Tax for SDGs Initiative

Aligning Tax Expenditures with the SDGs

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Background

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Governments pursue different policy goals such as attracting investment, mitigating inequality and greening the economy, through two main fiscal policy instruments:

- direct spending, and
- **tax expenditure (TE)**

TEs (also known as tax incentives, tax subsidies, tax benefits, tax reliefs, tax breaks) include tax exemptions, reduced rates, deductions, accelerated depreciation schemes, etc.

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Besides minor differences (e.g. inflation, behavioral aspects), the overall budget impact for the government (taxpayers) is the same:

- Giving (receiving) 100 USD ≈ reducing tax revenue (liability) by 100 USD

$$TR = t\ x\ B\left(\underbrace{TE}_{(-)}, \boldsymbol{X}\right)$$

Why to rationalize the use of TEs?

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Besides their stated policy goals, TEs are often costly and opaque and, when ill-designed, can be ineffective and trigger significant side effects or externalities

Hence, reforming TE systems should be seen as an avenue for governments to

1. increase **domestic revenue mobilization (DRM),** and
2. **better align their tax systems with the SDGs**

Effectiveness (or lack thereof)

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Case 1. Tax incentives for investment:

- Overestimation of elasticity of firms' investment decisions with respect to taxation in general (and corporate income taxes in particular)
- Other things matter as much (if not more) as taxation
- Yet, tax incentives for are used widely to attract investment and incentivize innovation (**SDG 9**) and boost economic growth (**SDG 8**)
- Tax incentives for investment are often ineffective – in particular tax holidays and special economic zones (SEZs)
- Redundant tax incentives for investment (windfall gains)

➢ Impact of Pillar 2 (Global Minimum Tax) ?

Side effects or Externalities

Case 2. Fossil Fuel Subsidies (FFSs):

Fossil fuel subsidies (FFSs) trough direct budgetary transfers, **TEs** and induced transfers amounted to almost USD 700 billion in 51 economies (OECD, 2021)

- Globally, TEs are one of the largest component of FFSs
- Besides their stated policy goal (boost economic growth, energy security), FFSs have a negative effect on the environment and climate change (**SDG 13)**
- Broad consensus on the need to phase out FFSs

➢ The impact on inequality and the burden of the transition should also be taken into consideration (**SDG 10 - Inequality**)

What is UNDP offering? – The STF

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- UNDP has developed the **SDG Taxation Framework (STF)**
- Whereas SDGs identify targets to be achieved and specify **what** are the indicators to achieve the targets, the STF explains **how** these indicators can be achieved and evaluates **coherence of tax systems** with specific SDG targets
- STF can support governments in examining the
  - magnitude of domestic tax collections
  - progressivity of the tax structure
  - effectiveness and efficiency of the tax administration
  - trust of the citizens in the tax system
- Target 17.1 Domestic resource mobilization (DRM) is critical for achieving SDGs…and TEs are key to increase DRM

What is UNDP offering?
TEs & SDGs

UNDP offer on TEs & SDGs provides a **self assessment**, two-stage **toolkit** to assess the alignment of national TE systems with the SDGs.

- **1st stage:** Structural conditions – pilot cases currently being implemented
- **2nd stage:** Individual TE alignment with the SDGs – work in progress

The Toolkit

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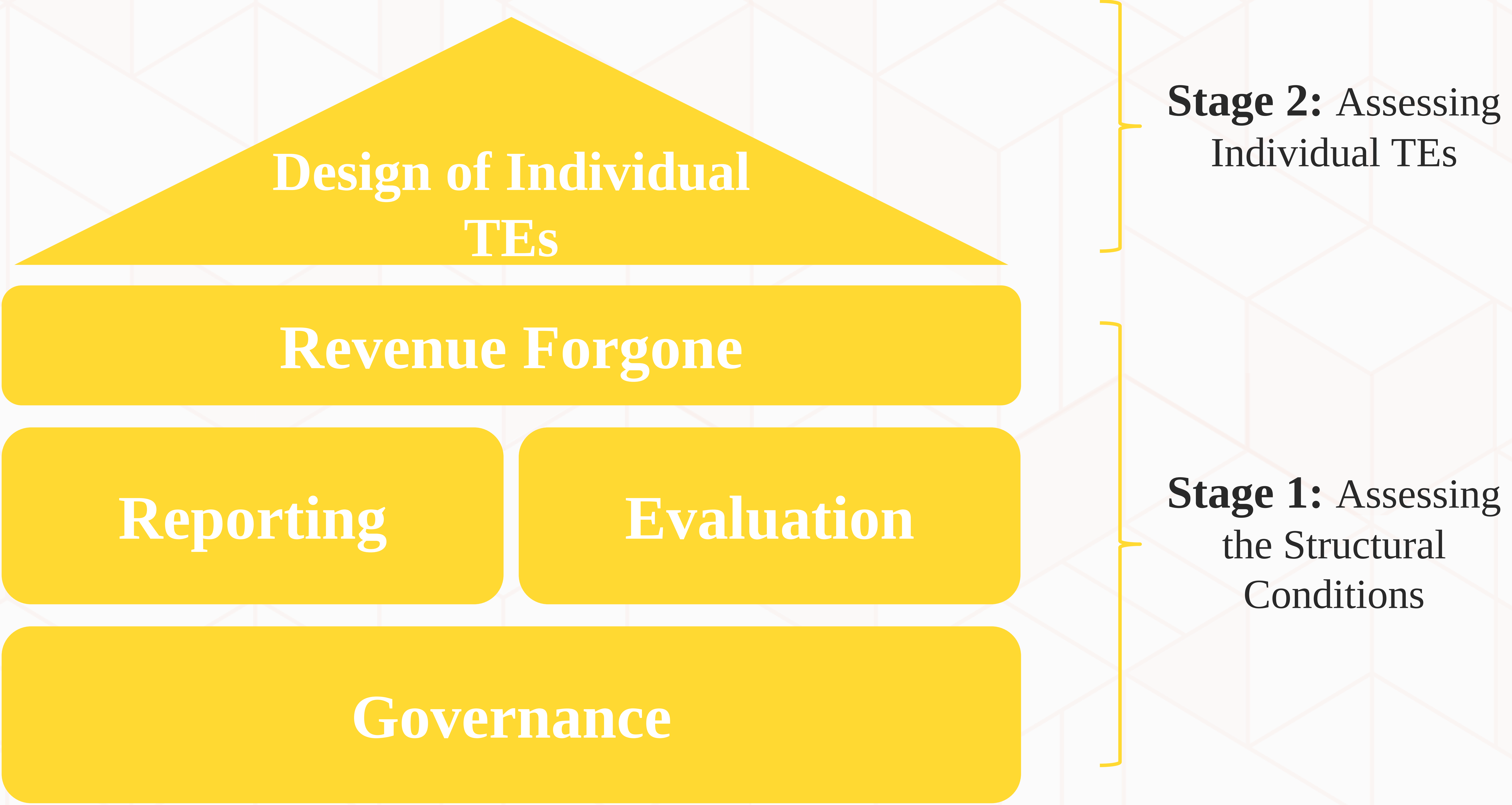

First Stage

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Dimension 1: Governance		
Subdimensions:		**Scoring**
1.1	Legal Basis	**A - D**
1.2	Fiscal Policy Integration	**A - D**
1.3	Institutional Setup	**A - D**
1.4	Institutional Capacity	**A - D**

Dimension 2: Reporting		
Subdimensions:		**Scoring**
2.1	Frequency and Regularity of TE Reporting	**A - D**
2.2	Accessibility and Visibility of TE Reporting	**A - D**
2.3	Revenue Forgone Estimates	**A - D**
2.4	Background Information on TEs	**A - D**

Dimension 3: Evaluation		
Subdimensions:		**Scoring**
3.1	Ex-Ante Examination Framework	**A - D**
3.2	Ex-Post Evaluation Framework	**A - D**
3.3	Occurrence of Ex-Post Evaluations	**A - D**
3.4	Implementation of Evaluation Results	**A - D**

Dimension 4: Revenue Forgone (RF)		
Subdimensions:		**Scoring**
4.1	RF as a Share of GDP	**%**
4.2	RF as a Share of Total Tax Revenue	**%**
4.3	RF as a Share of Government Spending	**%**
4.4	RF Targeting SDGs as a Share of Total RF	**%**

Subdimension 1. Legal Basis: Scoring

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Score	Description
A	*All of the following requirements apply:* 1. There is a legal requirement to periodically report on TEs. 2. The report is submitted to the National Assembly. 3. The institution in charge of TE reporting is clearly indicated in the law. 4. The legal requirement to report on TEs includes the description of policy objectives (ideally, with references to the SDGs) and costing of TEs (revenue forgone estimates). **Periodic reporting:** occurring at repeated time intervals. This can be because the TE report itself must be published periodically, or because another document to which the TE report is attached (e.g. the Budget) must be published periodically.
B	*At least the following requirements apply:* 1. There is a legal requirement to periodically report on TEs. 2. The report is submitted to the National Assembly.
C	There is a legal requirement to periodically report on TEs.
D	None of the above requirements apply.

Subdimension 1.1. Legal Basis: Assessment Questions

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Legal basis	Guidance	Answer	Comments	Sources
Is there a legal provision requiring to report on TEs?	**Legal requirement:** obligation specified in a public document with legal authority (law, directive, regulation, decree etc.).	*Yes/No*		
Does the legal provision requiring to report on TEs impose that reporting is done periodically?	A requirement to report periodically can be expressed directly or indirectly in the law (law, regulation, decree etc.). **Directly:** the legal prvision requiring to report on TEs specifically indicates that TE reports have to be published periodically (every year, or other period of time). **Indirectly:** the legal provision requiring to report on TEs is subordinated to the requirement to publish other document(s) (e.g. budget documentation, medium-term strategy etc.), and such document(s) are specifically required to be published periodically (every year, or other period of time).	*Yes/No*		
Is the TE report required to be presented to the National Assembly?	**National Assembly:** government institution where representatives of citizens publically deliberate and vote on national policies (e.g. parliement, assembly, council). The question focuses on national-level representative organs that have a mandate over policy-making in a jurisdiction.	*Yes/No*		

Subdimension 1.1. Legal Basis: Assessment Questions

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Legal basis	Guidance	Answer	Comments	Sources
Is the government institution in charge of TE reporting clearly indicated in the legal provision requiring to report on TEs?	**Government insitution:** entity that is under the authority of national government (e.g. ministry, agency, department, special unit)	*Yes/No*		
Does the legal provision requiring to report on TEs specify that reports must describe the policy objectives of TEs?	Beyond the requirement to report on TEs, the law could specify that the policy objectives of each TE provision are indicated in the report. This would ideally include a requirement to indicate which SDGs are being targeted by each TE provision (e.g. a TE that promotes energy transition would be identified with SDG 7). **Policy objective:** reason or purpose for which the tax law deviates from the benchmark, resulting in a tax expenditure.	*Yes/No*		
Does the legal provision requiring to report on TEs specify that reports must indicate the cost (revenue forgone) of TEs?	Beyond the requirement to report on TEs, the law may specify that the fiscal cost (revenue forgone estimates) of each individual TE provision are provided.	*Yes/No*		

Second Stage

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- Looks into specific TE provisions by assessing their **potential alignment** (or miss-alignment) with the SDGs.
- Based on 3 key questions:

a. *Is the TE's **stated policy goal** supportive or running against the SDGs?*

*b. Is the TE **effective** in reaching that policy goal, i.e. is the impact on the outcome variable the expected one? [only if answer to 2.a = supportive]*

*c. Are there potential **negative and/or positive externalities** affecting other SDG(s) being triggered by the TE?*

Earned Income Tax Credit (EITC)

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Policy goal: to bolster the economic security of low-income working families, especially those with children

Design:

- Tax credit for **low-income workers** with **eligible children** at a maximum rate of 45% of income
- The credit **plateaus and then phases out** at income levels and rates which depend upon how many qualifying children are eligible and marital status
- Credits in excess of tax liabilities owed through the PIT system are **refundable**

Evidence:

- It **encourages** single people and primary earners in married couples to **work**
- The EITC is **concentrated among the lowest earners**, with almost all of the credit going to households in the bottom three quintiles of the income distribution

Assessment Matrix

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D P

TE Provision	Assessment	Sustainable Development Goal																
		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
Earned Income Tax Credit (EITC)	*Objective*																	
	Effectiveness																	
	Externalities																	
Electric Vehicle (EV) Tax Credit	*Objective*																	
	Effectiveness																	
	Externalities																	
Mortgage Interest Deduction (MID)	*Objective*																	
	Effectiveness																	
	Externalities																	

Assessment	Green	Yellow	Grey
Objective	Supportive of SDG	Against SDG	Not supportive or against
Effectiveness	Good design	Design flaw(s)	No foreseen effect
Externalities	Positive externalities	Negative externalities	No foreseen effect

Electric Vehicle (EV) Tax Credit

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Policy goal: boost demand for EVs and accelerate the country's development of a nation-wide charging station network

Design:

- Buyers of a new plug-in **electric vehicle** (EV) may qualify for a credit up to $7,500, **if their income does not exceed**:
  - $300,000 for married couples filing jointly
  - $225,000 for heads of households
  - $150,000 for all other filers
- Only available for vehicles with **final assembly in North America**
- The credit is **non-refundable**

Evidence:

- Roughly 90% of the benefits captured by top-10 income earners
- Can violate WTO rules

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Mortgage Interest Deduction (MID)

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Policy goal: to boost levels of homeownership

Design:

- **Homeowners** can **deduct** mortgage interest on the first $750,000 ($375,000 if married filing separately) of indebtedness

Evidence:

- **Benefits highly concentrated** at the upper end of the income distribution
- Encourages high-income households to take out loans to buy **more expensive and larger houses** rather than investing in other assets

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Thank You!

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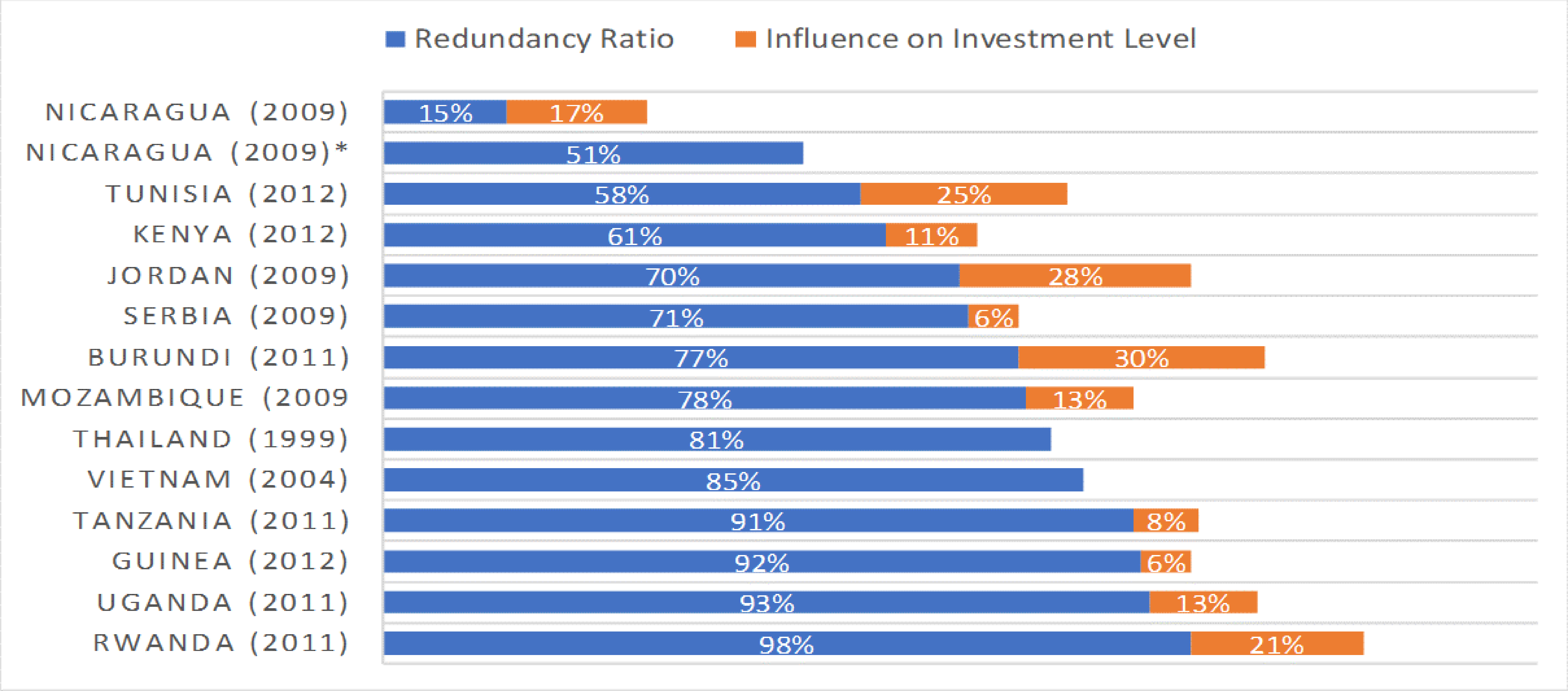
Salience of Tax Incentives based on Investor Surveys



Note: *Non-exportingfirms outsidefree zones.

Source: Own elaboration based on James, 2013.