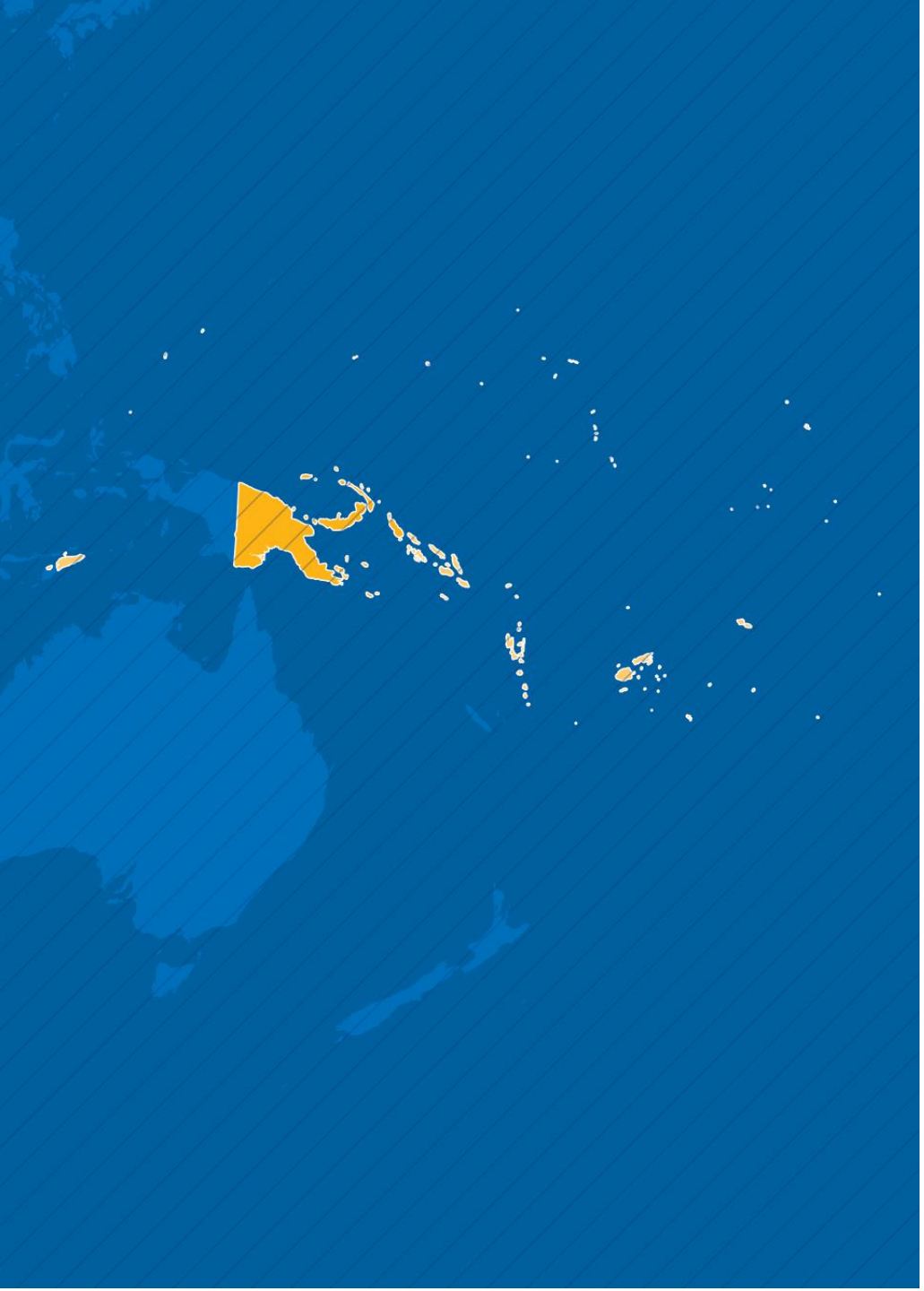

PFTAC PACER Plus Talanoa

FEBRUARY, 2025

Katrina Williams
Koni Ravono
Li Liu

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Session 3 – Domestic Revenue Mobilization

Broadening the Tax Base	Strategies to Optimize VAT	Tax Expenditures	Revenue Administration
Katrina Williams *Revenue Administration Advisor PFTAC*	*Li Liu* *Senior Economist IMF Tax Policy*	*Koni Ravono* *Short term expert PFTAC*	

Domestic Revenue Mobilization (DRM)

Process of generating income through internal sources: Primarily involves taxation

Components of DRM

- Effective collection of tax revenues
- Management of other domestic resources

Importance of DRM

- Ensures financial independence - Enhancing tax collection reduces dependence on foreign aid and loans

Economic Stability

- Stable revenue streams contribute to economic stability and planning

Challenges in Revenue Collection in the Pacific

External	Internal
Dependence on limited sources of income Over-reliance on Fishing Revenue Grants	**Lack of Reform Momentum** Slow progress in implementing necessary changes
Informal Economies High levels of informal economic activity limit tax collection effectiveness	**Understaffed Tax Administrations**
Political Will Success of DRM initiatives depends on strong political commitment and governance structures	**Administrative Capacity** Limited capacity and resources within tax administrations hinder effective tax collection
Economic Fluctuations Economic instability affects revenue collection and forecasting	**Policy and Legislative Constraints** Outdated or restrictive regulations Need for modernization and flexibility
Environmental Impacts Natural disaster Climate change	**Insufficient ICT Support** Lack of technological infrastructure

Key Strategies for Enhancing DRM

Broadening the Tax Base

- Expanding taxable activities and entities
- Increasing overall tax revenue

Enhancing Policy Frameworks

- Developing well-structured tax policies
- Promoting fairness, efficiency, and economic growth

Modernizing Tax Administration

- Utilizing modern technology
- Streamlining tax collection and management

Improving Tax Compliance

- Reducing tax evasion and avoidance
- Better enforcement and taxpayer education

Broadening the Tax Base

Definition and Purpose

- Increasing the range of income, goods, and services subject to taxation
- Enhancing revenue collection by capturing a wider scope of economic activities
- Reducing dependency on a narrow set of taxable items

Benefits

- Distributing the tax burden more evenly
- Improving compliance by minimizing loopholes and exemptions

Importance for Pacific Island Countries (PICs)

- Unique economic challenges: small and dispersed populations, reliance on external aid, limited economic diversification
- Optimizing domestic revenue mobilization efforts
- Increasing financial independence
- Supporting public services

Efforts to Broaden the Tax Base

Creating a Resilient and Inclusive Tax System

- Supporting long-term economic growth and stability

Introducing New Taxes

- Taxing previously untaxed sectors or activities

Eliminating Unnecessary Tax Exemptions

- Removing unneeded tax incentives

Improving Tax Compliance

- Reducing tax evasion

Enhancing Administrative Capacities

- Effective implementation and enforcement of tax policies

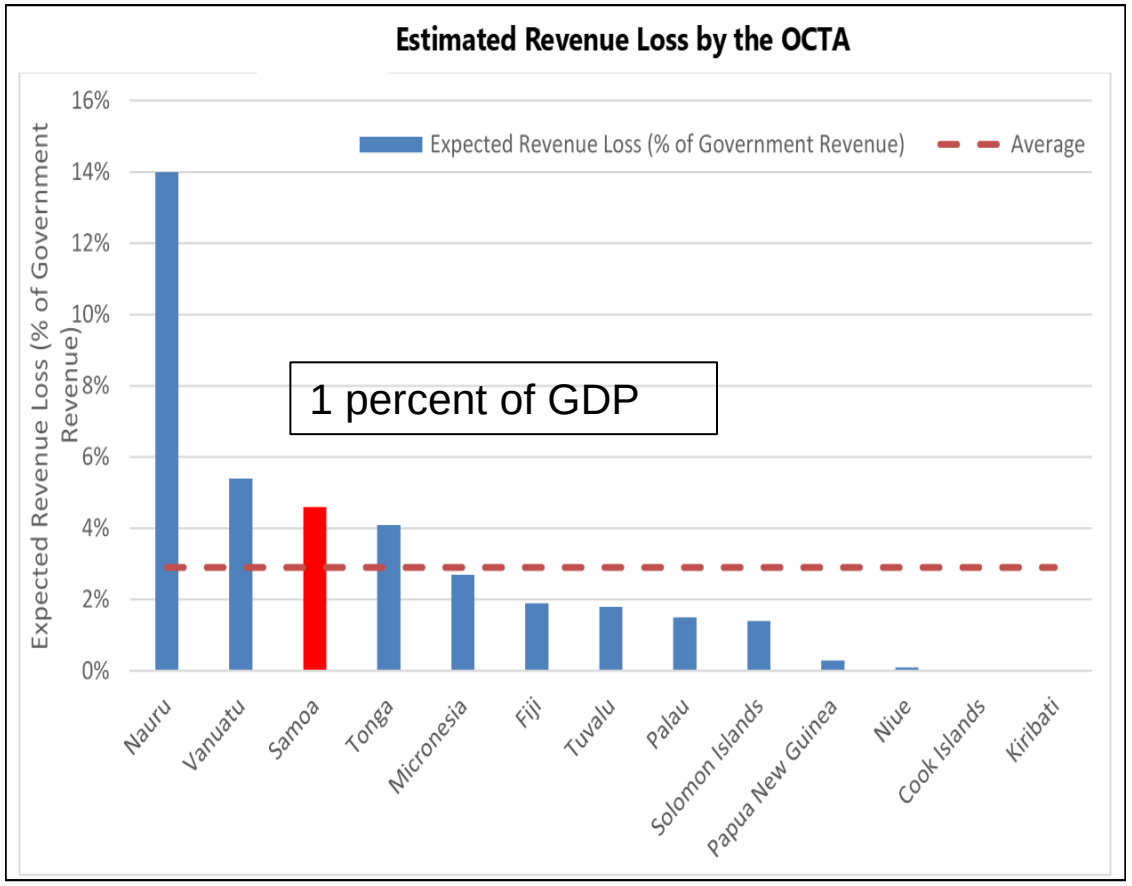
Resource Mobilization Options to Address PACER Plus (Li Liu)

Based on PACER Plus missions to Tonga (2019, 2020, 2025*) and Samoa (2020)

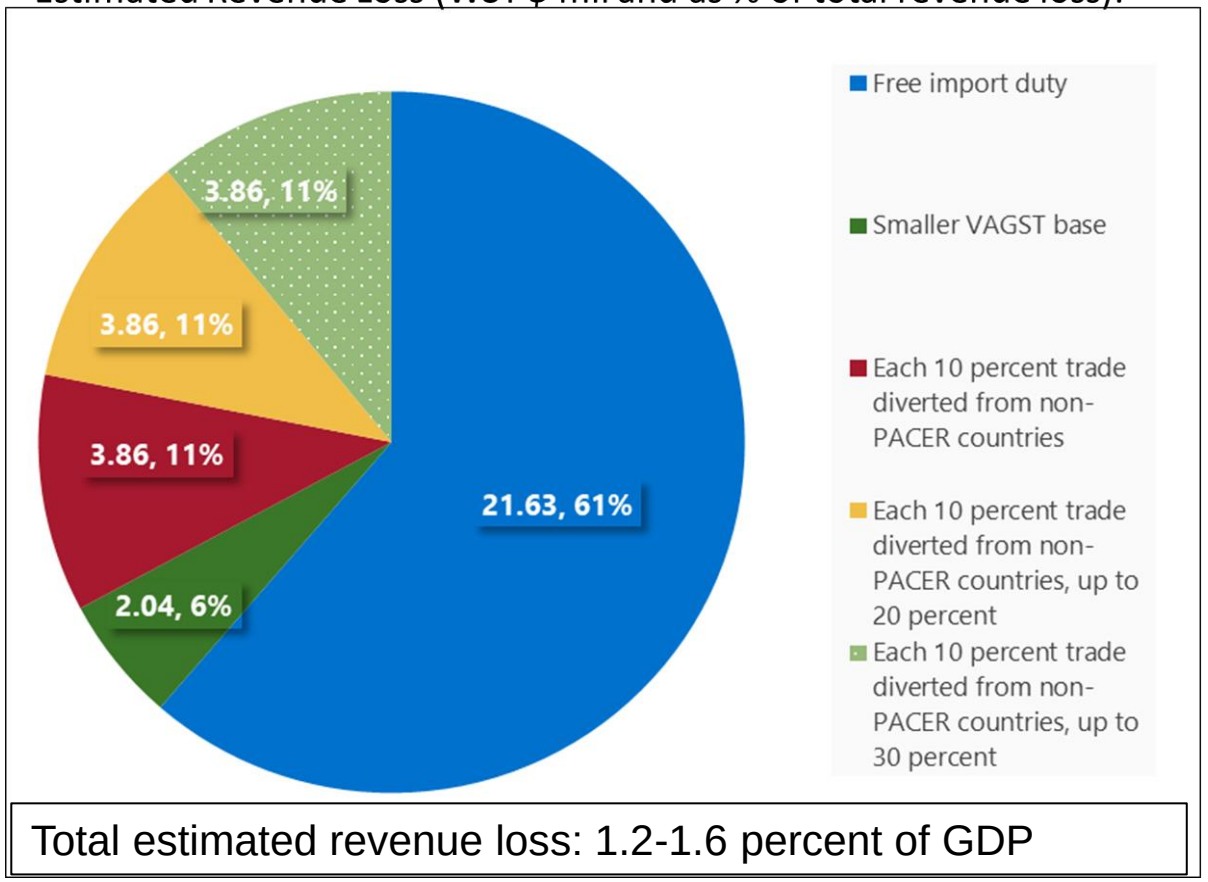
(9.45-10.15am)

(Likely) Substantial tariff revenue loss from PACER Plus

For Samoa:

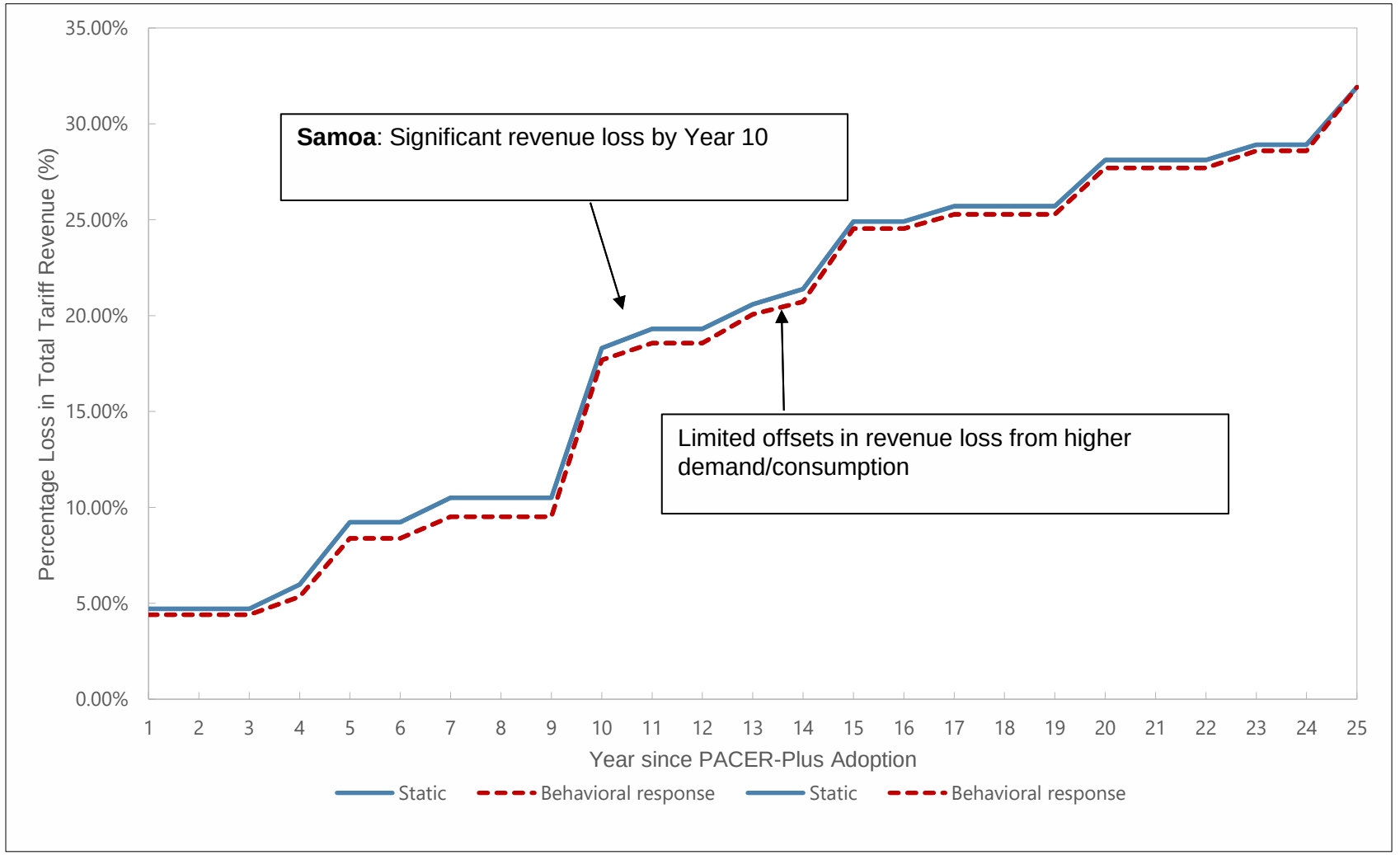


Estimated Revenue Loss (WST $ mil and as % of total revenue loss):

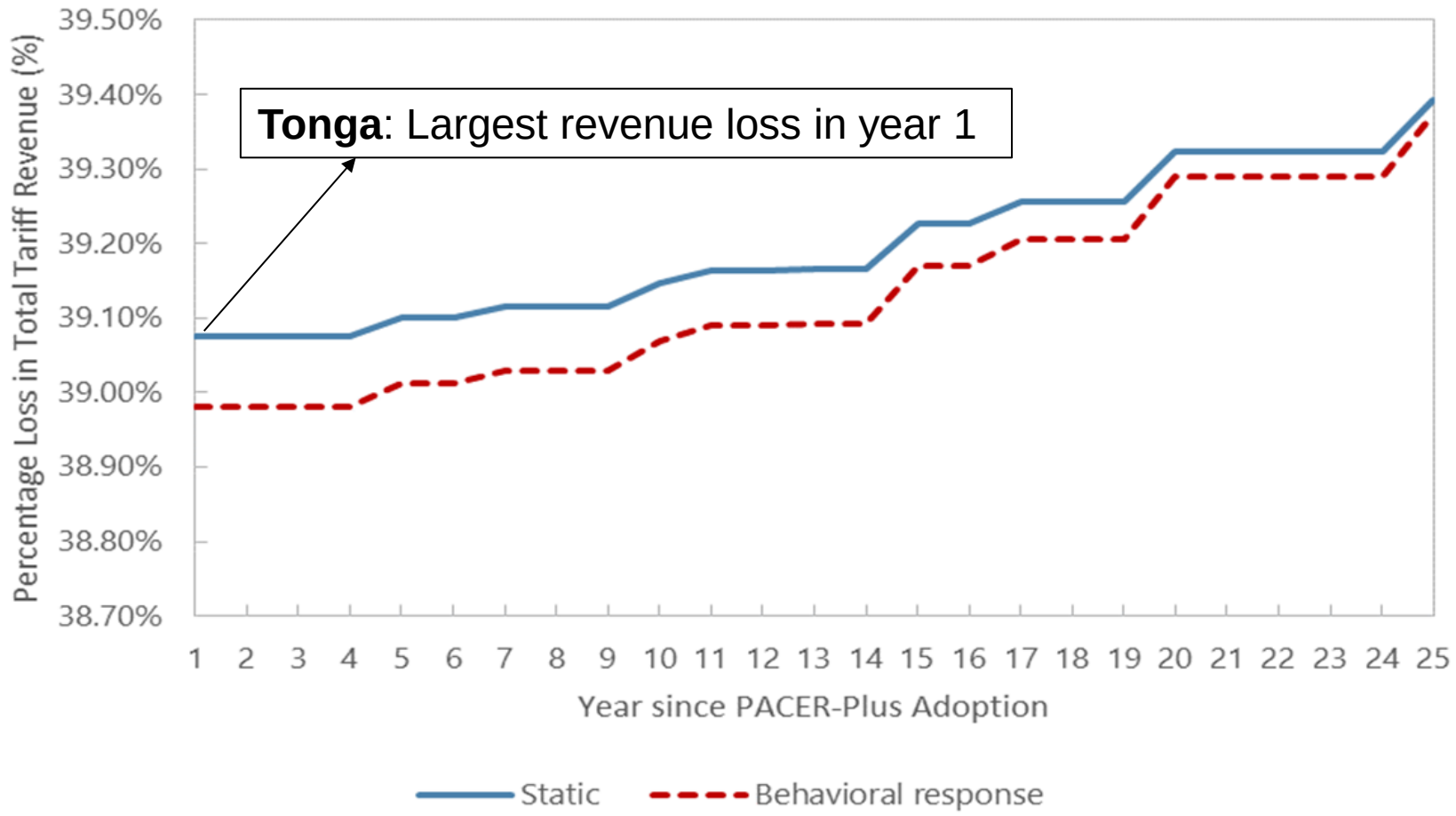


Total estimated revenue loss: 1.2-1.6 percent of GDP

Gradual revenue reduction with limited offset due to higher demand: Samoa



Gradual revenue reduction with limited offset due to higher demand: Tonga



Reform Options in Tax Policy (1)

Need to address multiple objectives:

- Compensate for loss of revenue
- Additional revenue needs, improving efficiency of the tax system while making it more equitable

Focus on policy reforms

- Some (but not all) revenue loss could be recovered through better tax compliance and improvements in administration
- E.g. continued reforms of the revenue authorities and addressing concerns such as import misclassification and undervaluation

Simplest reform option is to increase major tax rates (?!)

- **VAGST:** from 15% - 17-18%; politically infeasible
- **CIT:** above 27%; against international trend
- **PIT:** increasing the top PIT rate but the revenue impact is likely to be small

Reform Options in Tax Policy (2)

(1) Broadening the tax base

- Reviewing and reducing VAGST and import duty exemptions
- CIT: Rationalizing CIT incentives; strengthening the anti-avoidance rules; limiting loss carry forward period to five years
- Reviewing the differential rate of capital gains tax

(2) Reviewing some tax rates

- Increasing some excises, e.g., tobacco and wine
- Continuing to review non-tax fees and charges

(3) Expanding existing taxes or introducing new taxes

- Imposing a withholding tax on dividends paid to non-residents
- Introducing an excise tax on telecommunication services
- Introducing/expanding environmental taxes to address negative externalities

Morning Tea
10.15-10.30

Introducing Value Added Tax (VAT): Tax Policy design elements (Li Liu)

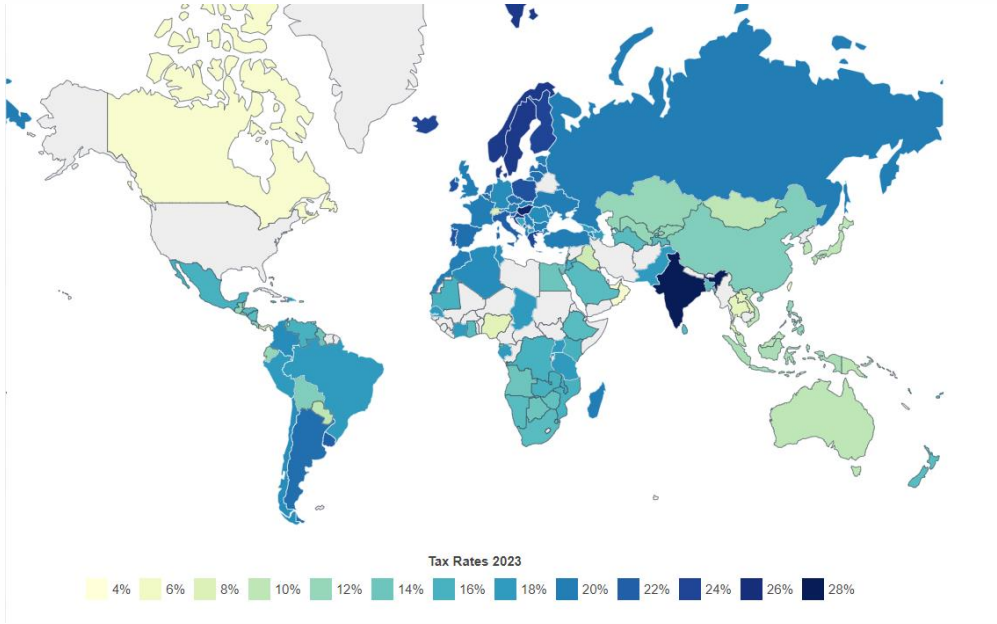
(10.30-11.30)

I. History and Trends

A Brief History of VAT

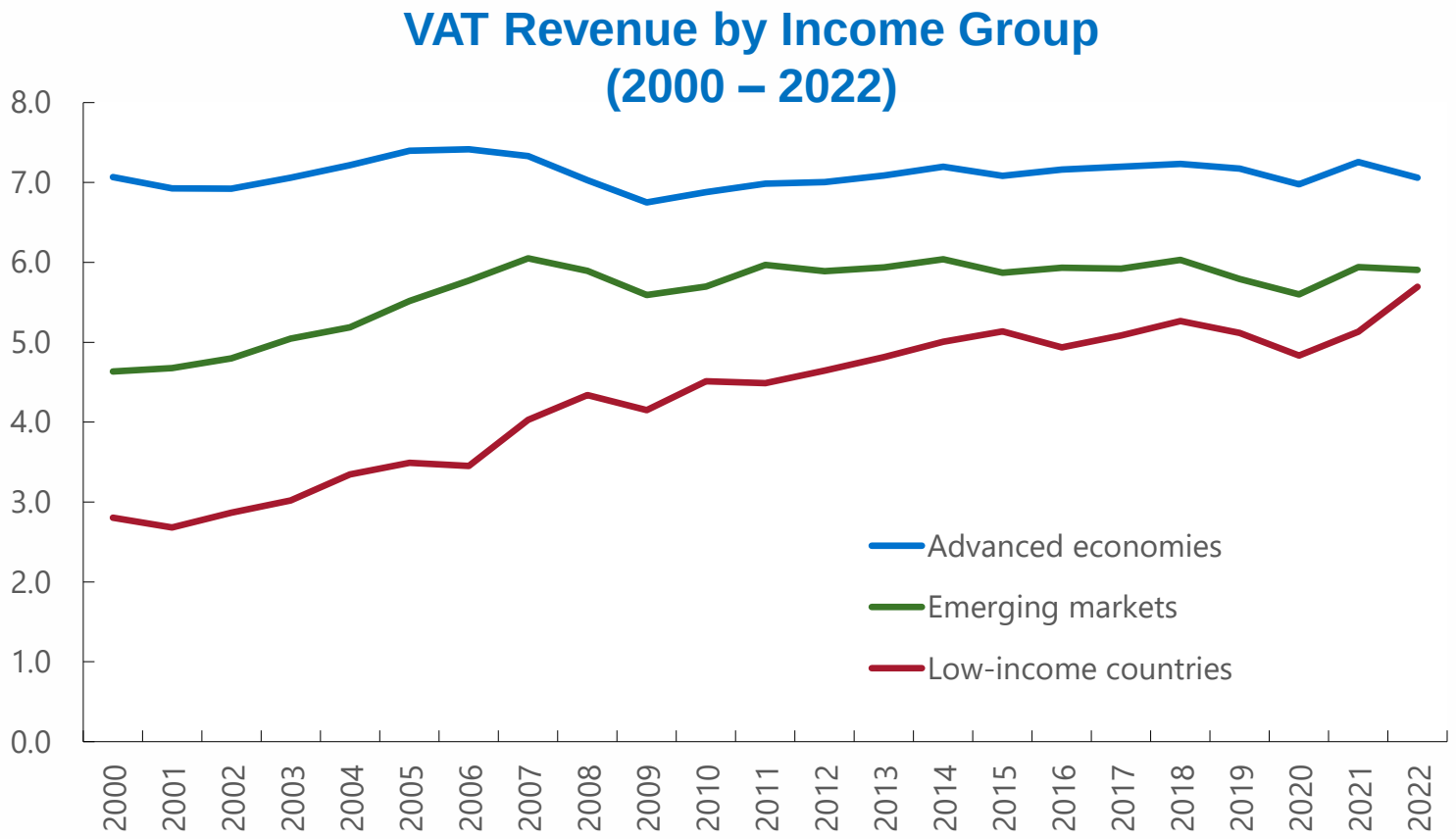
- Almost unheard of 60 years ago, now adopted in over 170 countries.
  - Notable exceptions: USA

- History of adoption marked by regional trends, and some evidence of IMF programs:
  - 1960s: Europe.
  - 1970s: Latin America.
  - 1990s: Economies in transition; Africa; Asia.
  - Recent adopters: GCC and oil producers; Small island economies (e.g., Caribbean and Pacific).
  - In progress: **Bhutan, Kuwait, Liberia, Qatar, Timor-Leste, etc.**



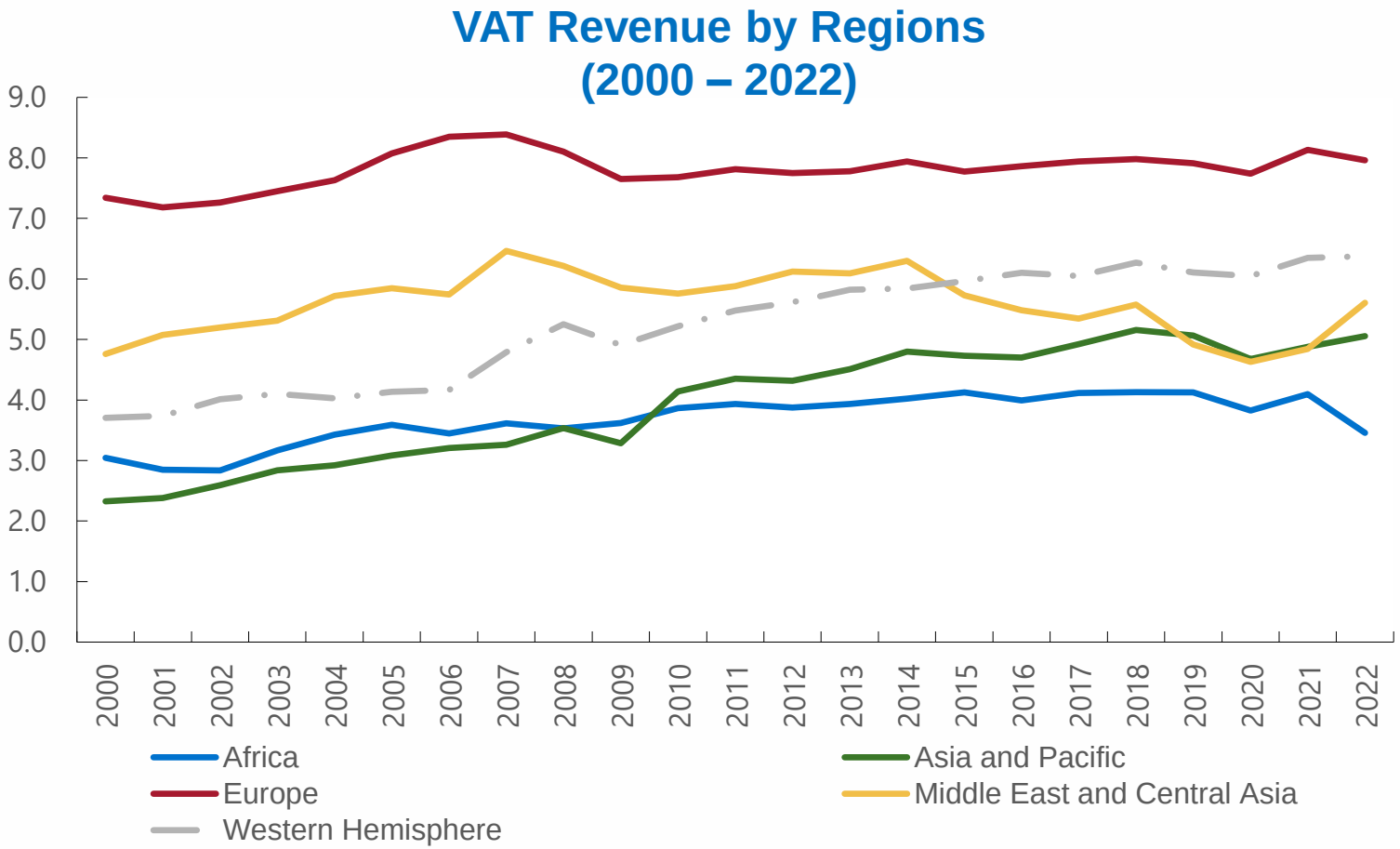
Source: World Population Review

Development in VAT Revenue: World



Source: WoRLD.

Development in VAT Revenue: APD



Source: WoRLD.

Measure of VAT Performance

- **C-efficiency** measures how effectively a country collects VAT relative to its theoretical maximum potential.

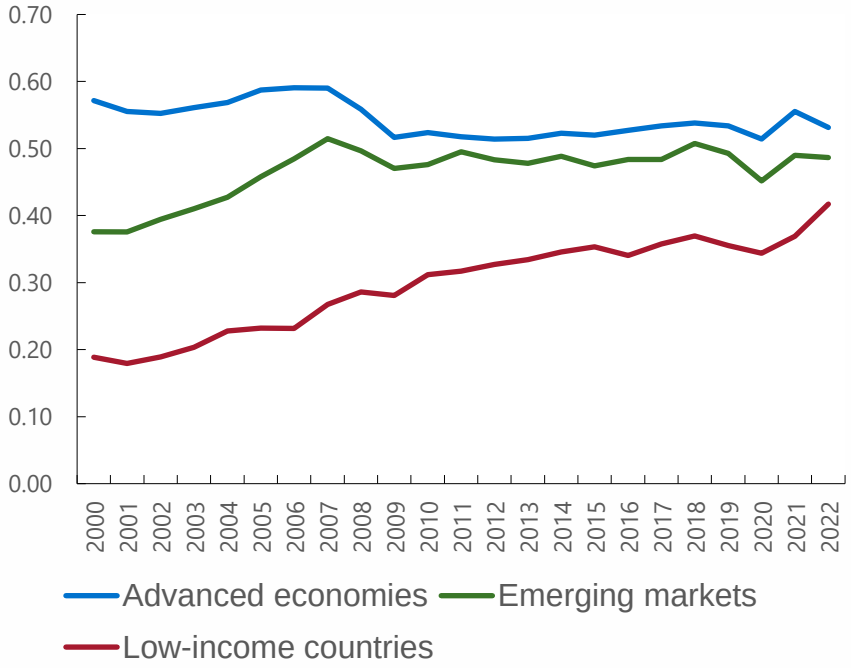
- C-efficiency =Actual VAT Revenues / Potential VAT Revenues

  Actual VAT Revenues: the total revenue collected from VAT in a given period, and Potential VAT Revenues: the revenue that would be collected if the standard VAT rate was applied to the entire consumption base without any exemptions, reduced rates, or non-compliance.

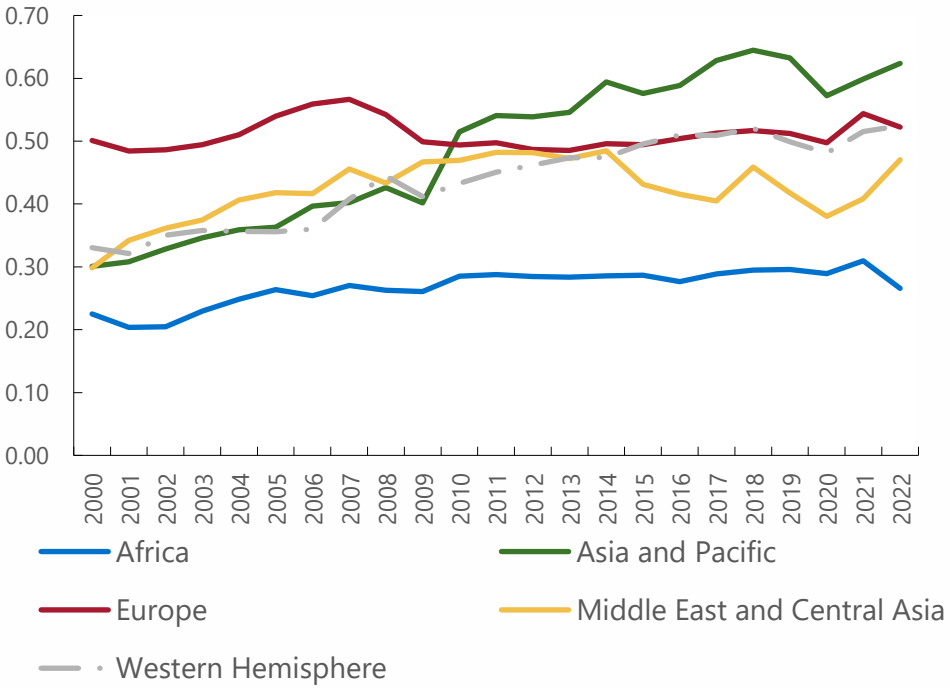
- C-efficiency serves as a benchmark for assessing the performance of a VAT system: A higher C-efficiency indicates that the VAT system is more effective in capturing its potential revenue.

VAT C-Efficiency

C-efficiency by Country Group (2000 – 2022)



C-efficiency by Region (2000 – 2022)



II. Principle and Design

What is a VAT?

- **A tax on domestic final consumption**
  - Imposed on a destination basis
    - Border adjustment mechanism (imports taxed; exports zero-rated)
  - Indirect tax
    - Collected by businesses (registration required), vendor model
    - Charged to consumers
- **A multi-stage tax**
  - Collected throughout the supply chain (unlike retail sales taxes)
  - Invoice-credit mechanism
  - Refund of excess tax credits
- **Universal, broad-based tax (ideally, single rate)**

VAT is a multi-stage tax

Invoice-credit method:

- Rate is applied to each taxable sale: $t \times sales$
- the tax remitted equals the difference between VAT collected on sales and VAT paid on inputs (input tax credits):

$$t_{remitted} = VAT_{output} - VAT_{input}$$

	Amount of Purchases	Sales	VAT 10%		VAT Paid
			Input Tax	Output Tax	
Wheat	0.0	100.0	0.0	10.0	10.0
Flour	100.0	180.0	10.0	18.0	8.0
Wholesale market	180.0	250.0	18.0	25.0	7.0
Bakery	250.0	300.0	25.0	30.0	5.0
Total			53.0	83.0	
Total tax collected				**30.0**	**30.0**

VAT vs Turnover and Retail Sales Tax

	Purchases	Sales	Value Added	VAT Rate 10%			Multi-stage	Single-stage	Single-stage
				Input Tax	Output Tax	Potencial Collection	Turnover Tax 3%	20% Tax on Wheat	10% Tax on Bread (RST)
Wheat	0.0	100.0	100.0	0.0	10.0	10.0	3.0	20.0	0.0
Flour	100.0	180.0	80.0	10.0	18.0	8.0	5.4	0.0	0.0
Wholesale market	180.0	250.0	70.0	18.0	25.0	7.0	7.5	0.0	0.0
Bakery	250.0	300.0	50.0	25.0	30.0	5.0	9.0	0.0	30.0
Total tax collected						30.0	24.9	20.0	30.0
Effective Tax Rate						10.0	8.3	6.7	10.0
The same Product but in Only One Stage: the Retail Sector									
Bakery	0.0	300.0	300.0	0.0	30.0	30.0	9.0	0.0	30.0
Effective Tax Rate						10.0	3.0	0.0	10.0

VAT requires sound rules on input deductibility

- Properly implemented and administered to counter fraud (strong anti-fraud rules and efficient tax administration)
  - Controls to avoid false invoice (“Achilles' heel” of many VATs)

- Restrictions to input tax recovery
  - Possible private consumption by businesses, e.g., cars, club memberships, supplies to employees (e.g. catering, in-kind benefits)
  - High value capital goods that also have mixed (business/non-business) use

- **Efficient refund (of excess credits) mechanism** needed:
  - Immediate refunds (preferred)
  - Limited carry-forward (acceptable)
  - Indefinite carry-forward (to be avoided)

Setting the VAT rate

- **Single positive rate** for domestic sales
- **Zero-rate for exports** (destination principle)
- Nevertheless, many countries use **multiple VAT rates** for domestic taxation, i.e., a standard rate and:
    - Reduced rates; super-reduced rates (<5%); zero rates;
    - Increased rates (usually for luxury goods/services or those with low price elasticity of demand, e.g., telecom).
- **Choice of rate** driven mostly by revenue needs
- **Should not deviate** much from neighboring countries (cross-border shopping)

Multiple rates are not good practice

- **Not effective at addressing equity issues**, especially if rate differential is small (products have price dispersion)
- **Direct revenue loss** (plus indirect loss due to governance issues—revenue leakage)
- **Complicates compliance and tax administration:**
  - Problem with delineation between goods and services taxed at different rates—numerous disputes (even under unified base).
  - Increasingly complex refund claims.
- **Multiple rates tend to proliferate**
  - Businesses seek special treatment if others get it; discretion and “preference creep” increases
  - End up tampering with the rest of the value chain if reduced rates lead to refunds, creating even more distortions.

Dispersion of VAT Rates by Region

- Mostly single rates in Africa, Asia, and Middle East (mixed in Latin America)
- Lower rates in Asia
- Multiple high rates in Europe

	Sub-Saharan Africa	Asia Pacific	Europe	Middle East & Central Asia	Western Hemisphere	World
Number of countries	43	26	42	24	34	169
Number of countries with multiple rates	21	13	39	10	21	104
Share of countries with multiple rates (%)	49	50	93	42	62	62
Maximum standard rate (%)	20.0	20.0	27.0	20.0	22.0	27.0
Minimum standard rate (%)	7.5	5.0	7.7	5.0	5.0	5.0
Average standard rate (%)	16.0	10.9	20.7	13.6	14.2	15.1

Note positive correlation between high standard rate and occurrence of multiple rates

Choosing the VAT base

- As broad as possible: ideally all goods and services taxed.
- But almost all countries apply preferential treatment to some goods and services
  - “Zero rated” goods and services
  - “Exempt” goods and services
- Key differentiation is ability to credit and potential price/revenue implications.
- Threshold choice will also determine the size of base

Limit zero-rating to exports and necessities

- Impact of zero-rating: by not taxing the sale but allowing for credits for the input tax, can lead to a lower **after-tax price**.

- Governments commonly lower the tax burden on low-income households by zero rating certain essential goods:
  - Basic food groceries; prescription drugs, books

- Excessive zero-rating will generate excessive refunds.
  - In response, countries tinker with other parts of the system to avoid refunds, introducing more and more distortions along the value chain.

Minimize exemptions to minimize distortions

- One step further than zero-rating: producers cannot claim input credit.

- “Cascading” breaks the VAT’s chain of credits on input purchases
  - Distorts input choice; can raise prices (and revenues).
  - Self-supply bias

- Governments generally only use exemptions when **value added is hard to define**, e.g., education, healthcare, margin-based financial services

- To improve efficiency, can also exempt those activities that alter the labor-leisure trade-off, e.g., childcare services (without them people cannot work)

- From equity point of view, temptation to exempt necessity goods
  - Can zero rate some, but better to apply standard rate to all goods, and use targeted pro-poor spending to address socio-economic needs.

Problems with Exemptions and Reduced Rates

- **Loss of neutrality**: relative price of goods is modified (e.g., substitute goods should never receive a differential treatment). If the exemption applies on intermediate consumption goods, it causes cascading effects.
- **Revenue loss. Except for** goods are used in the intermediate consumption VAT reduced rates or exemptions do not result in foregone revenue.
- **More complex** administration and compliance, in all types of procedures.
- **Avoidance and evasion** (create opportunities for deliberate misclassification).
- **Scope for disputes in courts**.
- A **precedent for other sectors to claim similar treatment**, which could further undermine the VAT design.
- The **distributional impact** of exemptions and reduced rates could be nil or very low

VAT Registration Threshold

Registration thresholds relieve suppliers from both the requirement to register for VAT and to collect the tax.

Threshold is usually based on **turnover**. Eligible SMEs that opt for the exemption are **not entitled to deduct input tax incurred on purchases of goods and services**

- Merit of voluntary registration below the threshold

Optimal VAT exemption threshold

- Balance the **trade off between the loss in revenue** and the savings of **compliance and administrative costs**
- With a tax rate of 15%, for developed economies the threshold has been estimated around US$ 40 thousand

Policy features of a “Good” VAT

- Designed to **raise revenues, predictably and efficiently.**
- **A multi-stage tax** that falls on (household) **final consumption** only
  - Use invoice-credit method; refund excess tax credits
- **Broad, unified base** (goods and services)
- Applied at a **single positive rate**
- Proper **registration threshold**
- Implemented according to **destination principle**
  - With appropriate **place of supply rules** for services/intangibles

Country Exercise on VAT

At your tables

- Discuss the elements of good VAT design : How does your country compare to ‘good VAT design’: what areas do you do well, which could be improved?

- Prepare report back – rate your country and explain why this rating: and one thing you could do to shift rating towards ‘10’

- NB: on a scale of 1 to 10 where:

1 - no VAT or consumption tax: 10 - where all elements of good VAT design are in place and operating to expectation

You have 30 minutes for this table discussion – report back in the afternoon after tax expenditure session

(11.30am-12.00pm)

Lunch
12.00pm-1.00pm

Tax Expenditure (TE)
(Li Liu)

(1pm-

I. A Brief Introduction of TE

Tax Expenditure Overview (TE)

- **Tax expenditure** refers to a provision in the tax code (or in Ministerial decrees with the force of law) that deviates from a *benchmark* tax system.
- **Tax expenditure reporting** describes each identified provision and provides an estimate of the revenue foregone.

Why do governments use TEs?

- Why do governments sometimes prefer tax expenditures over direct subsidies?
  - Don’t appear to cost revenue
  - Less visible than direct spending
  - Create the appearance of smaller government

- In other words, they’re *less transparent*
  - This can make their effect on the economy hard to detect and measure

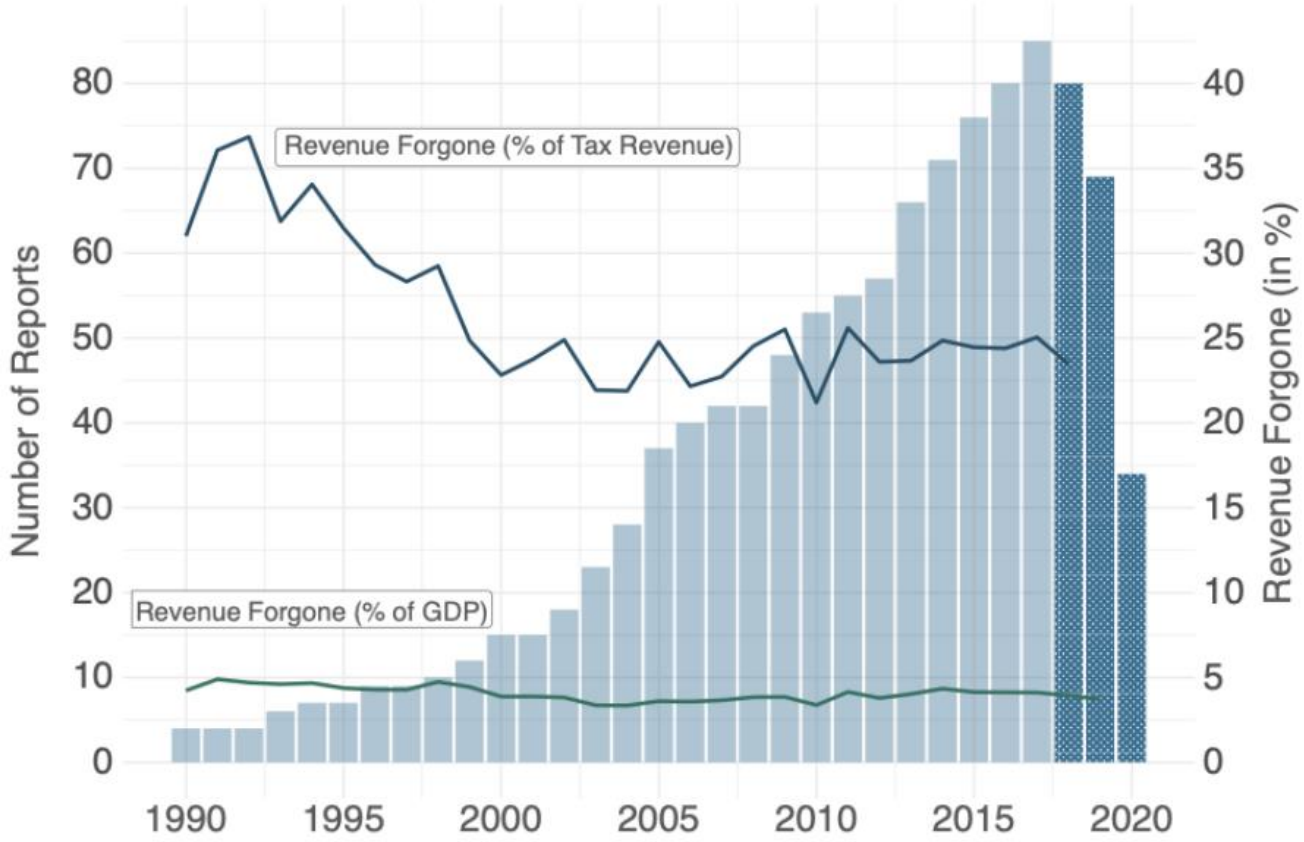
- TE reporting can greatly improve transparency and lead to positive tax policy reforms

What are the costs and benefits of TEs?

- TEs affect **all** taxpayers
  - Their beneficiaries pay less taxes…
  - …while other taxpayers must either pay more or get fewer government services
  - If the tax base is narrower, rates must be higher to raise the same amount of revenue
- High-rate, narrow-based tax systems are more distortive than low-rate, broad-based systems
  - Effective tax rates vary across different economic activities, distorting investment and employment
  - This tends to reduce economic growth

How much do tax expenditures cost?

Figure 1 Global unweighted average revenue forgone and number of reports



Source: Global Tax Expenditures Database (www.GTED.net); Redonda et al. (2022)

- A growing number of countries are estimating and reporting TEs
- Average revenue forgone
  - 3-5% of GDP
  - 20-25% of revenue

II. TE Reporting

Basic Elements of TE Reporting

- A description of the **benchmark** tax system.
- A description of **each tax expenditure**:
  - Legal provisions that relate to the tax expenditure.
  - Policy objective(s) being pursued by each tax expenditure.
  - Description of who benefits and (if available) the estimated number of beneficiaries
- Estimated tax **revenue foregone** for each identified tax expenditure.
  - Description of estimation method (e.g., micro-simulation model, Supply Use model, data from tax returns) and the data sources.

Benefits of TE reporting

- Improves **transparency and accountability**
- Provides **stock-taking** of existing tax measures
- Enhances **understanding of tax policy objectives**
- Informs **tax policymaking** (e.g., revenue mobilization)

TE reporting is a demanding process!

Define the Benchmark Tax System

- **Define** for each tax included in assessment:
  - *tax base*
  - *tax rate(s)*
  - *unit of taxation*
  - *period of time*
- **Decide** whether specific measures are in benchmark

Identify Deviations from the Benchmark

- **Analyze** the legislation to identify tax expenditures
- **Prepare** an inventory
- **Describe** each tax expenditure

Estimate the Cost of Tax Expenditures

- **Identify** available data
- **Develop** required data
- **Decide** on viable estimation techniques
- **Develop** and populate models

Prepare a Tax Expenditure Report

- **Decide** on report content and format
- **Describe** tax expenditures and provide cost estimates
- **Table** in Parliament
- **Publish** on Ministry website

Benchmark tax system: basis for identifying TEs

- For each type of tax, the benchmark should be a broad tax covering the entire tax base
  - Value-added tax: all domestic consumption
  - Income tax: all sources of income
    - Labor income
    - Capital income (e.g., business profits, dividends, interest, rents, capital gains)
  - Excise tax: commodities with harmful effects
    - Negative externalities and internalities (e.g., fossil fuels, vehicles, plastics, alcohol, tobacco, gambling, sugar)

Estimating TEs: “Revenue foregone” method

- One measure of the revenue gain from eliminating a tax expenditure

Cost = (revenue without existing provision) –
(revenue with existing provision)

- Assumes no change in taxpayer behavior
- Assumes unchanged compliance/administration
- Costs tax expenditures one at a time assuming others remain unchanged

How to analyze TEs?

- Each tax expenditure should be examined independently on its own merits.
  - Not all tax expenditures are bad.
  - Can be useful to look at how the cost of a tax expenditure has changed over time.

- There is no “ideal” ratio of tax expenditures to GDP and international comparisons are often inappropriate.
  - Vary by tax systems, benchmark.
  - Shouldn’t isolate tax relief from program spending – policy choice in how support is delivered.
  - Interaction effects with and between revenue streams can be significant, so adding up the cost of individual tax expenditures distorts their total impact.

What is TE Governance?

- Legal and institutional framework for introducing, implementing, and monitoring tax incentives
- Sound TE governance is fundamental to effective tax expenditure management

The importance of good TE governance

- Experience in emerging and developing economies shows that tax incentives and other expenditures are usually:
  - Scattered in multiple laws
  - Offered by multiple agencies
  - Subject to a high level of discretion
- These features lead to proliferation of poorly coordinated tax incentives
  - Non-transparent
  - Questionable economic benefits
  - High revenue cost
- A sound TE governance framework corrects these flaws

TE centralization

- Provide tax incentives only through legislation, subjecting them to parliamentary scrutiny
  - Stakeholders – including taxpayers – should have input into policy formulation
- Consolidate all legislation authorizing tax expenditures under a single statute – the tax code
- Consolidate all authority over tax incentives and other expenditures under a single government entity
  - Since revenue is concerned, this should almost always be the Ministry of Finance
  - Other agencies likely to be less mindful of revenue costs

TE costing and transparency

- Compile a thorough public inventory of existing TEs, including their policy objectives
- Collect the data necessary to estimate the revenue cost of all TEs
- Publish estimates of itemized TE costs as part of the annual budget
- Compile revenue estimates for all prospective tax incentives prior to adoption
- For concessionary agreements, include details on major tax incentive beneficiaries and their performance

TE evaluation and rationalization

- Regularly review existing TEs to determine whether their benefits justify their costs
  - Some simple measures (revenue costed per additional job) can help start the conversation
  - Legislation authorizing new TEs should specify first review period

- Eliminate TEs that do not provide any (or only a small) net welfare benefit
  - Where appropriate, replace with other provisions that better target the desired policy goal

III. A Deep Dive into VAT Expenditure Estimation

Based on a TA mission to Nepal (2024)

Recap: Basic workings of a VAT (1)

Transactions – all **standard-rated** supplies

Production-distribution chain	Purchases (excl. VAT)	Sales (excl. VAT)
Producer	0	4 000
Manufacturer	4 000	10 000
Retailer	10 000	20 000
Consumer	20 000	-

VAT consequences (assume VAT rate of 10%)

Production-distribution chain	Purchases	Sales	Revenue service
Producer	0	400	400
Manufacturer	(400)	1 000	600
Retailer	(1 000)	2 000	1000
Consumer	(-)	-	-

Recap: Basic workings of a VAT (2)

Transactions – manufacturer and retailer make **zero-rated** supplies

Production-distribution chain	Purchases (excl. VAT)	Sales (excl. VAT)
Producer	0	4 000
Manufacturer	4 000	10 000
Retailer	10 000	20 000
Consumer	20 000	-

VAT consequences (assume VAT rate of 10%)

Production-distribution chain	Purchases	Sales	Revenue service
Producer	0	400	400
Manufacturer	(400)	0	(400)
Retailer	(0)	0	0
Consumer	(-)	-	-

Recap: Basic workings of a VAT (3)

Transactions – **manufacturer** makes **zero-rated** supplies, but **retailer** makes **standard-rated** supply

Production-distribution chain	Purchases (excl. VAT)	Sales (excl. VAT)
Producer	0	4 000
Manufacturer	4 000	10 000
Retailer	10 000	20 000
Consumer	20 000	-

VAT consequences (assume VAT rate of 10%)

Production-distribution chain	Purchases	Sales	Revenue service
Producer	0	400	400
Manufacturer	(400)	0	(400)
Retailer	(0)	2 000	2000
Consumer	(-)	-	-

Recap: Basic workings of a VAT (4)

Transactions – **manufacturer** makes **exempt** supplies, but **retailer** makes **standard rate supply**

Production-distribution chain	Purchases (excl. VAT)	Sales (excl. VAT)
Producer	0	4 000
Manufacturer	4 000	10 000 + (≤ 400)
Retailer	10 000 + (≤ 400)	20 000 + (≤ 400)
Consumer	20 000 + (≤ 400)	-

VAT consequences (assume VAT rate of 10%)

Production-distribution chain	Purchases	Sales	Revenue service
Producer	0	400	400
Manufacturer	(-)	-	-
Retailer	(-)	2 040	2040
Consumer	(-)	-	-

VAT Benchmark

- **Tax Base**
  - Tax applies on a “destination basis” – at the point of final consumption.
  - Single rate on all domestically consumed goods and services, excluding:
    - Financial services (margin-based)
    - Residential accommodation (not residential property)
    - Portion of the VAT threshold expenditure (optimal VAT benchmark threshold)
- **Tax Rate**
  - The standard rate is the benchmark rate.

Common deviations from benchmark

- **Zero-rated supplies**
  - No cascading, revenue loss if supply to consumers
- **Exempt supplies**
  - Cascades, only revenue loss if exempt supply (not input into standard rated supply, as seen in the previous example)
- **Threshold**
  - Part of threshold is to lower administration costs, which would have been a budget item
- **Other deviations**
  - Reduced rates deviate from standard rate
  - Other schemes that results in revenue loss

Deviations in Nepal

- **Zero-rated supplies**
  - Imports by diplomats, solar energy batteries to consumers, scooters for disabled persons
- **Exempt supplies**
  - Foodstuffs, health, transport, education, water, electricity, capital goods to consumers etc.
- **Threshold**
  - Low thresholds means limited or no tax expenditure
- **Other deviations**
  - None

Data requirements

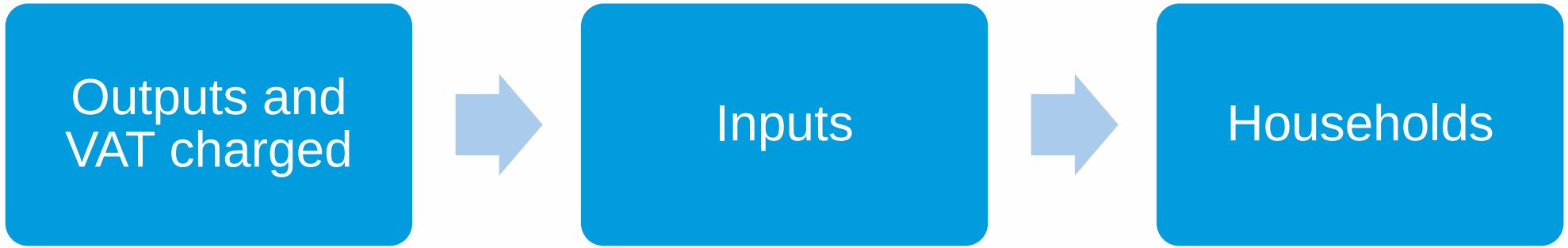
- **Input/output tables**
  - Estimates can be obtained with this data alone
- **Household consumption data**
  - Allows for granular estimates and equity considerations
- **Customs data**
  - Required for exempt imports by consumers with data if not captured in household consumption data
- **National account data**
  - Required to balance consumption in the model and to account for exported tourism services.
- **Business turnover data**
  - Used to determine size of VAT threshold expenditure and for exempt supplies domestically consumed by non-residents (e.g. tourists consuming travel agency services)

Method: Step 1, Household Data

Quintile	Good/Service 1	Good/Service 2
1	20	2
2	35	9
3	60	16
4	87	16
5	120	87

- By detailed commodity code
- Weighted to final consumption expenditure
- Be aware of data errors

Method: Step 2, Input-Output Tables



- Taxes on products and services includes excise duties
- First estimate effective VAT rate of outputs
- Multiply value of inputs with effective VAT rate
- Obtain rate for exempt supplies to households (cascaded VAT)

Method: Step 3, VAT rates

Quintile	Good/Service 1 (13%)	Good/Service 2 (Exempt)
1	20	2
2	35	9
3	60	16
4	87	16
5	120	87
Total	322	130
VAT rate	Estimate	From input/output table

- Estimate
  - Calculate VAT collected on exempt supplies
  - Reduce total revenues by exempt supply collections
  - Calculate effective VAT rate on standard-rated consumption
  - Possible to adjust rates for informality (including imports)

Method: Step 4, Policy Changes - Revenues

Quintile	Good/Service 1 (15%)	Good/Service 2 (Exempt)
1	20	2
2	35	9
3	60	16
4	87	16
5	120	87
Total	322	130
VAT rate	Estimate	Increase to effective VAT rate
VAT	X	Y

- Estimate revenues foregone
  - Increase each exempt supply rate to effective VAT rate
  - Calculate additional revenues obtained

Method: Step 6, Other expenditures

- Customs data: Value of exempt VAT for qualifying goods
  - Not all imports exempt from VAT are tax expenditures
  - Only exempt goods imported by consumers
  - Be aware of double counting – not already captured in household consumption
  - Exempt goods imported by producers and use to make exempt supplies to consumers already captured in household model.
  - Exempt goods used to make taxable supply is not a TE

- National Account data
  - Use VAT return data if TE provided on exported tourism services

- Business turnover
  - Optimal benchmark threshold – formula in report
  - Exempt supplies to non-residents consumed domestically – look at taxpayer level data and estimate value-added – perhaps obtaining indicator of value added from VAT return data.
  - VAT expenditures adjusted with revenues foregone due to threshold

Country exercise and report backs on VAT System

Place country name and rating on a sticky label: Place sticky label on the ‘continuum’ between 1 and 10

- Explain to the group your reasoning for that rating

- What one thing would you focus on to shift your rating towards a ‘10’

Briefly describe the main VAT expenditures in your country, including their costing and reform plans, if applicable (15mins).

Thirty minutes in total for report backs.

(1.45pm-2.30pm)

Afternoon Tea
2.30-2.45pm

Revenue Administration
VAT Compliance
(Koni Ravono)

(2.45pm-3.45pm)

Administrative Gaps

1. **Policy & Legal Framework**
   - VAT Policy to be updated and relevant
   - Procedural Guidelines to be made available for Implementation by Tax Administration Staff

2. **ICT System and Data**
   - Need for Upgrade in system and modernize
   - Data cleansing for compliance and audit purposes
   - Lack of information and authenticated data from third parties– requiring Exchange of Information MOU
   - Reports on revenue performance from trusted system

3. **Processes & Resources**
   - Process of core tax functions aligned (i.e. Registration, Lodgement, Payment/Refund, Reporting)
   - Lack and limited resources available
   - Smallness in size leads to administrations improvising with available resources
   - Multitasking

Administrative Gaps

4. **Upskill Staff and Capacity Building**
   - Staff turnover and migration requires need to upskill and train staff

5. **External Networking and Partnership Agreements**
   - Networking between customs and taxation.
   - Engagements with other law enforcement units

6. **Compliance Risk Management Framework**
   - Promote Voluntary Compliance
   - Taxpayer Services assistance for voluntary compliance
   - Compliance Improvement Strategy

Country Exercise – Administrative Gaps

(Identify and discuss 3 key priorities for your VAT Administration)

1. Policy & Legal Framework
2. ICT System and Data
3. Processes & Resources
4. Upskill Staff and Capacity Building
5. External Networking and Partnership Agreements
6. Compliance Risk Management Framework

Summary and Key Insights

(3.45pm-4pm)