Tax Expenditures and Revenue Estimation

Asian Development Bank

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Tax expenditures

- Used to achieve political economy objectives, such as
  - supporting welfare level of a segment of the population,
  - incentivize investments and production,
  - encourage savings,
  - stimulate employment.
- Serves to change the behavior of consumers and producers by changing relative prices.
- Used by developed and emerging market economies for varying purposes (first bullet).
- Deviate from a "benchmark tax system."
- Results in forgone tax revenues.

Approaches to Tax Expenditures

- As part of public finance management, governments should review and report tax expenditures in order to formulate their tax policy. Tax expenditures should be guided by these principles:
- ***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 ?

Estimation of Tax Expenditures: Methods and Models

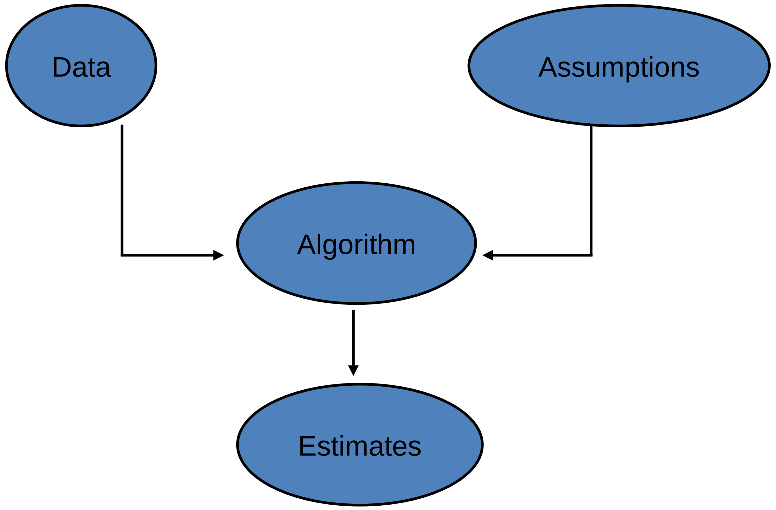
- Measurement of revenue cost and benefits of tax expenditures against a benchmark tax system can be estimated by the following methods.
  - ***revenue forgone*** **(the most common method)**
  - ***revenue gain***
  - ***outlay equivalent***

- Estimates using aggregate statistics
- Aggregate simulation models
- Microsimulation models
  - for the personal income tax
  - for the corporate income tax
  - for indirect taxes (VAT and Excises)

- Data requirements
  - Individual taxpayer data
  - Tax calculator
  - Output (revenue forgone and its distribution)

Estimation of Revenue Forgone

- Revenue forgone can be estimated in general terms, as:
- Revenue forgone= (Tax Expenditure item)*(Effective tax rate)
- However, more can be learned about the impact of a tax expenditures by using models, in particular, microsimulation models.



- For further information of tax expenditure estimation and the use of various data sources, one can refer to the ADB document

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