



More than Revenue: Taxation as a Development Tool

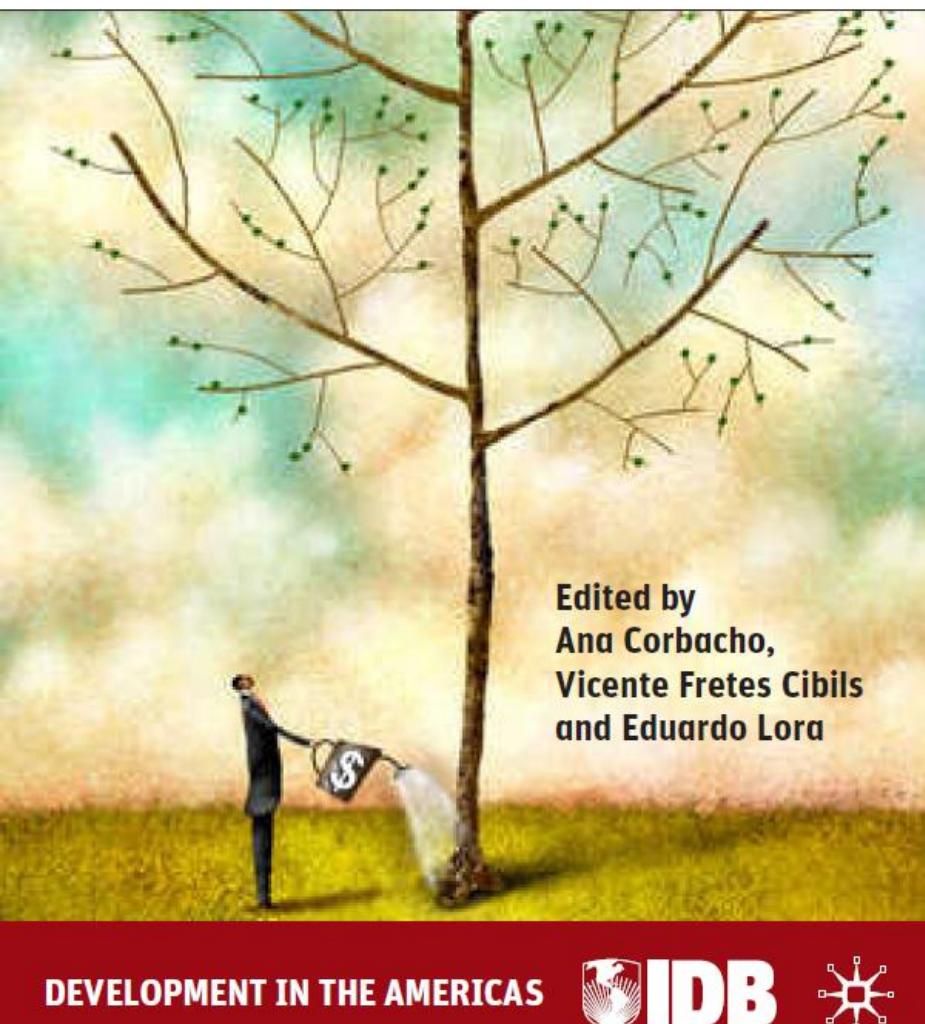
José Juan Ruiz

Improving Tax Institutions and Rules in LAC

1. 2007 San José Consultation: the biggest challenge and the biggest opportunity to advance economic and social progress in LAC
2. Recent growth of Tax Revenues in LAC has been the fastest in the world ... but still a long way to go:
 - Most countries still far from exhausting their revenue potential
 - More than revenue: taxes has to be designed as tools for stimulating development

More than Revenue

TAXATION AS A DEVELOPMENT TOOL



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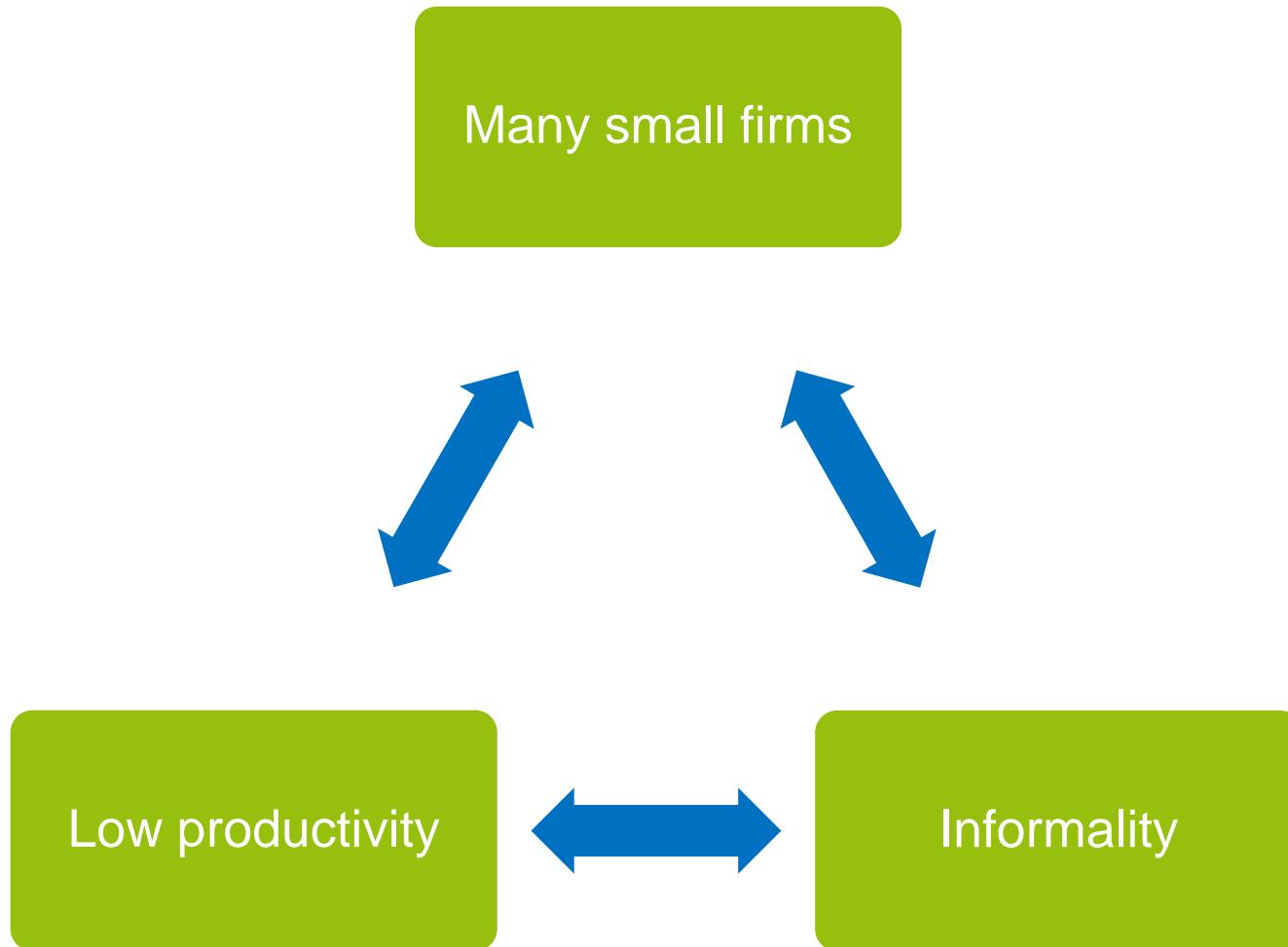
Harvesting for Development

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Pro development Tax system: Some Principles

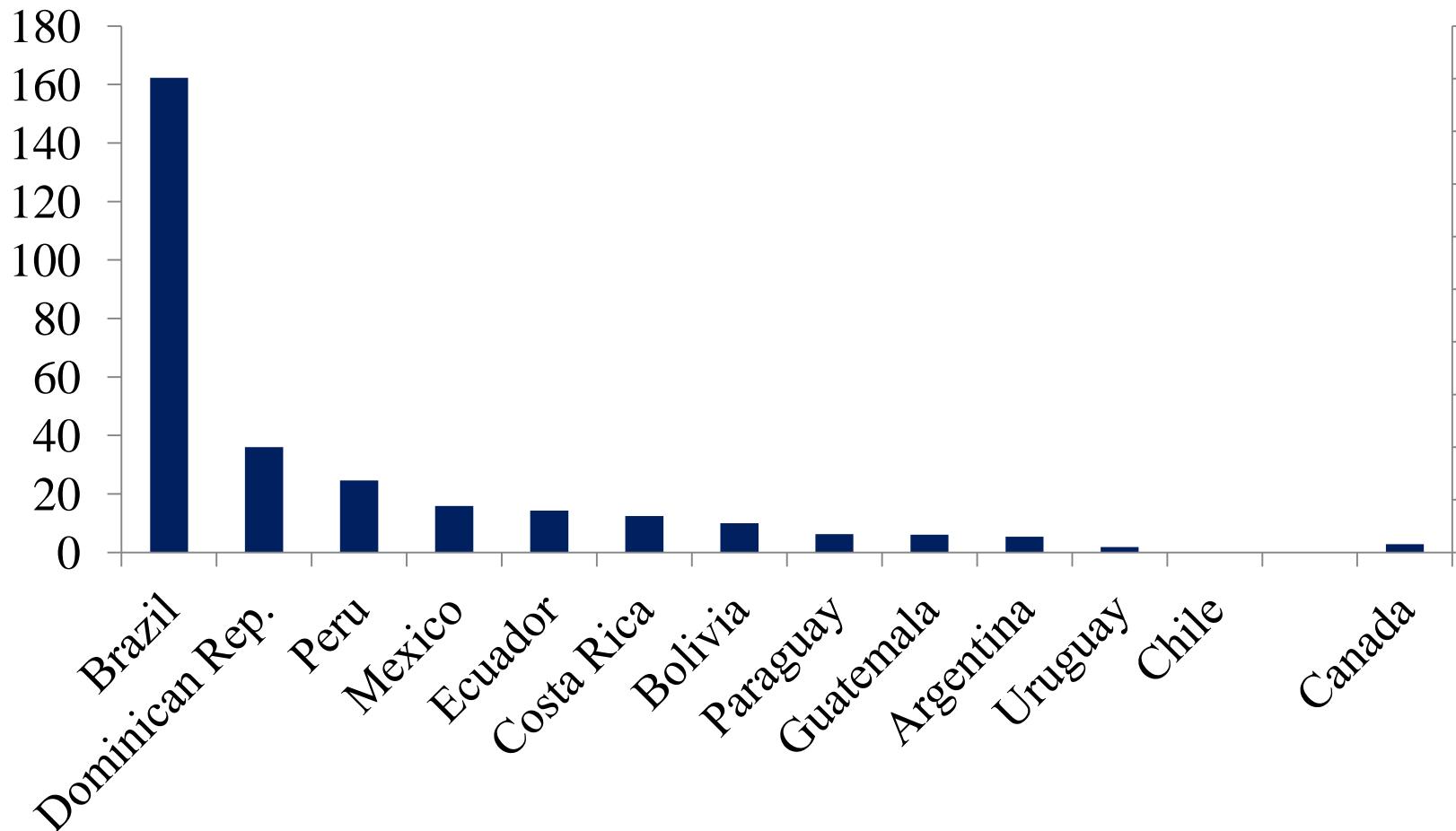
1. ***Taxes that favors the Poor:*** A real and progressive Income Tax
2. Tax Systems ***simpler and with a broader base***
3. ***Stronger Tax Administrations: Compliance***
4. ***Ensure Local Governments have enough resources to act as agents of development***
5. ***Tax system that look to the future: Natural resources and environmental taxes.***

The vicious triangle of the small firms



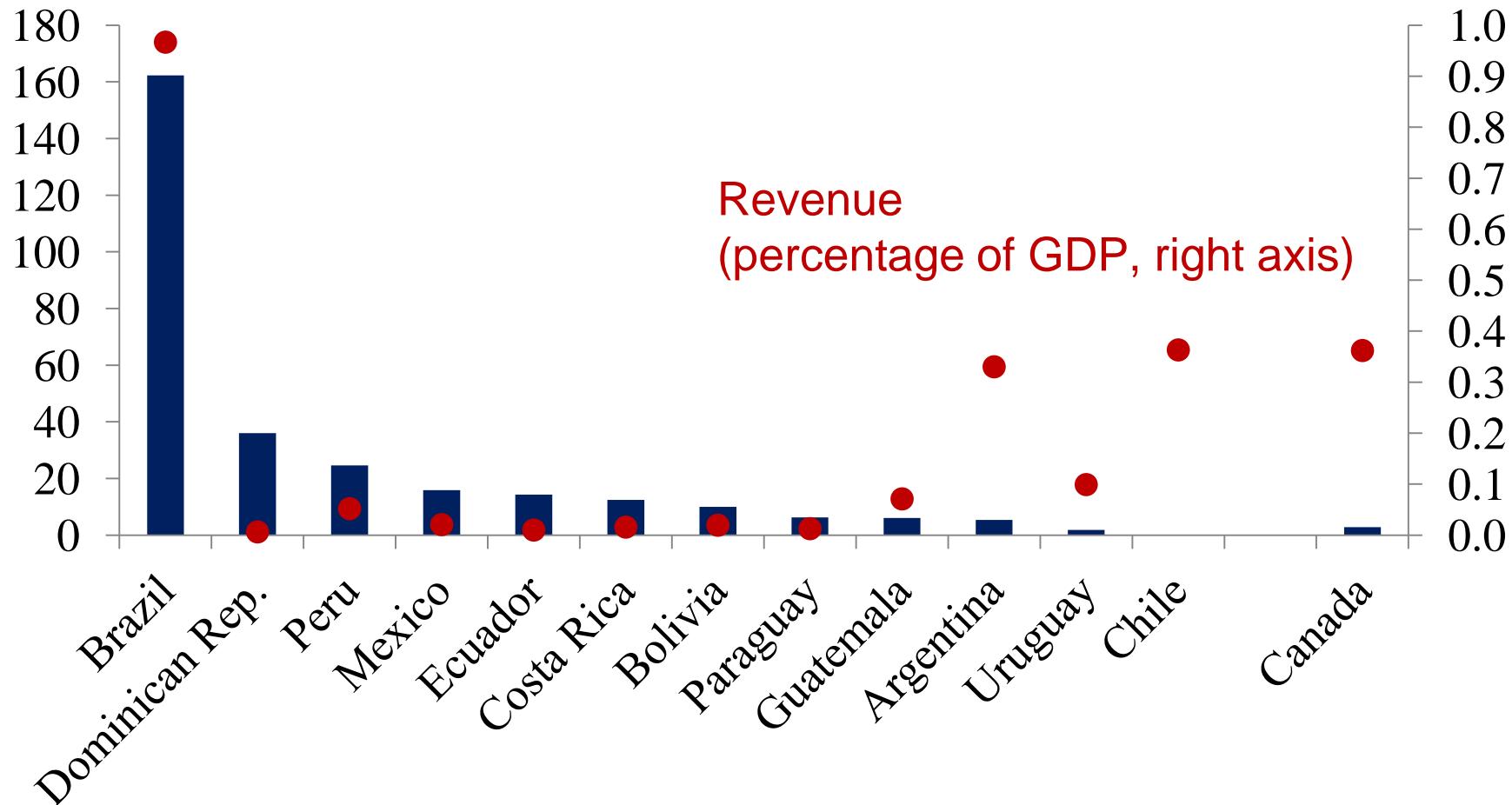
Special regimes: Fiscal dwarfism without revenue

Simplified Regimes: Maximum Income Limits



Special regimes: Fiscal dwarfism without revenue

Simplified Regimes: Maximum Income Limits



...that creates sizable horizontal inequity

Tax wedge for contributor in the third decile (percentage of wages)

	Special Regime	Salaried Worker
Argentina	10.9	34.0
Bolivia	30.5	27.6
Brazil	3.8	34.7
Chile	23.0	23.3
Costa Rica	12.5	37.2
Mexico	9.3	25.8
Peru	18.0	40.2
Uruguay	20.1	32.8
Average	16.0	32.0

Obstacles to tax reform: Mainly political economy

- **Dependence on revenues from non-renewable natural resources**, which discourages domestic revenue mobilization
- **Resistance of economically and politically powerful interest groups** that benefit from tax concessions
- **Poor perception by the median voter** of
 - The value of public goods and services
 - The link between revenues and the fiscal space for improving the provision of such goods and services
 - The effectiveness and fairness of the tax administration
 - The cost of tax expenditures
 - Soft budget constraints that discourage sub-national tax effort

How to overcome these obstacles?

- **Increased budget transparency and communication**
 - Estimate and disseminate the distribution of costs and benefits of tax expenditures
- **Institutional reforms**
 - Save part of resource revenues
 - Harden the sub-national budget constraint
 - Increase autonomy and transparency of tax administration

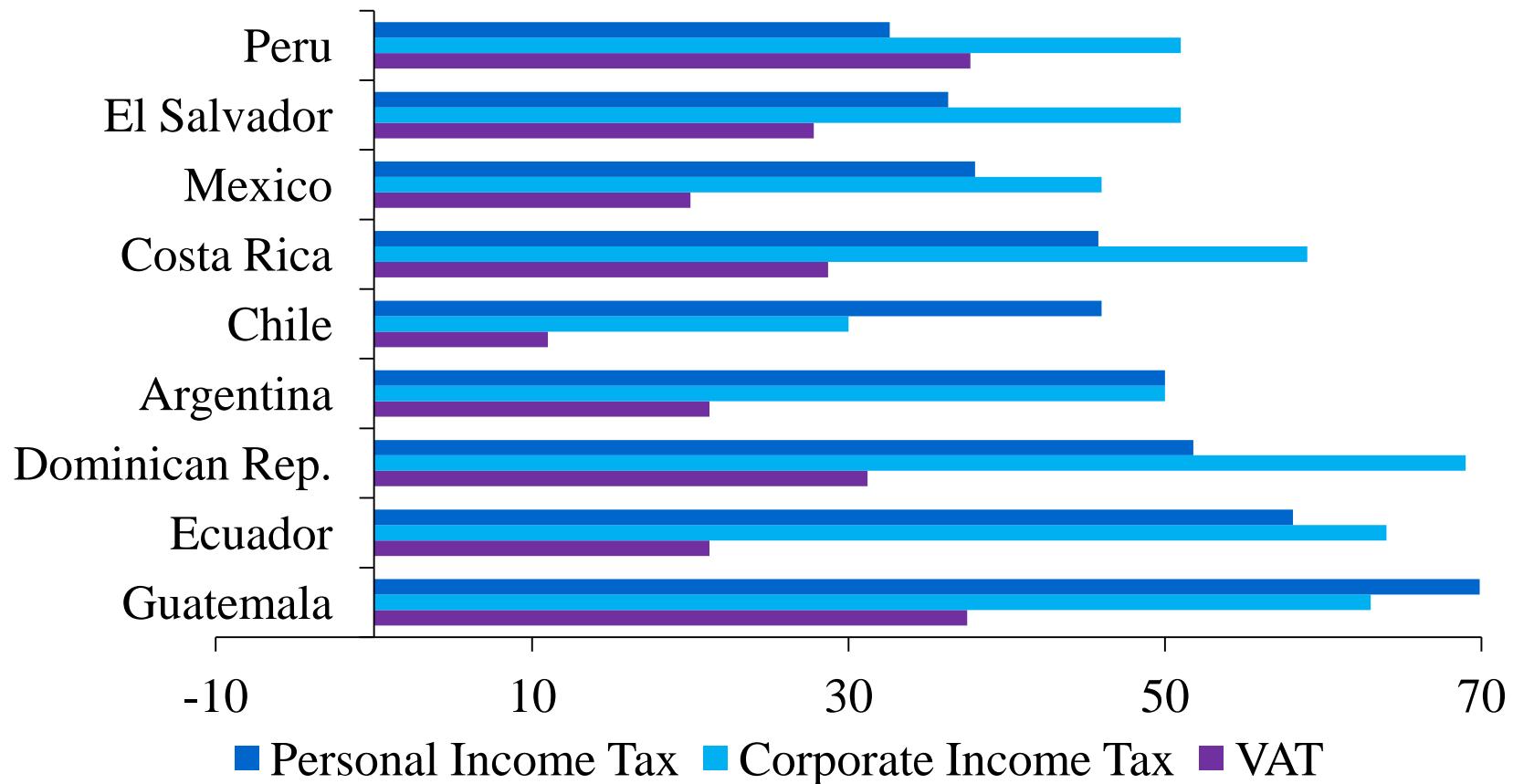
Institutions for People



Inter-American Development Bank/ www.iadb.org

Generalized evasion in income taxes

Tax Evasion Rates
(percentage)



Minimum chances of being audited

Invoice Controls, Mass Audits, and In-depth Audits, 2010
(Percent of active taxpayers inspected)

	Invoice controls	Mass audits	In-depth audits
Argentina	1.7	1.6	0.4
Chile	5.9	14.8	0.2
Colombia	0.1		
Costa Rica		0.3	0.1
Dominican Rep.	10.0	1.2	0.0
Ecuador	0.0	1.0	0.1
El Salvador	10.0	0.9	0.8
Guatemala	0.2	0.2	0.1
Mexico	0.1		0.2
Panama	0.1	2.0	0.0
Peru	4.2	3.6	0.2
Average	3.1	2.8	0.2

To collect taxes is essential, but not enough

- Increase revenues
 - Reform personal income taxes
 - Strengthen subnational revenues (ej., property and green taxes)
- Fight inequities
 - Reduce VAT regressivity with transfers to poor households
 - Gradually incorporate middle classes to personal income tax
- Promote productivity
 - Eliminate exemptions, incorporate SMEs to general regimes
 - Dismantle distortionary heterodox taxes
- Bet on the future
 - Tax “bads” (externalities from fuels, trash)
 - Prepare for when natural resources get exhausted

VAT reform options

- **Main recommendations**
 - Eliminate pervasive exemptions
 - Unify rates
 - Use part of additional revenues to compensate poor households
 - Use the rest to reduce payroll taxes
- These reforms would
 - Reduce informality
 - Improve productivity and external competitiveness
 - Facilitate tax administration
 - Not hurt the poor

Taxing “bads” to protect “goods”

- **Main recommendations**
 - Focus excises on a few goods whose consumption is to be discouraged (notably alcohol and tobacco)
 - Strengthen environmentally-related taxes
 - Eliminate significant energy subsidies in some countries
 - Consider the introduction of taxes on carbon emissions
- Such reforms would
 - Mobilize revenue
 - Promote efficiency in the use of scarce resources
 - Improve vertical equity

Local taxes for local development

- Sub-national governments in LAC have limited sources of own revenues (except states in Brazil), hampering political accountability, fiscal responsibility, and improved provision of goods and services
- **Potential new sub-national tax handles**
 - Regional income tax (or surcharge on national income tax)
 - Regional VAT (Problem: complexity of taxing interstate trade)
 - Regional or local excise taxes (or surcharge on national excises)
- **Better utilization of existing sub-national revenues**
 - Property taxes (with improvements in property cadasters)
 - User fees
 - Tax administration

Phasing out “heterodox taxes”

- **Main recommendations**
 - Eliminate financial transactions and export taxes
 - Progressively reduce presumptive tax regimes (including special regimes for SMEs), as tax administration improves
- Such reforms would improve efficiency, including by reducing disincentives for SMEs to outgrow special regimes
- They would need to be combined with other recommended reforms to offset potential revenue losses