.mh.gob.sv/portal/page/portal/PMH/*France*

http://www.performance-publique.gouv.fr/farandole/2009/pap/pdf/VMT2_2009.pdf

- *Germany*

http://dip21.bundestag.de/dip21/btd/16/099/1609900.pdf

- *Ghana*

http://www.mofep.gov.gh/budget.cfm

http://www.mofep.gov.gh/budget2009.cfm

http://www.mofep.gov.gh/budget2009.cfm

- *Guatemala*

http://www.minfin.gob.gt/archivos/proypre09/documentos/gtributario.pdf

- *India*

http://www.indiabudget.nic.in/ub2009-10/statrevfor.htm

http://www.indiabudget.nic.in/ub2009-10/afs/afs2.pdf

- *Indonesia*

http://www.anggaran.depkeu.go.id/Content/08-08-15,%20NKdanRAPBN2009.pdf

- *Italy*

http://leg16.camera.it/_dati/leg16/lavori/stampati/pdf/16PDL0011450.pdf

- *Kazakhstan*

http://www.minplan.kz/economyabout/247/23847/

- *Kenya*

http://www.treasury.go.ke/index.php?option=com_docman&task=doc_details&gid=87&Itemid=54

- *Malaysia*

http://www.treasury.gov.my/pdf/budget/bs09.pdf

- *Mexico*

http://www.apartados.hacienda.gob.mx/presupuesto/temas/ppef/2010/temas/expo_motivos/ingresos/iniciativa_lif2010.pdf

- *Morocco*

http://www.finances.gov.ma/portal/page?_pageid=53,17812956&_dad=portal&_schema=PORTAL

- *New Zealand*

http://www.treasury.govt.nz/budget/2009/estimates

http://www.treasury.govt.nz/budget/2009/ise

- *Norway*

http://www.statsbudsjettet.dep.no/upload/Statsbudsjett_2009/dokumenter/pdf/stm.pdf

- *Papua New Guinea*

http://www.treasury.gov.pg/html/national_budget/national_budget_2011.html

- *Peru*

http://www.mef.gob.pe/DNPP/proyectosley/2010/Exp_Motiv_Ley_Presupuesto2010.pdf

http://www.bcrp.gob.pe/transparencia/normas-legales/ley-de-transparencia-y-acceso-a-la-informacion-publica.html

http://www.mef.gob.pe/ESPEC/marco_macro.php (See "Marco Macroeconómico Multianual 2011-2013").

- *Portugal*

http://www.dgo.pt/oe/2009/Proposta/Relatorio/rel-2009.pdf

- *Russia*

http://www1.minfin.ru/

- *Serbia*

http://www.mfin.gov.rs/download/pdf/dokumenti/Memorandum%20%20o%20budzetu%20i%20ekonomskoj%20i%20fiskalnoj%20politici%20za%202010.%20godinu%20sa%20projekcijama%20za%202011.%20i%202012.%20godinu_jun_2009.pdf http://www.mfin.gov.rs/download/pdf/dokumenti/Memorandum%20on%20the%20budget%20for%20the%20year%202010.pdf

- *Slovakia*

http://www.finance.gov.sk/en/Default.aspx?CatID=292

- *South Africa*

http://www.treasury.gov.za/documents/national%20budget/2011/review/chapter%205.pdf

- *Spain*

http://www.sgpg.pap.meh.es/Presup/PGE2009Proyecto/MaestroTomos/PGE-ROM/doc/L_09_A_1.PDF

- *Sweden*

http://regeringen.se/content/1/c6/11/16/79/bc7025e7.pdf

- *Trinidad & Tobago*

Publicly available but not on the internet: Ministry of Finance

- *Turkey*

http://ekutup.dpt.gov.tr/program/2009/hedef-i.pdf

- *Uganda*

http://www.finance.go.ug/docs/BTTB09-10.pdf

- *Ukraine*

http://gska2.rada.gov.ua/pls/zweb_n/webproc4_1?id=&pf3511=36140

- *United Kingdom*

http://www.hm-treasury.gov.uk/d/bud09_chaptera_307.pdf

- *United States*

http://www.gpoaccess.gov/usbudget/fy11/pdf/spec.pdf (Chapter 16), or
http://www.whitehouse.gov/omb/budget

- *Zambia*

http://www.zra.org.zm/Budget.php

Appendix 3: What questions should a budget advocacy group ask the government about tax expenditures?

This Appendix contains some sample questions that a civil society budget group, or think tank, could ask the Ministry of Finance, or Treasury, of the government about tax expenditures.

Who Knows What About Tax Expenditures

	Tax Expenditures	**Action taken**
Who keeps account of tax expenditures?	(specify agency)	If yes, what action is taken? How is accounting carried out?
Who manages financial control of tax expenditures?	(specify agency)	
To which government agency are tax expenditures reported?	(specify agency)	How is report done? What is content of report?
Who audits tax expenditure reporting and management?	(specify audit agency)	How is audit managed?
Are tax expenditures reported to Cabinet?	(Yes/No)	How is report done? What is content of report?
Are tax expenditures reported to Parliament?	(Yes/No)	How is report done? What is content of report?
Are tax expenditures reported to the public?	(Yes/No)	How is report done? What is content of report?
Are tax expenditures reviewed by the media and/or civil society organisations/ NGO's?	(Yes/No/Which organizations review tax expenditures?)	How is review done? How does government hear views about tax expenditures?

Source: World Bank,
http://web.worldbank.org/WBSITE/EXTERNAL/TOPICS/EXTPUBLICSECTORANDGOVERNANCE/EXTPUBLICFINANCE/EXTTPA/0,,contentMDK:20237087~menuPK:2090883~pagePK:148956~piPK:216618~theSitePK:390367~isCURL:Y,00.html
(with variations by the authors).

Sample Questions about Tax Expenditure Management

1. Is there a stated definition of tax expenditure for any of the taxes levied by the government?
If yes:
a. What is the definition?
b. What taxes are covered?
c. What levels of government are covered?
d. What is the benchmark tax system?
e. Are some features of the current tax system included in the benchmark and so not considered tax expenditures?
f. Is each tax expenditure identified and described?

2. Where are tax expenditure data reported?
a. In the budget documents?
b. In some other document?

3. How often are tax expenditures reported?

4. Are tax expenditures quantified at all?
If yes:
a. Which tax expenditures are quantified?
b. What method is used?
c. What years are covered (current year/past/future years?)

5. Does the government identify the policy reason for a tax expenditure?
a. Is a justification provided for the tax expenditure?
b. Why was the tax expenditure selected, instead of a direct spending program?

5. Are tax expenditures reviewed regularly in the budget process? If so, how?

6. Are there any data on expirations of tax expenditures, or required reauthorizations of mandatory and tax law provisions?

7. Provide any listing of new tax expenditures recently enacted and their cost.

8. Are proposed new tax expenditures costed in the budget?

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http://www.oecd.org/document/37/0,3343,en_2649_34119_44961317_1_1_1_1,00.html

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