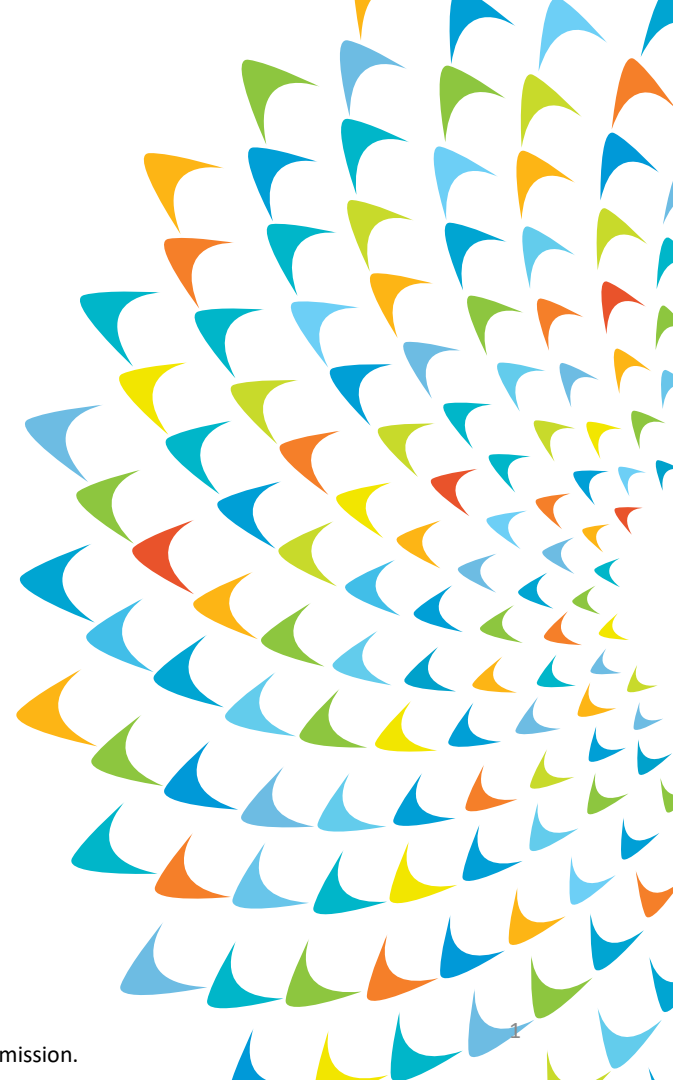




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ADB Support for Tax Expenditure Analysis

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Introduction

Tax expenditures can be defined in several ways.

“Tax expenditures are alternative policy means by which governments deliver financial support to individuals and companies.” (Heady & Mansour 2019).

*“Tax expenditures **are resources foregone** by the State for the existence of benefits and incentives that reduce the tax burden of certain taxpayers.” (CIAT 2011).*

“Tax expenditures are provisions in the tax legislation that reduce the tax liability of specific groups of individuals or businesses. Tax expenditures (TEs) are deviations from a benchmark tax system in which such specific provisions are absent.” (IMF 2020).



Introduction

1. Tax expenditures can be costly (the global average over the 1990-2020 period is 3.8 per cent of GDP and 23 per cent of tax revenue).¹
2. Low-income countries often use tax incentives to stimulate growth and attract investment. Customary to give tax holidays in Asia and the Pacific (APAC) region.
3. The guiding principle for introducing tax expenditures should be based on:
 - Relevance: is the tax measure consistent with policy priorities?
 - Effectiveness: Is the tax measure meeting its objective effectively, without unwanted outcomes?
 - Efficiency: Is the tax measure the most appropriate and efficient means to achieve objective?

1/ https://gted.taxexpenditures.org/wp-content/uploads/2023/10/von-Haldenwang-et-al-2023_-_TEs-in-an-era-of-transformative-change.pdf



ADB's Tax Expenditure Estimation Toolkit

- Governments have to address technical and methodological challenges to define a benchmark. The need was felt for a comprehensive and easy to follow guide on estimating tax expenditures detailing steps along the way.
- To properly account for and report the revenues foregone from tax concessions, ADB developed a toolkit on tax expenditure estimation.²
- This tool kit provides step-by-step guide to policy makers on methods and models in estimating the revenue cost of tax expenditures and is a good **value addition** by ADB through providing a **knowledge solution**.
- The tool kit describes the process of estimating revenue cost of tax expenditures including data collection, development of stylized models and their outputs.
- **Institutionalizing tax expenditure estimation methodologies is expected inform the development of good tax policies.**

2/ <https://www.adb.org/publications/tax-expenditure-estimation-tool-kit>



ADB's Tax Expenditure Estimation Toolkit

- Tax expenditure estimation models described with samples in the toolkit include:
 - Simulation models based on aggregated taxpayer data;
 - microsimulation models using micro-data from individual taxpayer data sources;
 - indirect methods using data from sources external to the tax administration including
 - national accounts data,
 - survey data such as the household income and expenditure survey data.



Bhutan Summary

- First ever comprehensive tax expenditure statement for Bhutan.

- Completed during 2022 and 2023, producing estimates for 2021.

- Covers five major revenue streams:
 - Corporate Income Tax
 - Business Income Tax
 - Personal Income Tax
 - Sales Tax
 - Customs

- Completed remotely by ADB in collaboration with Department of Revenue and Customs in Bhutan.

- Estimates produced for five major taxes, despite significant data constraints.



Estimated Revenue Foregone By Tax Type

Tax	Estimated revenue foregone (2021)
Corporate Income Tax	Nu 4.5 million under FIA – 2020 data. 2021 data not available. Data issues significant.
Business Income Tax	Nu 92 million, arising from micro-exemptions and tax holidays specifically for businesses. Data issues significant.
Personal Income Tax	Nu 2.35 billion, approximately 1.25% of GDP. The personal allowance accounted for Nu 1.56 billion
Sales Tax	Nu 900 million for ST on imported products (0.5% of GDP). For ST on domestic products, Nu 524 million identified, but perhaps incomplete. approximately 0.7% of GDP (but likely to be underestimated).
Custom Duty	Nu 1.18 billion due to zero-rating in legislation (increase from Nu 260 million in 2020 due to new customs legislation in 2021), plus Nu 662 million (due to Fiscal Incentives Acts) approximately 0.9% of GDP



Bangladesh Tax Expenditures

- The Asian Development Bank has been assisting the revenue authority in Bangladesh develop its capacity to undertake tax expenditures analysis.
- Several multi-day workshops held to build capability for tax expenditures analysis (TEA).
- ADB arranged for three National Board of Revenue (NBR) officials to participate in the tax expenditures workshop organized by ATI in Manila in February 2023.
- In March 2023, a three-day workshop was delivered in Dhaka and NBR officials from the Income Tax, VAT and Customs Wings were in attendance.
- This was followed up with a further five-day training in Dhaka in July/August 2023 for the VAT and Customs wings focusing on their specific issues.
- Workshops covered theory of tax expenditures, application to Bangladesh and tax expenditures estimation techniques.
- Follow up sessions via zoom focusing on practical data analysis and estimation techniques.
- The results of this analysis were published in the last Budget (June 2023). **Estimated at around BDT 1,258.13 billion (3.56% of GDP) for direct taxes alone.**



Mongolia Tax Expenditure Study

- An analysis of tax expenditures was undertaken for Mongolia.
- This was part of a broader project relating to Strategies for Financing Social Protection to Achieve Sustainable Development.
- A review of legislation was undertaken. This was to establish a reference or benchmark tax system appropriate for Mongolia and to identify an inventory of tax expenditures.
- Focus was on PIT, CIT, VAT and Customs for FY2021.
- Mongolian system has some interesting features in FY2021 including a flat rate PIT system and a progressive rate CIT system.



Mongolia-Tax Expenditures Results

- Of the 81 identified tax expenditures included in the tax expenditures inventory, 50 could be quantified from the tax return data provided.
- Estimates were quantified using a revenue foregone approach.
- The **estimated revenue foregone was around MNT 1,479.01 billion (3.3% of GDP).**
- Significant tax expenditures included tax concessions under product sharing agreements for companies operating in the oil and gas sector and reduced rates on certain forms of incomes and savings.



Conclusion & Looking Ahead

- Tax expenditure (and tax gaps) are one set of diagnostics for tax policy reform, in the same way as TADAT is for tax administration.
- These diagnostics provide us with specific policy actions for strategic revenue plans as well as for policy-based programs by ADB e.g. in Pakistan/Bangladesh/Uzbekistan.

Takeaways:

1. Even when we use the more conservative legal approach to estimating tax expenditures, they can amount to several percentage points of GDP.
2. In some cases, the legal approach does not allow us to capture the full revenue potential that can be realized by more fundamental reform of the tax ecosystem.



<https://www.adb.org/publications/tax-expenditure-estimation-tool-kit>



Thank you.
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