



# TAX INCENTIVES TO PROMOTE SOCIAL GOALS

2<sup>nd</sup> International Tax Forum “Fiscal Policy and Inclusive Growth”, Manila, Philippines – 28 October, 2016

*Presentation by Sarah Perret (OECD)*



# Conclusions

---

- Be very careful with using tax incentives to promote social goals
  - Some may have limited additionality
  - Some may actually not support the ones that they are intended to support
  - Some may actually be regressive
  - + additional risks typically associated with tax expenditures
- This requires a careful assessment of tax incentives both *ex-ante* and *ex-post*.
- This also requires assessing whether the policy objective could be better achieved through alternative policies – a lot of room in developing countries to improve better targeted policy tools:
  - A well-designed personal income tax system
  - Direct cash transfers



# Taxation and Inclusive Growth

---

- New OECD paper released in July on *Taxation and Inclusive Economic Growth*
- Follows up previous work on Taxation and Economic Growth but with a focus on inclusive growth
- Definition of inclusive growth:
  - Sharing the benefits of increased prosperity more evenly across the population
  - Dynamic definition of equity
  - Equality of opportunity matters



# Tax incentives to promote social goals

---

## Aims

- Provide tax relief
- Induce behavioural change

## Types of “social” tax incentives

- **Children:** e.g. tax credits/allowances for children
- **Employment:** e.g. reduced SSCs for low-income workers
- **Food:** e.g. reduced VAT rates on food and other basic goods
- **Pension savings:** e.g. deductions for pension savings
- **Health:** e.g. deductions for private health expenditures
- **Housing:** e.g. mortgage interest deduction, property tax deduction
- **Culture:** e.g. reduced VAT rates on cultural goods



# Additionality of tax incentives

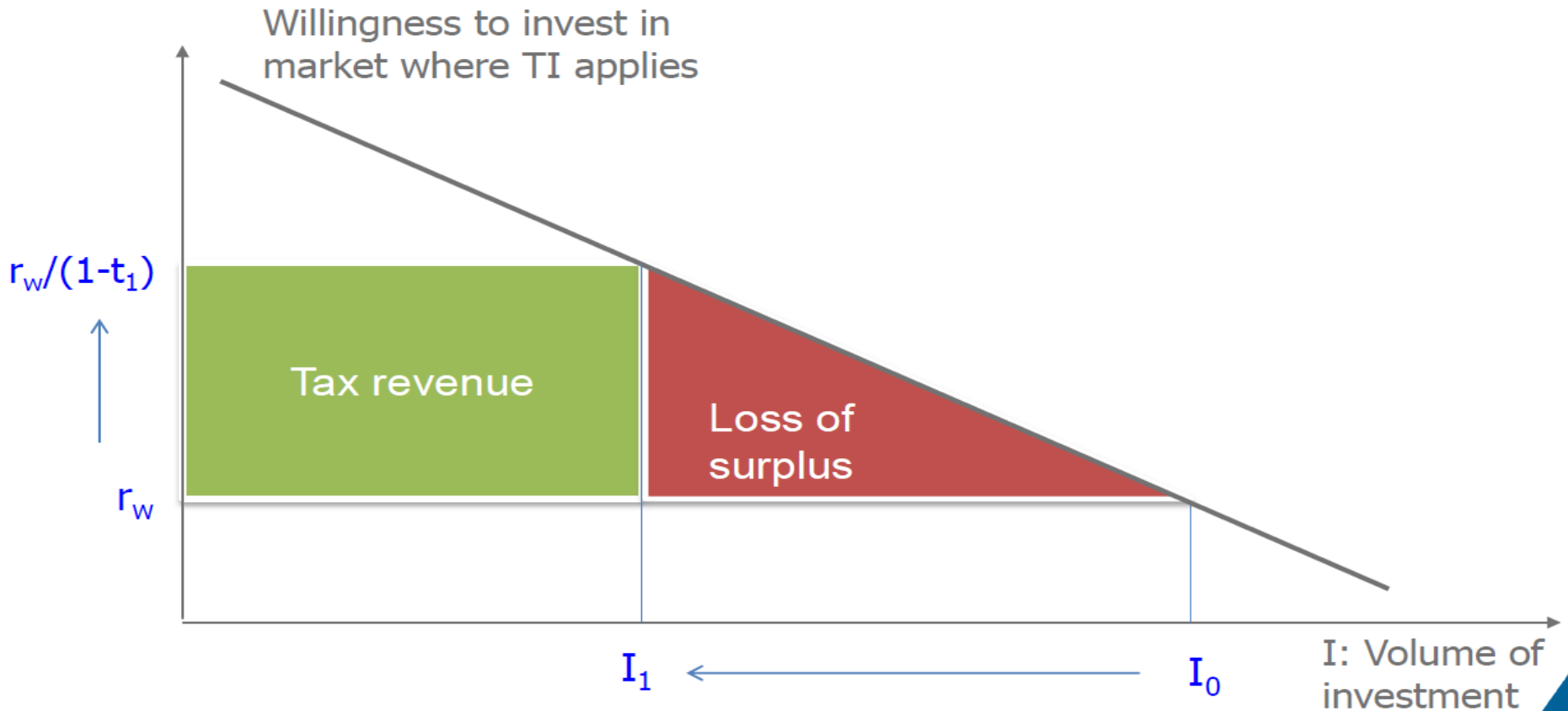
---

- To maximise **additionality**, target activities/taxpayers that will be sensitive to changes in ETRs (high behavioural response)
  - E.g. tax incentives for employment targeted at those with high labour supply elasticities (young workers, women, low-skilled workers)
- **Behavioural responses**, in turn, will depend on various factors:
  - E.g. for low-income workers, if alternatives to formal work (e.g. possibility of not working or possibility to work in the formal sector) are viable, labour supply elasticities will be high.
- On the other hand, avoid providing incentives for which supply is inelastic



# Behavioural response and additionality

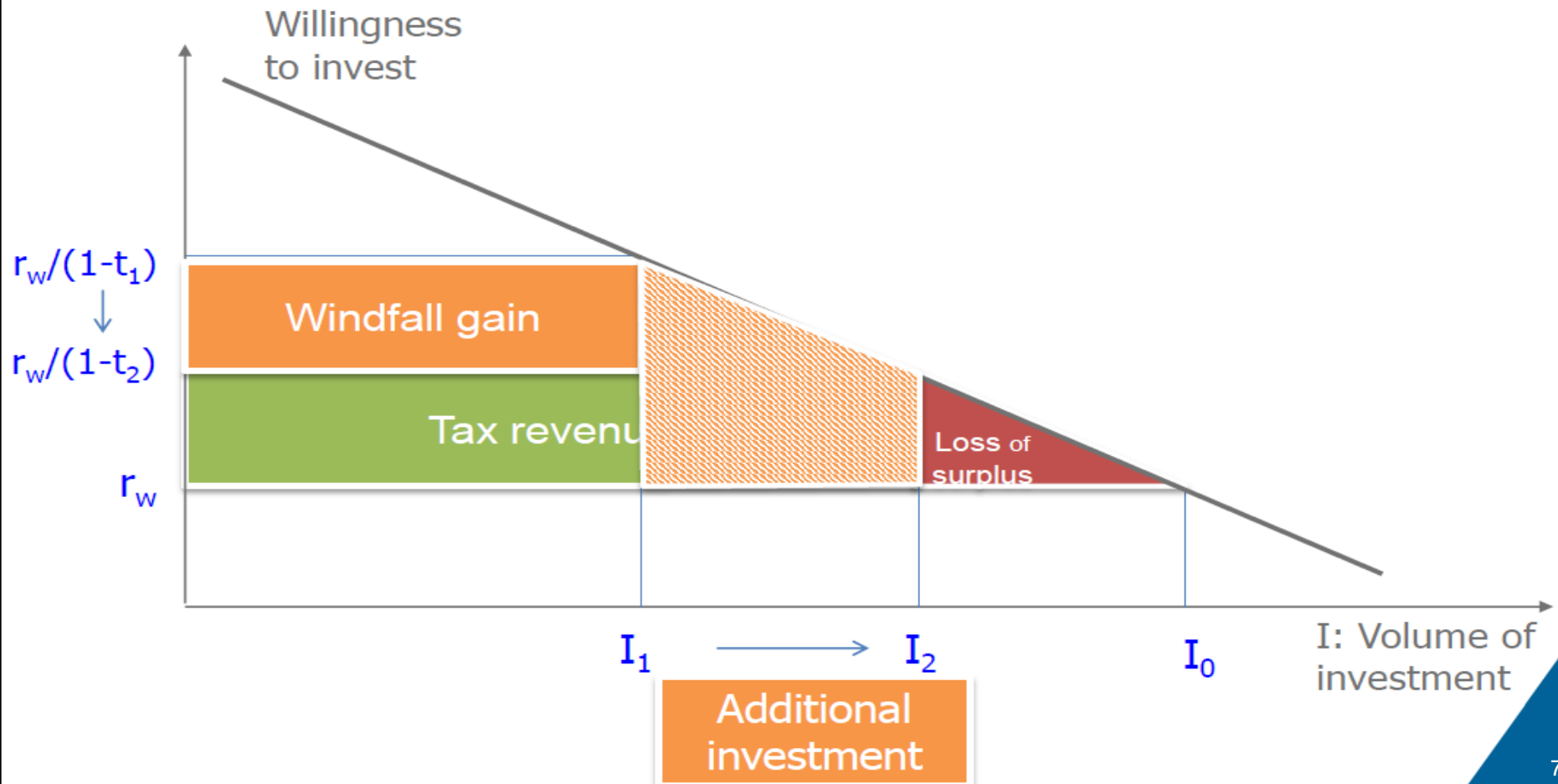
## Example: Tax incentive for investment





# Behavioural response and additionality

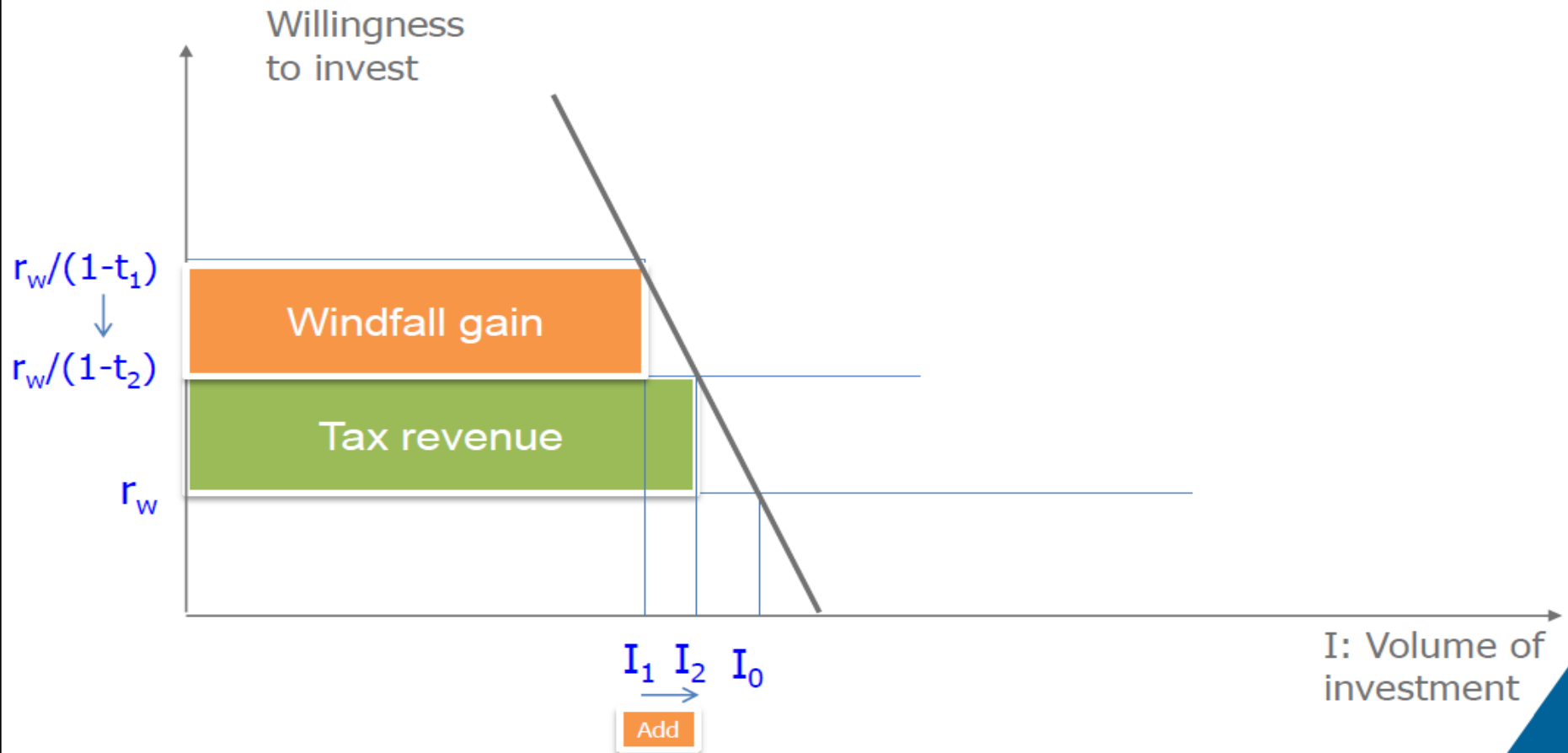
## Example: Tax incentive for investment





# Behavioural response and additionality

## Example: Tax incentive for investment







# Incidence of tax incentives

---

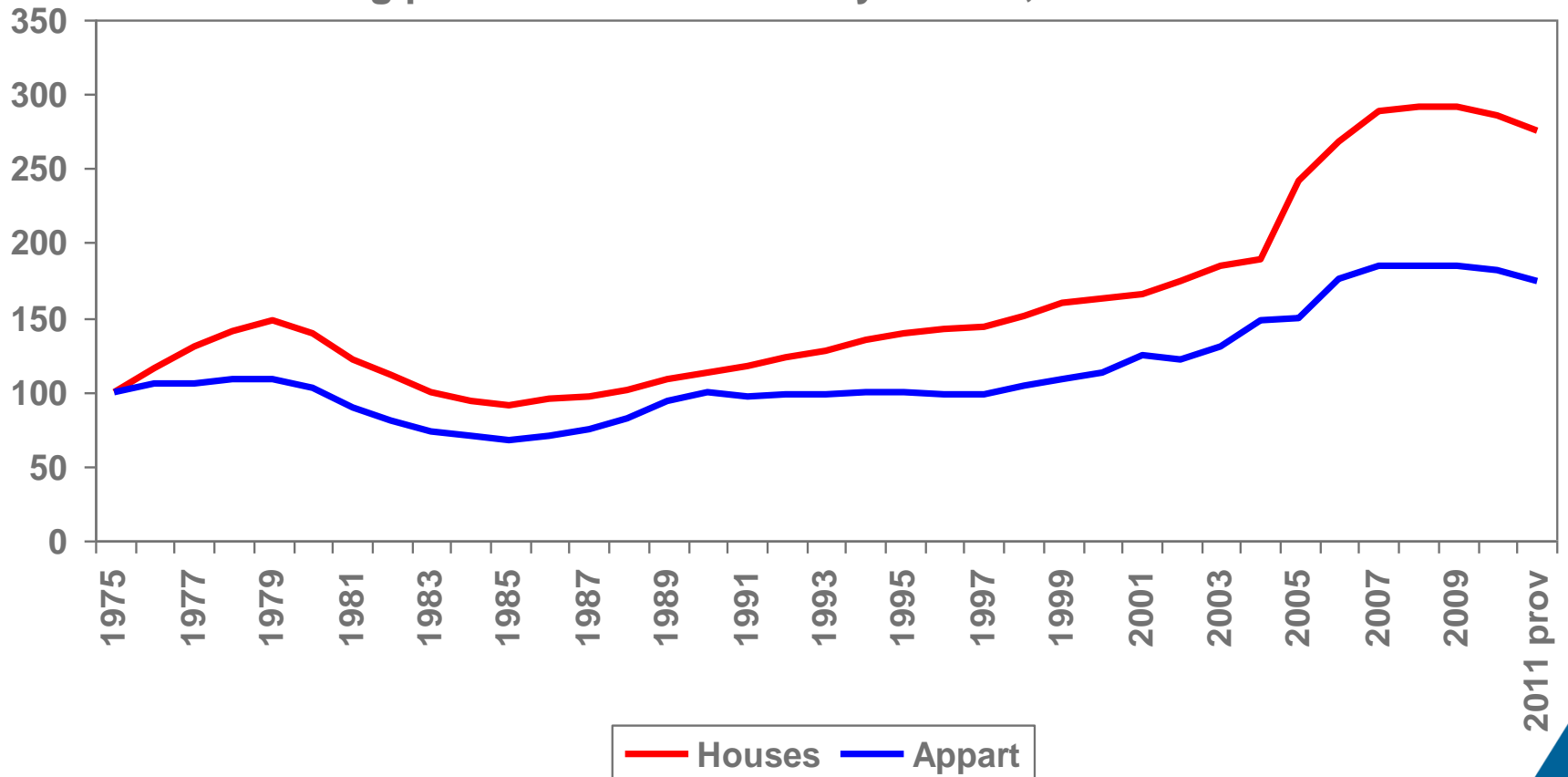
- The taxpayers directly paying the tax may not be the ones ultimately bearing the burden of the tax
- Examples where the final incidence of a tax incentive may differ from the primary one:
  - Incentives for housing may be capitalised in higher pre-tax prices
  - Reduced VAT rates translate into higher pre-tax prices, due to imperfect competition
- Tax incidence depends on behavioural responses to tax changes as well as on other factors (e.g. degree of competition and the linkages across markets)



# Incidence of tax incentives

## Example: New tax incentives for housing in Belgium

Housing prices on the secondary market, constant euros

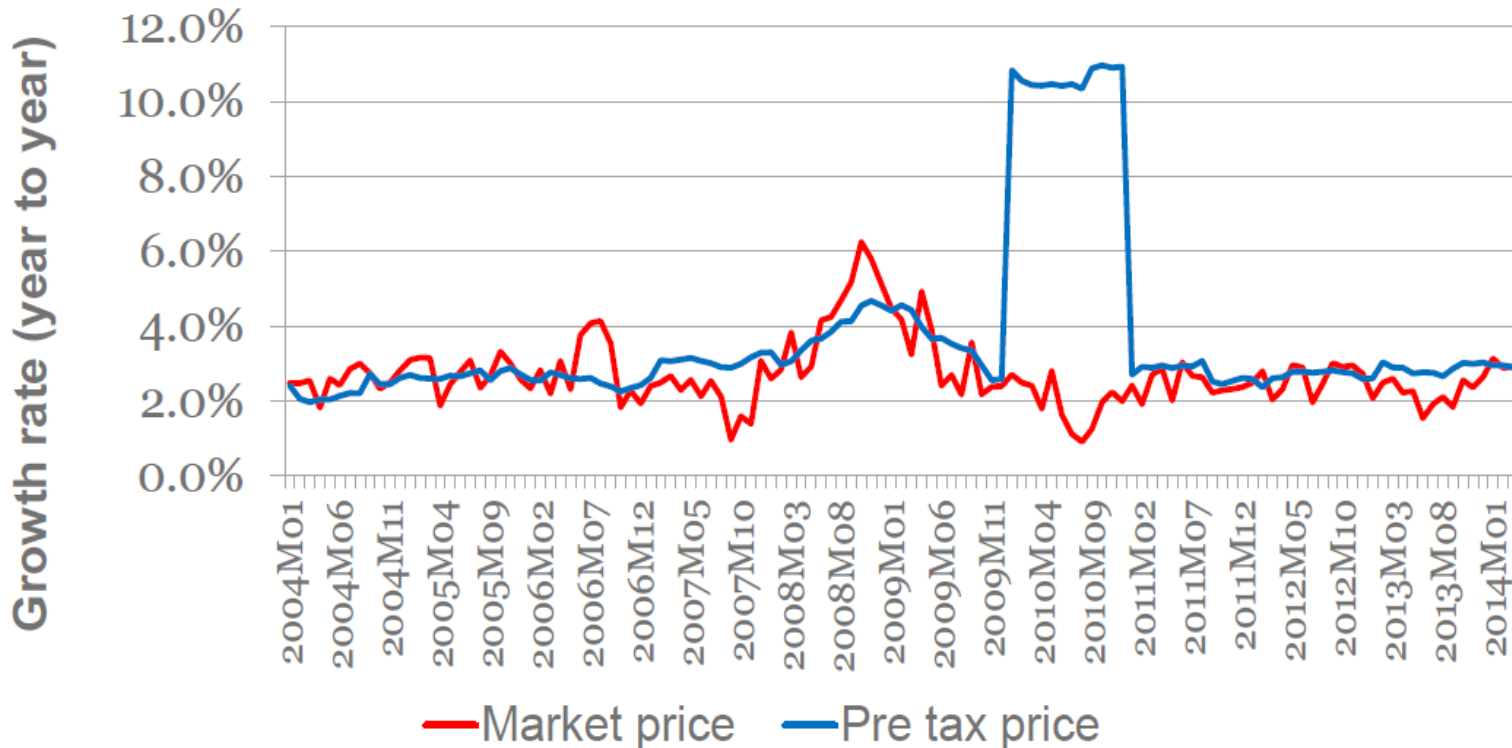




# Incidence of tax incentives

Example: Reduced VAT rates in the restaurant sector in Belgium

### Prices in restaurants

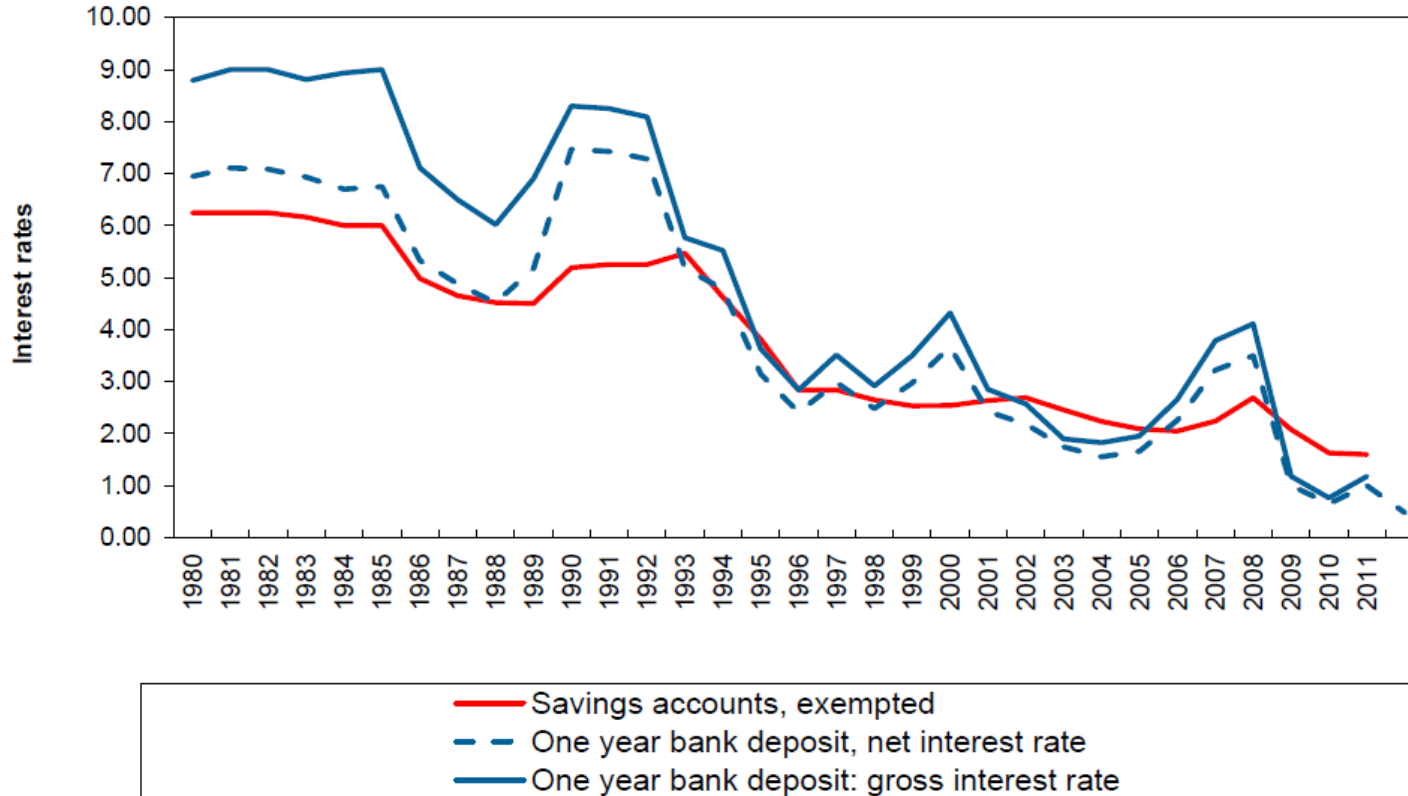




# Incidence of tax incentives

## Example: Savings account exemption in Belgium

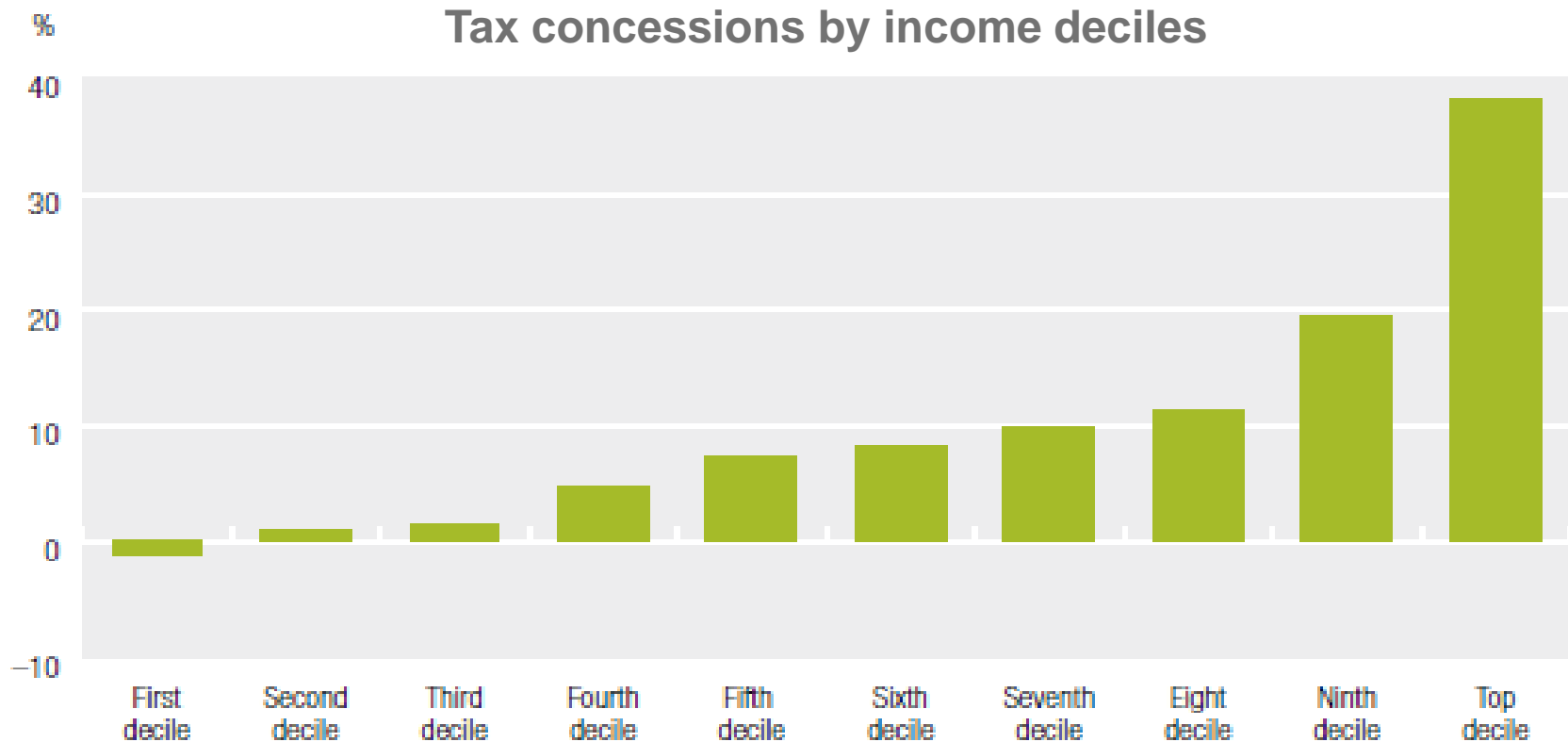
### Interest rates from exempt and non-exempt deposits





# (Unintended) distributional effects of tax incentives

## Example: Superannuation tax concessions in Australia



Source: CEDA (2015), based on Treasury figures



# (Unintended) distributional effects of tax incentives

## Example: Tax credit for electric vehicles in the US

Table 2: Distributional Effects of Selected Tax Credits

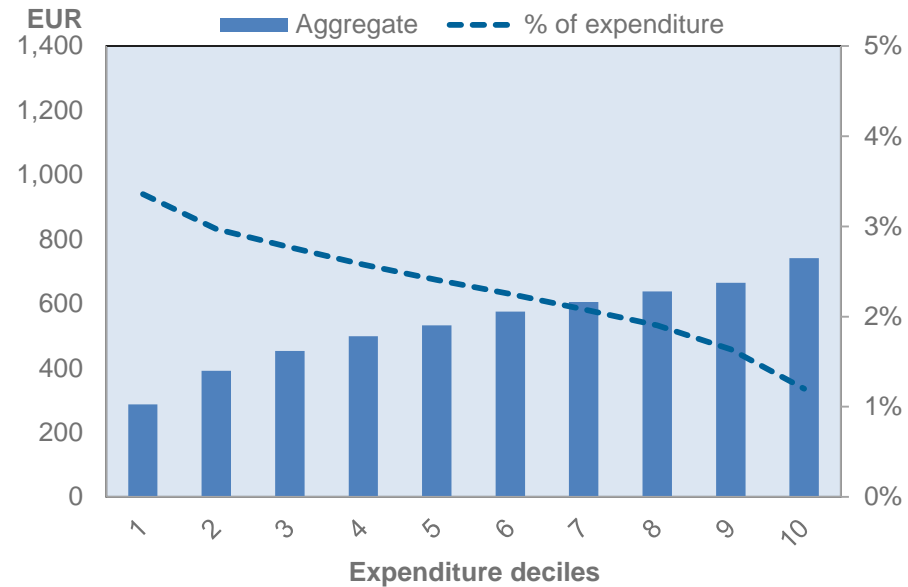
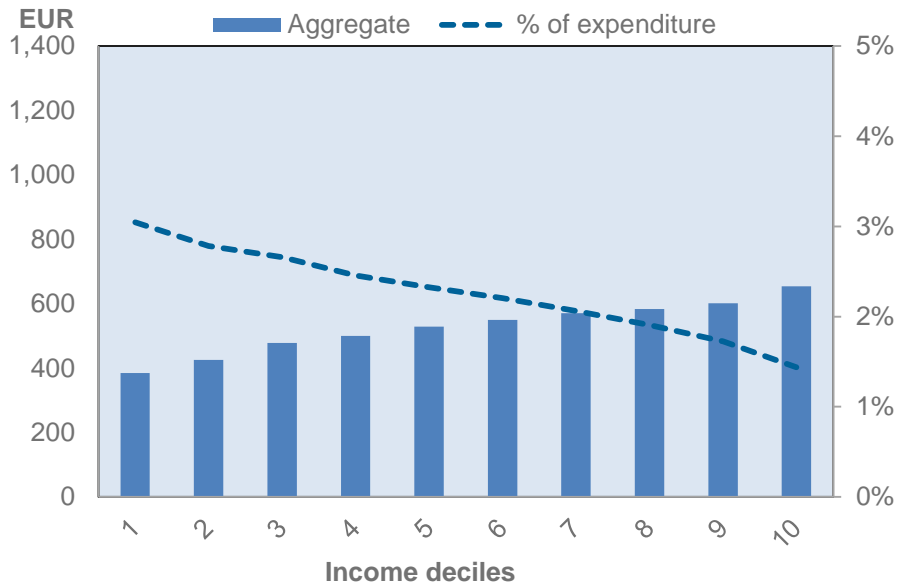
| The Distributional Effects of<br>U.S. Clean Energy Tax Credits<br><br>Severin Borenstein and Lucas Davis<br><br>July 2015<br><br><b>EI @ Haas WP 262</b> | Percent of Credit Received<br>by Income Category (in thousands) |               |               |               |                |            | Concentration<br>Index |
|----------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------|---------------|---------------|---------------|----------------|------------|------------------------|
|                                                                                                                                                          | \$0–<br>\$10                                                    | \$10–<br>\$20 | \$20–<br>\$40 | \$40–<br>\$75 | \$75–<br>\$200 | \$200<br>+ |                        |
|                                                                                                                                                          | Panel A. Clean Energy Tax Credits                               |               |               |               |                |            |                        |
| Residential Energy Credits                                                                                                                               | 0%                                                              | 1%            | 10%           | 28%           | 48%            | 14%        | 0.606                  |
| Alternative Motor Vehicle Credit                                                                                                                         | 0%                                                              | 1%            | 9%            | 32%           | 47%            | 11%        | 0.584                  |
| Plug-in Electric Drive Vehicle Credit                                                                                                                    | 0%                                                              | 0%            | 1%            | 10%           | 54%            | 35%        | 0.801                  |
| Panel B. Other Major Tax Credits                                                                                                                         |                                                                 |               |               |               |                |            |                        |
| Earned Income Tax Credit                                                                                                                                 | 18%                                                             | 49%           | 32%           | 1%            | 0%             | 0%         | –0.415                 |
| Making Work Pay Credit                                                                                                                                   | 7%                                                              | 14%           | 25%           | 28%           | 26%            | 0%         | 0.163                  |
| Child Tax Credit                                                                                                                                         | 2%                                                              | 13%           | 31%           | 31%           | 23%            | 0%         | 0.185                  |
| First-time Home Buyer Credit                                                                                                                             | 7%                                                              | 6%            | 23%           | 40%           | 24%            | 1%         | 0.222                  |
| Foreign Tax Credit                                                                                                                                       | 0%                                                              | 0%            | 1%            | 2%            | 9%             | 88%        | 0.954                  |

Note: This table was constructed by the authors using U.S. Department of the Treasury, Internal Revenue Service, “Statistics of Income, Individual Tax Returns,” 2005–2012. The first five income categories are approximate quintiles (18%, 17%, 24%, 21%, 18%), and 3% of tax returns fall in the last category. Residential energy credits includes both the NEPC and the REEPC. The Earned Income Tax Credit, Making Work Pay Credit, Child Tax Credit, and the First-Time Home Buyer Credit are all refundable, while the Foreign Tax Credit is not. See Appendix A for details.



# Who benefits from reduced VAT rates?

All-country average tax expenditure from reduced rates on food (15 countries)





# Additional risks associated with tax expenditures

---

- Revenue forgone
- Distortions / horizontal inequities
- Tax planning
- Fraudulent use
- Administrative complexity
- Lack of transparency
- Difficult to withdraw tax incentives and pressure to extend – risk of proliferation
- Risk of having to raise standard rates and further increase distortions to raise revenues





# Conclusions

---

- Be very careful with using tax incentives to promote social goals
  - Some may have limited additionality
  - Some may actually not support the ones that they are intended to support
  - Some may actually be regressive
  - + additional risks typically associated with tax expenditures
- This requires a careful assessment of tax incentives both *ex-ante* and *ex-post*.
- This also requires assessing whether the policy objective could be better achieved through alternative policies – a lot of room in developing countries to improve better targeted policy tools:
  - A well-designed personal income tax system
  - Direct cash transfers



---

**Thank you!**