



# **Taxation for Development:** **A Reform Agenda**

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# To collect revenue is essential but not enough

- **Main reform objectives for the region**
  - Increase revenues
  - Improve horizontal and vertical equity
  - Promote efficiency and productivity
- **There are trade-offs, but also scope for synergies**
  - Several recommendations can achieve more than one objective
- **No one-size-fits-all prescription**
  - Reform strategies need to be tailored to countries' economic, institutional and socio-political context

# Personal income tax reform options

- **Main recommendations**
  - Reduce the personal income exemption level
  - Cap deductions that rise with income
  - Broaden the tax base
  - Adopt a dual income tax
- These reforms would
  - Increase revenue
  - Improve horizontal equity and efficiency
  - Increase the redistributive capacity of the tax
  - Facilitate tax administration and enforcement

# Corporate income tax and natural resources

- **Corporate income tax**
  - Reduce pervasive tax incentives
  - Combat tax avoidance, especially through transfer pricing
  - Possibly utilize increased revenues to reduce corporate tax rates
- **Natural resource taxes**
  - Shift from royalties to more efficient profit taxes

# 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

# 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

# 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



# 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

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