Domestic Revenue Mobilization

21 - 23 September 2021

Building a DRM indicator for budget support

- SMART indicator:
  - Specific, Measurable, Achievable, Relevant, Timely
- Final goals:
  - Increasing the tax revenue to GDP ratio (quantity)
  - Improving the quality of the tax system
    - Tax system: Tax policy and revenue (tax and customs) administration,
    - Transparency, fairness, inequality, gender
    - Environment (Green taxation)
- Which instruments? Policy or administration?
  - Trade-off between large or specific indicator (political

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Some examples of DRM indicators

General (policy and adm.)
Improving domestic revenue mobilization
Increasing total current revenue collection of at least 0,5 percentage point of GDP
Respect of Extractive Industries Transparency Intitative standards
Tax cadaster
Tax administration
Increasing the number of taxpayers
50% increase or more in the issuance of fiscal receipts in 2015 compared to 2014
20% increase of average additional taxation, identified for large taxpayers and other taxpayers compared to 2014
Increase revenue collections : Improve tax IS systems : SIGTAS version 3. Core modules are implemented and functional. The lost of core modules includes: registration, accounting, appeals and audit.
Reducing VAT credit reimbursment to one month for some firms and to three months for the others
90 percent of importations are effectively registered in ASYCUNDA
Tax policy
Creating a tax policy unit
Tax expenditures assessment and publication
Streamlining tax expenditures

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Questions?

- Do you have an experience in building a DRM indicator?
- Beyond DRM indicator for budget support purpose, are you engaged in tax policy dialogue with the authorities?
- Which DRM issues do you have?

DRM (Introduction): Questions

- What is the average tax revenue to GDP ratio in developing countries?
  - 5 percent, 10 percent, 15 percent, 25 percent, 35 percent
- What is the average tax revenue to GDP ratio in developed countries?
  - 5 percent, 10 percent, 15 percent, 25 percent, 35 percent
- Why taxation is crucial for developing countries?
  - Please rank your these elements:
  - Financing public expenditure, Building Nation State, Reducing Inequalities, Reinforcing democracy…

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DRM (Introduction)

- Tax Revenue to GDP ratio
  - OECD countries: around 35 percent (Denmark, France above 50 percent)
  - Developing countries: around 15 percent (Nigeria, DRC less than 10 percent)
- ECOWAS, WAEMU: 20 percent (one of the convergence criteria).
- World Bank, UN:
  - Depend on the definition of the failed, failing, and fragile States
  - Below 10 percent, **Fragile States** (unable to deliver basic public goods and services).
  - https://data.worldbank.org/indicator/GC.TAX.TOTL.GD.ZS

Why do developing countries tax so little?

- Informal sector and small-scale firms
  - Dual approach of development economics.
- Natural resource sector:
  - Resource rent sharing issue, resource curse/blessing
- Weak political institutions
  - Low contestability of power/accountability, corruption.
  - Aid: Samaritan dilemna
- Lack of political will to reform : lobbying, information.

DRM (Introduction)

1. Tax is an important source for financing public expenditures.

    Alternative ways: Debt, seignoriage (Zimbabwe=>hyperinflation), ODA.

    Which social contract? Public expenditure (the COVID 19 case).

2. Addis Tax Initiative (August, 2015)

    Tax= Priviliged tool for financing SDGs

3. Why **D**RM?

    Domestic because of the worldwide tax transition**:**

    Decrease in tariff rates and revenue (Free trade, WTO)

    ⇒Increase in the taxation of domestic activity.

    But, carbon tax adjustment => New green tariffs?

DRM: A tool for State building

- Taxation = « The Thunder of History », Schumpeter
  - Taxation and wars
- Monopoly of legitimate violence, Weber
  - DRC, Failed States.
- Accountability of government
  - EU approach: Collect more, spend better
- State capacity
  - Taxation, tax administration, tax policy

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Questions?

Tax policy and tax administration: *Question*

- What are the best solution for you?
- *Please rank your replies*
  - Increasing tax rates
  - Broadening tax bases
  - Reinforcing tax audits
  - Introducing new taxe
  - Reorganizing tax and customs administrations

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Tax policy and tax administration

- Tax system: Tax policy and Tax administration
- Tax policy:
  - Finance Law, Tax Code or Act, Sectoral Codes (Mining, Petroleum, Forest, Agricultural…).
- Tax administration:
  - Organization of the tax authority: administrations, Revenue Agency, privatization…

Tax Policy (Goals)

- Increasing the tax revenue to GDP ratio;
- Improving the efficiency (neutrality) of the tax system;
- Improving the fairness of the tax system (equity, gender issue…).

Tax Policy (Instruments)

- Direct Taxes

  Personal Income Tax (PIT), Corporate Income Tax (CIT)

- Indirect Taxes

  Value Added Tax (VAT), Excises

- Other taxes

  Property taxes, fees

- Beyond taxes

  Tarifs, Quasi-taxes…

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General recommendations in tax policy

- Principles:
  - Simplicity, efficiency, equity, fairness, inclusiveness
- Be carreful: Potential trade-off.
  - For instance, an equitable PIT may be very complex to administer.
- Low tax rates and large tax base.
  - Reducing or increasing some tax rates, suppressing some taxes.
  - Broadening the tax bases.
  - Tax flexibility (crisis).

Questions?

Tax administration (Goals)

- Collect the right amount of tax
  - …at the right **time**
  - …at minimal **cost** to the government
  - …while imposing the least **burden** on taxpayers
- Customs (very important in LDCs to raise revenue
  - Maintain a balance between trade facilitation, revenue generation and border protection.
  - Ensure proper classification and valuation of goods
  - Clear goods promptly but manage risks well

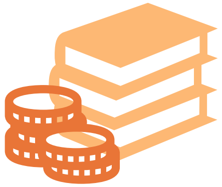
Tax administrations (Tools)

- Taxpayer registration (TIN)
  - Publication online of TIN? (e.g. Burkina Faso).
- E-Filling, Taxpayer services
- Audit, Objections and appeals
- Functional organization of tax administration
  - Customer segmentation: Large Taxpayer Unit
  - Semi-Autonomous Revenue Authority (SARA)
  - Tax farming: a long history

Digitalization process: The case of Kenya (IMF study)

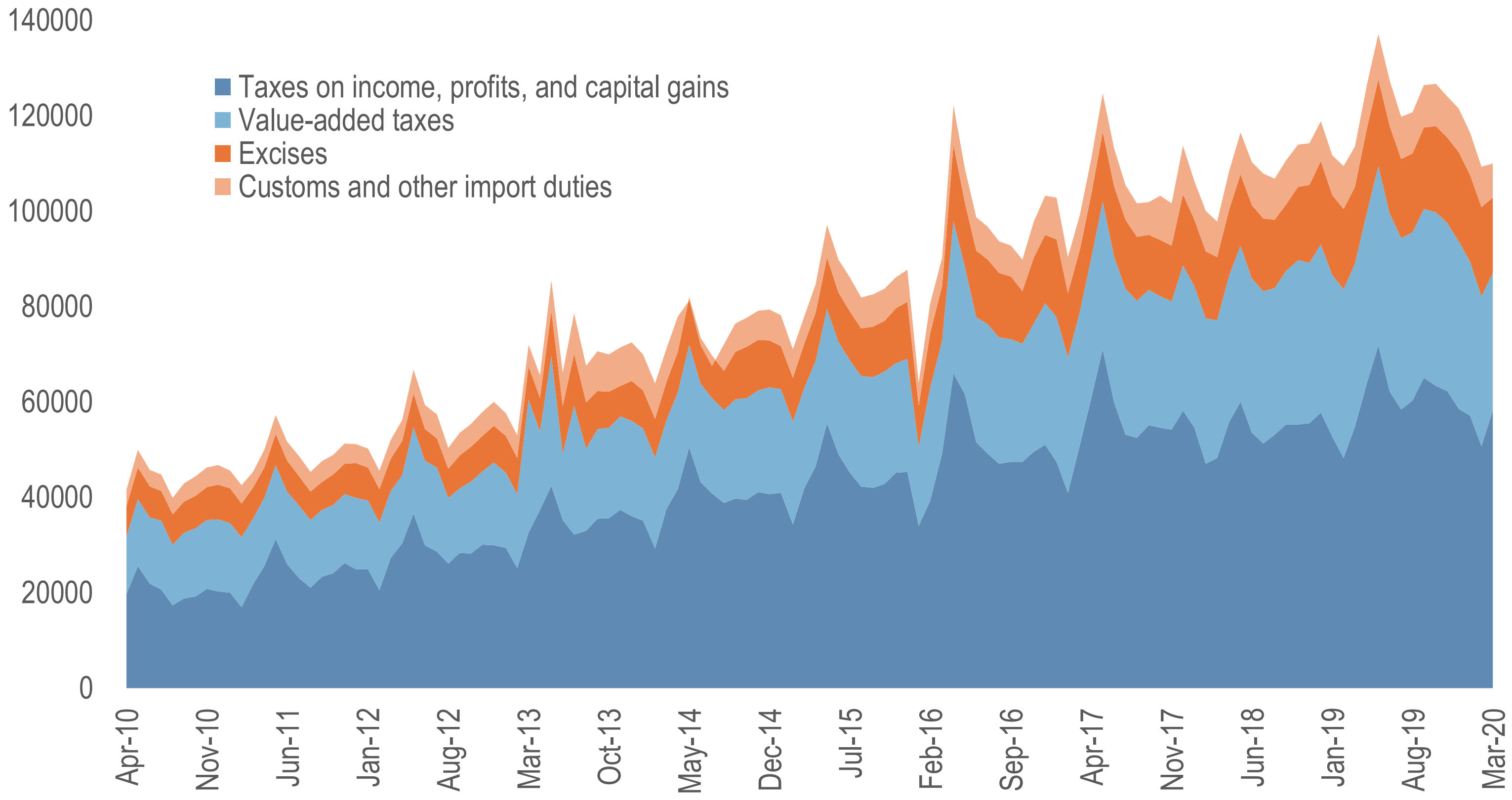
Digital tax administration

Biometric ID and digital payments



Financial inclusion and literacy

Kenya: Composition of Tax Revenue
(3-months rolling average; million Kenyan Shillings)



Source: IMF staff calculations

General recommandations in Tax/Customs administration

- Improve taxpayer databases
  - Lack of coordination between tax administration and customs.
- Improve taxpayer services
- Simplify tax payment processes
  - Lowering compliance costs
- Risk-based audit (mirror analysis)
- Reinforce internal control (corruption)
- Appeals processes (often inadequate, unfair or nonexistent)

Tax Administration Diagnostic Assessment Tool (TADAT)

- Purpose: provide an objective and standardized assessment of the relative strengths and weaknesses of the administration of a country's tax system.
  - Customs are not covered.
  - Scoring approach.
  - Public Reports: Jordan, Liberia, Georgia, Zambia.

http://www.tadat.org/

Questions?

Tax expenditures

- What is this stone?

Tax Expenditures

- Tax expenditure is transfer of public funds resulting from a reduction of tax obligations in relation to a standard, rather than direct spending (OECD, 2010).
  - Tax reliefs, tax subsidies or tax aids
  - Exemptions, reduced rates…
- Two conditions for tax expenditures:
  - (1) a reduction in government tax revenue, and
  - (2) a deviation from the tax norm, called the benchmark tax system.

Tax expenditure assessment

- An important tool to streamline tax systems.
  - Proliferation of tax expenditures (=the results of lobby groups or policy).
  - Tax expenditures seem less harmful than direct tax due to the lack of their estimation.
- Improving fiscal transparency:
  - The publication of tax expenditures estimations as an Appendix to the Finance Law.
- Reinforcing the power of the MoF on the tax system.
- A new database: https://gted.net/
  - 97 covered countries.

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Tax expenditures promoting investment: Tax incentives

- Another kind of tax competition (less transparent)
- Discretionary or rule
  - Investment code, Free Area Law, Individual tax agreements, etc
- Who ask for tax exemptions/derogations?
  - Lobby groups (firms)
  - Sectorial ministers (mining, oil, tourism, agriculture, etc)
    - Mining code, Tourism code, Agricultural code…

Tax expenditure in favor of consumption

- Reduced or zero VAT rates
  - **Incidence theory:** Assuming that the reduction in tax rate will be reflected in prices.
- PIT:
  - Mortgage interest deductibility: 59 Billions of USD in 2016 (US)
  - Family quotient, credit for child dependent,
  - Deductions for medical expenses, for education expenses, etc.
- Beyond the estimation of tax expenditures, are they equitable?

Beyond tax expenditures: Tax gaps

- Tax policy gap
  - Difference between tax due under “optimal” tax policy and that under current tax policy.
  - Focus on tax policies to close loopholes, broaden base, and tax expenditures.
- Tax compliance gap
  - Difference between tax due under current tax policy and that actually collected.
  - Focus on efficiency and effectiveness of tax administration, reinforcing voluntary compliance, good tax governance, and fighting evasion and illicit financial flows

Questions?

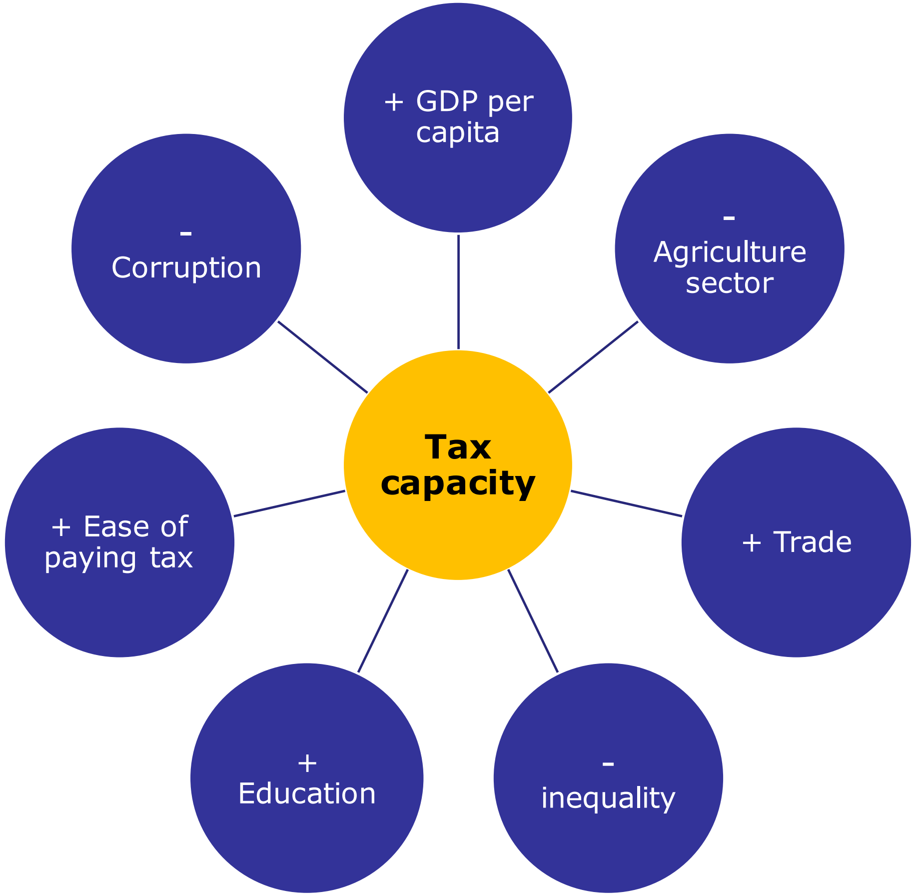
The efficiency of tax incentives?

The equity of indirect tax exemptions?

Tax effort: Questions

- Are tax effort and tax perfomance equivalent?
  - Yes, No
- Does tax revenue increase with the size of agriculture?
  - Yes, No

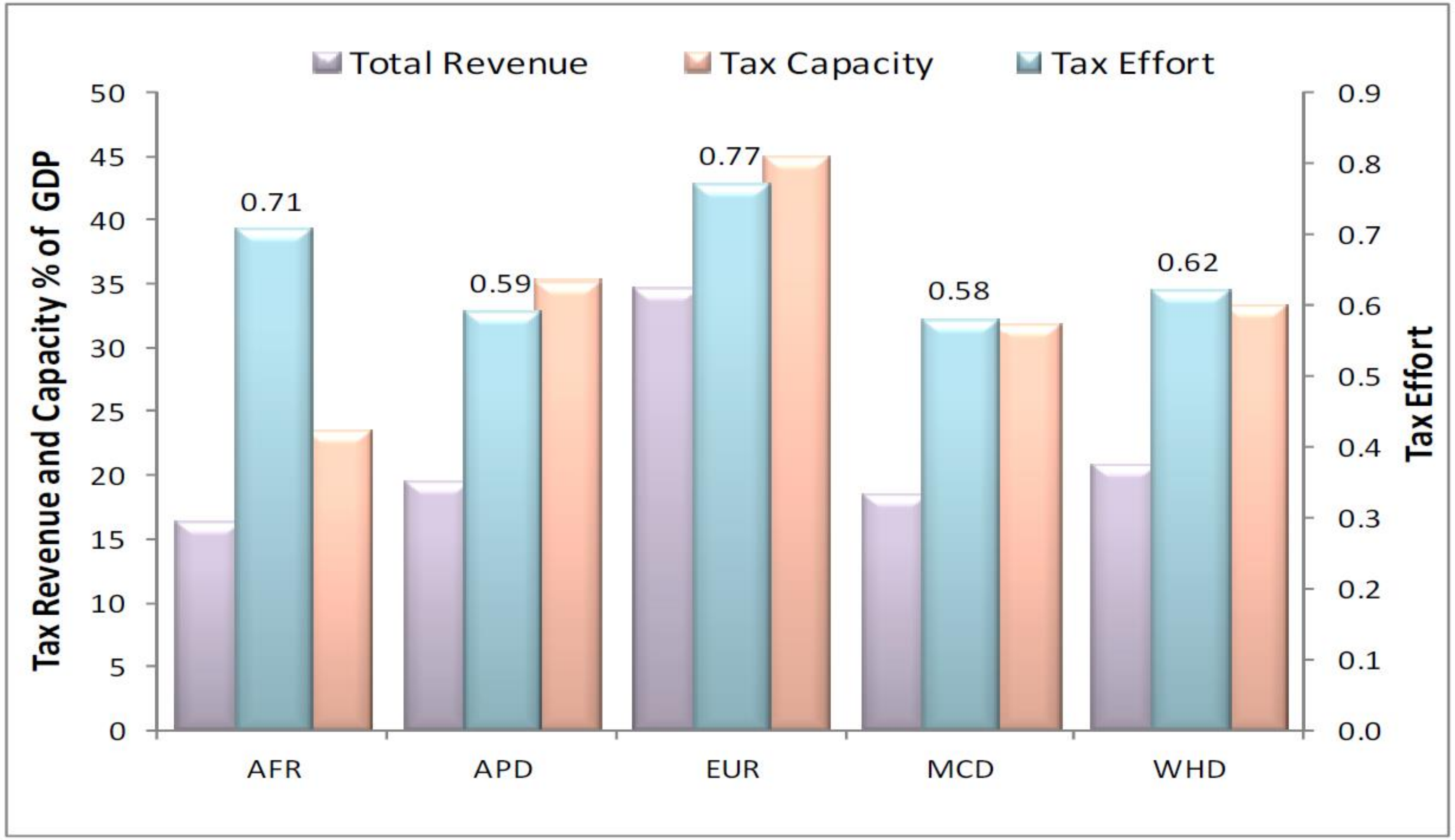
Tax effort (empirical)



- Empirical analysis (Stochastic frontier) between potential tax revenue and actual collected tax revenue.

Tax effort

Figure 1. Countries' Tax Effort by Region



Worldwide Long-Term Trends in Tax Reform

- Tax transition (DRM)
  - Increased pressure to reduce tariff duties (free trade)
  - Increased reliance on VAT
- Increased tax competition for foreign direct and portfolio investment
  - Switch to dual income tax system
- Reduction in top tax rates under personal income tax system
- Reduction in top tax rates under business profits tax (CIT)

Questions?

Taxonomy of taxes: Questions

- What is the main source of tax revenue?
  - Corporate Income Tax, Personal Income Tax, Value Added Tax, Tariffs, Property Tax
- Which tax instrument is the more efficient to reduce inequality?
  - Corporate Income Tax, Personal Income Tax, Value Added Tax, Tariffs, Property Tax
- Which tax may discriminate against women?
  - Corporate Income Tax, Personal Income Tax, Value Added Tax, Tariffs, Property Tax

Taxonomy of taxes

- **Indirect taxation**
  - VAT
  - Excises
- **Direct taxation**
  - PIT
  - CIT
- Others
  - Property taxes
  - Natural resource taxation
- The progressivity or regressivity of tax
  - Equity, fairness of the tax system

VAT

- The main source of tax revenue
- VAT: An important tax innovation (France, 1947; 190 countries)
  - Delegate the effort of tax collection to the private sector (VA Chain)
- The Tax transition: Decrease tariff rate and adopt VAT
- C-efficiency of VAT= VAT/(t*GDP)
- VAT is neutral (?)
- VAT liability threshold: a level of turnover

The regressivity of VAT

- Classic approach (developed countries)
  - Final consumer (household) pays VAT.
  - VAT is inequitable since poorer households consume relatively more than richer households.
  - Multiplication of VAT rates and VAT exemptions in order to protect the poorest household and restore some progressivity for VAT.
- *Developing countries*
  - Does the poorest household have access to the market?
  - Farmer are selfconsumers.
  - Moreover, VAT acts as a protective tariff for these farmers since their activity is below the threshold.
  - VAT exemption on food products, which are locally produced, reduced the income of farmers.
  - Unique VAT rate is simpler to administer.

Main VAT issues

- VAT exemption or zero VAT rate
  - Tax incidence: Protecting the poorest?
  - Zero rate: exportations
- Non deductibility => VAT = Sales tax
  - Petroleum products: Risk of smuggling?
- Tax expenditure issue.
- VAT credit refund (incidence theory)
- VAT and informality

Questions?

Exercises and Green taxes

Sin tax	Tobacco, alcohol, soft drinks?	Very regressive	Earmarking? Discourage bad behavior?
Luxury tax	Gold, diamonds, yachts	Usually progressive	Revenue focus
Externalities (Green Tax)	Unit or value of products that cause pollution or other “negative” externalities	Unclear, more regressive	Tax on pollutants in factories, hydrocarbons

Exercises

- Ad valorem, specific or both
- Elasticity of demand
  - Ramsey law: the rate is inversely proportional to the demand elasticity.

Green taxes

- Protecting the environment:
  - Targetting polluting activities (production, consumption)
- Pigou vs Coase (bargaining)
- Tax *à la Pigou*
  - Internalize negative externalities/spillovers
- Carbon tax.

Questions?

PIT (Personal income Tax)

- Taxing individual or household
  - Gender issue if household
  - Family coefficient in Africa (relevant?)
- Several sources of invidual income: wages, rent, capital income, profit (self-employee)
- Three main systems
  - Comprehensive income tax; Dual income tax; Flat tax
- Political debate around the Top margin tax rate: Progressivity of PIT.

Questions?

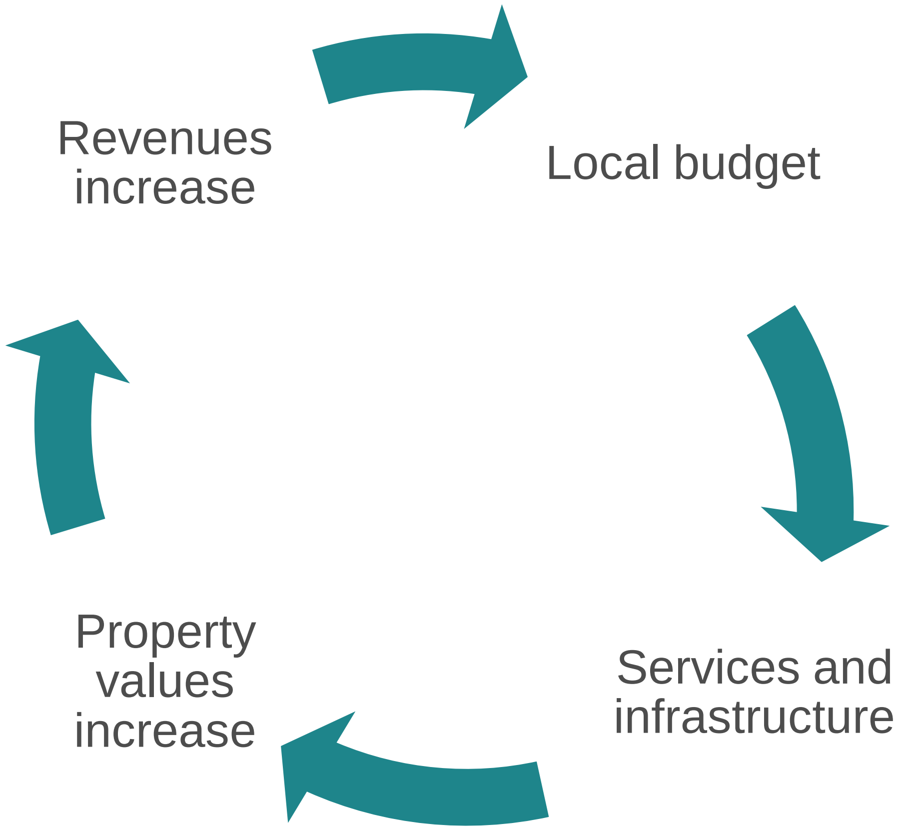
CIT (Corporate Income Tax)

- Tax on Profit
  - Definition of Profit (very complex)
  - Physicial person and corporations
- More important revenue in developing countries than in developped ones.
  - Highly concentrated in devloping countries (<30 firms = 70% of CIT revenue)
  - Minimum tax based on turnover
- Agressive tax planning: BEPS (OECD)
  - See Issue 3.

Questions?

Property Taxes

- The missing tax in developing countries (3-5% of GDP in OECD)
- Tax on land and fixed assets (first step towards a Wealth tax)
- Efficient and redistributive tax
- Political issues (very sensitive):
    - Property rights,
    - Value assessment (2 mechanisms: rural, urban),
    - Blockchain (Sweden, Ghana, Rwanda)



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Questions?

Issue 1 : The fragmentation of taxing power

- How tax policy is defined in the country?
  - Who does determine the tax law?
  - *MoF versus other Ministries (e.g. Ministry of Mining)*
- Implementation of tax policy
  - Who does collect tax?
  - Quasi-tax/Parafiscalité
- Ex.: Dem. Rep. Congo, DGRAD
  - Agencies…

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Issue 2: Inequalities

- Progressivity of PIT
- Regressivity of indirect taxation
- Wealth taxation (property tax)
- Tax fairness => Fiscal fairness
    - Commitment to Equity
    - « Analyzing the tax side without the spending side can be misleading. »
    - Lustig: https://commitmentoequity.org/

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Ghana Example

Taxes	Expenditures
Direct Taxes	Direct Transfers
PAYE	LEAP (simulated)
Presumptive taxes (informal)	School feeding program
Presumptive taxes (formal)	Pensions*
Indirect Taxes	Indirect Transfers
VAT	Electricity subsidies
Import duties	Fertilizer subsidies
Cocoa duties	Kerosene cross-subsidy
Excises	
Petroleum products	In-Kind Benefits
Beverages	Public schooling (various levels)
Tobacco products	Public health services, inpatient
Communications services	Public health services, outpatient

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Issue 3: Natural resources tax regime

- Resource curse (oil, mining)
- Main recommandations for Natural resource tax regimes

  1. Transparency (EITI)
  2. Simplicity (e.g. Ring fencing principle)
  3. Stability (Asymmetric stability clauses)
  4. Progressivity

Ad valorem Royalty, CIT…

Issue 4: Agressive tax planning

- Mutlinational Enterprises & Tax havens
- Avoid to pay tax in a country by manipulating the costs or reducing the turnover through transfer pricing, debt shifting…
  - Double Tax Agreement (DTA)
- Solutions (on going)
  - Transparency, whitholding tax regimes (DTAs)
  - Arm’s length principles, Thin capitalization rule…
  - OECD/BEPS package and inclusive framework
  - Minimum tax rate at 15 percent (US proposal)

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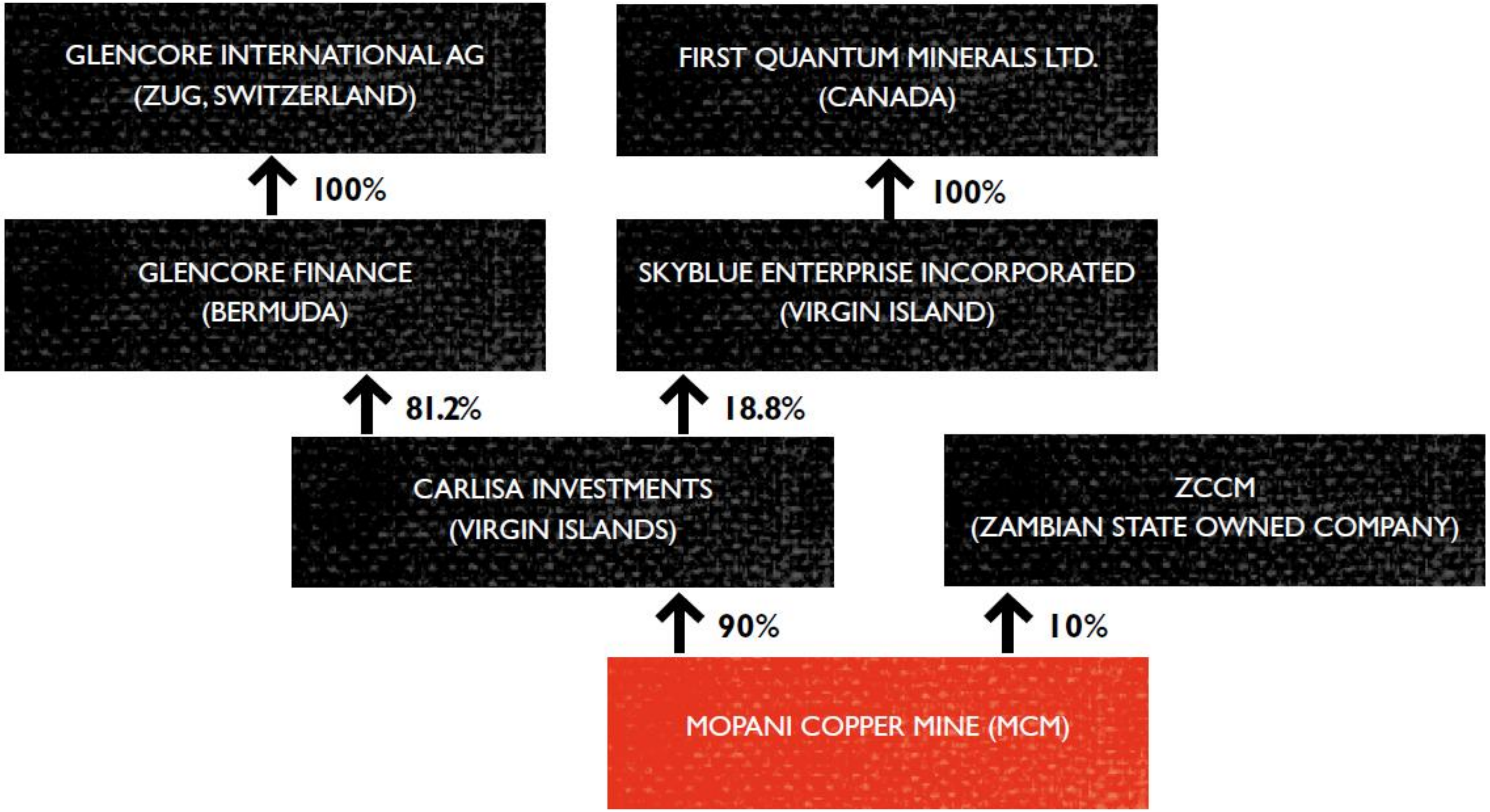
Ex. of agressive tax planning: Minimizing turnover

- Concerned sectors: Extractive industry, exporting sectors.
  - Reducing reported turnover
  - Decreasing CIT, mining royalties, government oil share
- Hedging contract between a subsidiary located in a standard tax rate country and a subsidiary in a tax heaven.
  - Selling the produced good below its market value.
- Example : Glencore in Zambia

Structure of Mopani copper mine



Source: *Africa Progress Panel Report 2013*, p.49

To go further: Tax incidence

- How the tax burden is shared between producer and consumer?
  - Whoever is paying the tax (consumer or producer).
  - Does a tax on beer (excise) increase the price of beer or reduce the profit of brewery?
- Depends on
  - Elasticity of price demand (consumer), substitutability of the taxed good, service or factor.
  - Market structure (monopoly, oligoploy, perfect competition).
- Pass through analysis
- Beyond, Marginal Excess Burden of taxation,
  - Haberger triangle, CGEE, DSGE

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