

Session 2: Establishing a Benchmark

Kyle McNabb
k.mcnabb@odi.org.uk

Introduction

- What is a Benchmark Tax System (BTS)
- Two approaches in theory
- Defining the BTS in practice
- Principles and Criteria
- A middle-ground? The UK's approach
- Conclusion

What is a Benchmark Tax System (BTS)?

- Simply put: a reference point against which to measure revenue foregone
- Any provision not part of the 'benchmark system' is thus costed in the TE Report.
- Definitions differ from country to country.
- There is no 'right' way to define a BTS
 - But guiding principles can be useful
- Important to first start with a definition of tax expenditures

Defining the Benchmark Tax System

- The BTS defines the scope of provisions to be costed in a TE reported and evaluated further down the line
- Fairly universally accepted that a benchmark system **should** be defined, however the choice over **how** this is done is less clear cut; CIAT (2011), for example, note that this process is one of the “most complex” parts of compiling a TE report.
- Broadly, the choice comes down to one of two methods, namely
 - 1. A “normative” approach
 - 2. A “legal” approach (positive approach)

Defining the Benchmark Tax System

▪ 1. The Normative Approach

- Involves comparing a country's tax system to some 'ideal', which is usually rooted in ideas around what constitutes an "optimal" tax system
- It requires the policymaker to first define what – for a specific country – an optimal tax system would look like before identifying the places in which the national system deviates from this.
- In practice, almost no countries define their BTS according to the normative approach

Defining the Benchmark Tax System

- **2. The “legal” (positive) approach**
- Grounded in a country’s tax (or other) legislation:
 - i.e. look at tax legislation and identify any deviations as tax expenditures.
- Strictly speaking, a “*perfectly*” positive analysis would be free from *any* value judgement and would merely constitute a descriptive account of “what is”.
- But in practice, not usually done;
- Some guiding principles are therefore useful:

Defining the Benchmark Tax System

(From Geourjon *et al.* 2018)

▪ 1. The 'General' Tax System

- Starting point for defining BTS can be the “general” tax regime. Main factors are:
 - The definition of the tax base
 - Tax Rates applicable to that base

- Defining the BTS *wholly* on the General Tax Regime is perhaps the most “**black and white**” method. But:
 - i. Many provisions are almost universally accepted as part of BTS
 - ii. Significant “grey areas” exist in all countries.

Defining the Benchmark Tax System

▪ 2. National Tax Policy Choices

- Gov't might decide to consider some tax relief as 'normal' e.g., as an integral part of a policy to provide support to a particular sector of the economy (e.g., health, education).
 - These reliefs are often included as part of the BTS and not costed
 - But this precludes any monitoring and evaluation of the reliefs and thus any analysis of their effectiveness vis-à-vis their original goal is not possible.
 - A TE may not be the most effective way to achieve a stated policy goal, but without TE reporting, one cannot begin to assess

▪ 3. Bilateral Agreements

- For example, a Double Taxation Agreement

▪ 4. Project Aid

- Previously it was generally accepted that aid projects should not be taxed, but increasingly donors are willing to consider this.
- An evaluation of the cost of such exemptions would shed light on its impact and could persuade the authorities to encourage those technical and financial partners that have committed to paying taxes to do so.

Defining the Benchmark Tax System

▪ 5. Regional Agreements

- A customs union, for example, where the common external tariff is the norm for customs duties.
 - E.g. in Uganda, EAC and COMESA imports are treated as part of the BTS

▪ 6. International Agreements

- Provisions in international agreements can be decided at the international level; international law can take precedence over national and local law.
 - E.g. Nairobi protocols, Chicago Convention, Florence agreement

Defining the Benchmark Tax System

- Criteria to determine what constitutes part of a BTS *might* be:
 1. Can a country unilaterally change the provision?
 2. Is a taxpayer / sector /activity administrable?
 3. Is the tax owed by a public entity?
 4. Would the activity in question happen in the absence of the tax relief?
 5. Measurability is not a good criteria!

Structural and Non-Structural Reliefs

- Is there a middle - ground?

- In the United Kingdom, reliefs are categorized as:
 1. **Structural Reliefs**

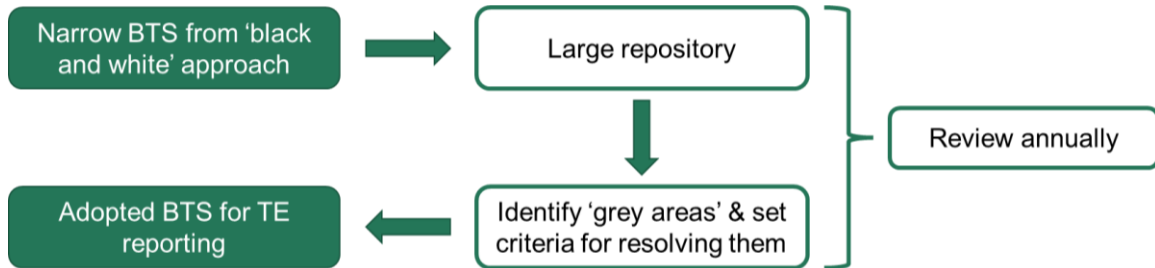
 2. **Tax Expenditures** *or*

 3. **Reliefs Exhibiting features of both**

Structural and Non-Structural Reliefs

- A 'structural relief' applies to a provision that could “reasonably be regarded (or partly regarded) as an integral part of the tax structure” or are required in order to “define the scope of the tax” (HMRC, 2021)
 - An example' in the UK is the tax-free allowance on personal income tax. This exists as a part of the progressive rate structure in the UK, but it is not considered as a TE.
- There are numerous areas where a provision exhibits features of both a structural relief and a tax expenditure
 - Consider a capital allowance: the part of the allowance that accounts for economic (or commercial) depreciation could (reasonably) be considered as a part of the tax system, whilst any accelerated depreciation allowance *over and above the rate of economic depreciation* might be considered as a TE.

One potential approach:



Defining the Benchmark Tax System

- There is ultimately no correct way to do this; all countries differ.
- A narrow benchmark (larger repository of TEs) = higher transparency
 - Can help to inform monitoring effectiveness of provisions, evaluating alternatives, or contributing to wider discussions (e.g. the taxation of foreign aid activities).
- Where possible, adopting criteria (such as those discussed above) and using them as guidelines for decision making is useful and helps to remove subjectivity from the process. But not always easy.

The Centre for Tax Analysis in Developing
Countries (TaxDev)
LinkedIn: @taxdev
Twitter: #TaxDev

www.taxdev.org

The Institute for Fiscal Studies
7 Ridgmount Street
London
WC1E 7AE

www.ifs.org.uk

The Overseas Development Institute
203 Blackfriars Road
London
SE1 8NJ

www.odi.org

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