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Tax Expenditure Assessment: From Principles to Practice - Methodological guide

Anne-Marie Geourjon, Yannick Bouterige, Emilie Caldeira, Bertrand Laporte,
Céline de Quatrebarbes

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Tax Expenditure Assessment: From Principles to Practice

Methodological guide

Under the supervision of Anne-Marie GEOURJON
Authors: Bertrand LAPORTE, Emilie CALDEIRA,
Céline de QUATREBARBES, Yannick BOUTERIGE.



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Methodological guide

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This guide was produced by a team coordinated by Anne-Marie Geourjon and composed of Bertrand Laporte, Emilie Caldeira, Céline de Quatrebarbes and Yannick Bouterige. It draws on Ferdi's tax expenditure evaluation experiences in several developing countries.

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Tax Expenditure Assessment: From Principles to Practice

Methodological guide

**Under the supervision of Anne-Marie GEOURJON,
head of program, FERDI**

- Yannick BOUTERIGE, Research Assistant, FERDI
- Emilie CALDEIRA, Associate Professor,
Université Clermont-Auvergne, CNRS, IRD, CERDI
- Bertrand LAPORTE, Associate Professor,
Université Clermont-Auvergne, CNRS, IRD, CERDI
- Céline de QUATREBARBES, Research Officer, FERDI

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Abbreviations & Acronyms

- **ASYCUDA**: Automated System for Customs Data
- **BEC**: Broad Economic Categories
- **BTS**: Benchmark Tax System
- **CD**: Customs Duty
- **CET**: Common External Tariff
- **CGT**: Capital Gains Tax
- **CIAT**: Inter-American Center of Tax Administrations (*Centro Interamericano de Administraciones Tributarias*)
- **CIF**: Cost, Insurance, & Freight
- **CREDAF**: Exchange and Research Center for Tax Administration Managers (*Centre de Rencontre et d'Échanges des Dirigeants des Administrations Fiscales*)
- **DFI**: Import Tax Duty (*Droit Fiscal d'Importation*)
- **DGD**: Directorate General of Customs (*Direction Générale des Douanes*)
- **DGE**: Directorate of Large Enterprises (*Direction des Grandes Entreprises*)
- **DGI**: Directorate General of Taxation (*Direction Générale des Impôts*)
- **DIT**: Directorate of Information Technology
- **DPME**: Directorate of Small and Medium Enterprises (*Direction des Petites et Moyennes Entreprises*)
- **ED**: Excise Duty
- **FERDI**: International Development Research Foundation (*Fondation pour les Études et Recherches sur le Développement International*)
- **GDP**: Gross Domestic Product
- **GNF**: Guinean Franc
- **HS**: Harmonized System
- **ITD**: International Tax Dialogue
- **MGA**: Madagascar Ariary
- **MT**: Minimum Tax
- **NTE**: Non-Tax Expenditure
- **OECD**: Organisation for Economic Cooperation and Development
- **PIT**: Personal Income Tax
- **RD**: Registration Duty
- **RTL**: Excise Duties Processing Fee (*Redevance pour le Traitement des Liquidations*)
- **TDP**: Regressive Protection Tax (*Taxe Dégressive de Protection*)
- **TE**: Tax Expenditure
- **TIN**: Tax Identification Number

- **TPU** : Tax Policy Unit
- **UNESCO** : United Nations Educational, Scientific, and Cultural Organization
- **VAT** : Value-Added Tax
- **WAEMU** : West African Economic and Monetary Union
- **WCO** : World Customs Organization
- **WT** : Withholding Tax

Introduction

According to CREDAF's methodological guide on tax expenditure evaluation published in 2015, tax expenditures are incentive-based measures that significantly impact government budgets insofar as governments deliberately forgo tax revenue to support the productive or social sector. The OECD's 2010 publication on tax expenditures defines these expenditures as "a transfer of public resources achieved by reducing tax obligations with respect to a benchmark tax rather than by direct expenditure"¹.

Tax expenditure analysis seeks to inform tax policymakers. To this end, two complementary evaluation approaches are available: estimating the budgetary cost of tax measures that deviate from the benchmark tax, and assessing their effectiveness with respect to their initial goals. Only the combination of these two evaluations makes it possible to streamline the system of tax incentives in order to increase domestic revenue mobilization. However, this guide does not address the second approach to evaluation². Publishing an estimate of tax expenditures in the annex to the finance bill is a step toward greater budget transparency.

The tax expenditure evaluation process does not consist in estimating an overall tax gap. Rather, to guide tax policy choices, it is necessary to measure the budgetary cost associated with each specific relief measure. This approach involves estimating the cost of relief measures that can be accurately identified, that is, based on detailed tax data rather than on aggregate data from the national accounts. Clearly, its main limitation is that it underestimates tax expenditures due to the limited availability of such data. It is also worth noting that this approach based on data accepted by the tax administration estimates tax expenditures *ceteris paribus*, including the administration's ability to enforce the law and detect fraud. The cost created by tax law (the "policy gap") is therefore increased by the cost of inconsistent compliance with the law (the "compliance gap")³. However, estimating tax expenditures for a given level of tax administration capacity is a pragmatic approach justified by the ongoing nature of the process, which is intended to inform budget choices annually. This approach removes the need to bet on marked improvement in the behaviour of taxpayers or the tax administration, which is

1. See also Surrey (1976), Bratic (2006), and Altshuler and Dietz (2008) for definitions of tax expenditures.

2. For tax expenditure evaluation criteria, see in particular Surrey (1976), Kleinbard (2008), and Myles et al. (2014).

3. In contrast, in the decomposition of the VAT C-efficiency ratio, the policy gap is included in the strict sense in the total cost of VAT tax expenditures, that is, assuming perfect tax compliance. It is dissociated from the compliance gap, the second factor in C-efficiency (Keen, 2011). Meanwhile, evaluations of tax gaps—an increasingly common practice in developing countries—estimate the difference between actual receipts and those that theoretically should have resulted given the legal provisions, that is, the "compliance gap" (Gemmell and Hasseldine, 2012; Tax Gap Project Group, 2016; Hutton, 2017).

unlikely in the short term. Only an estimate of the specific cost of a measure coupled with an analysis of its impact can contribute to the informed optimization of tax expenditures. The scope of the evaluation of tax expenditures thus expands as more data are made available by the annual publication of evaluation reports, which considerably limits the reliability and suitability of comparisons of total tax expenditure costs across both space and time.

This guide details the method used for evaluating the budgetary costs of tax expenditures generated by exemptions from personal income tax, capital gains tax and withholding tax, corporate income tax (CIT), including the minimum tax, customs duties, excise duties, value-added tax (VAT), and registration duties. This method is based on the use of available tax data in the two administrations involved in the management of these taxes and fees: customs, and tax administration.

The methodology proposed here is informed by the experience of FERDI's experts in the preparation of tax expenditure reviews, most recently in Cameroon and Madagascar for the fiscal year 2015 and in Guinea for the fiscal year 2016. This guide has an operational goal, hence its multiplicity of examples and calculation methods. Its scope is broad since tax expenditure evaluation should be tailored to the scope of evaluation, the tax system, and available data in each country.

Evaluating the budgetary cost of tax expenditures involves three steps, with this guide devoting a section to each one. The process should be assigned to a tax policy unit that reports directly to the Minister of Finance. FERDI recommends setting up two working sub-groups: A Legislation sub-group responsible for the legal aspects, and an Evaluation sub-group responsible for budgetary costings (see Box 1).

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(I) Identification of tax expenditures requires an understanding of tax law arrangements. The responsibility of the Legislation sub-group, this entails:

- (1) An inventory of legislation;
- (2) A description of the general regime;
- (3) A list of relief measures;
- (4) Choice of the benchmark tax system (BTS) and identification of those relief measures that constitute tax expenditures;
- (5) Preparation of an interim report for approval of the BTS by the Ministry of Finance and submission to the Evaluation sub-group.

(II) Budgetary evaluation aims to cost tax expenditures. The responsibility of the Evaluation sub-group, this entails:

- (6) Definition of the estimation method;
- (7) Definition of the scope of evaluation;
- (8) Collectection of economic and tax data;
- (9) Calculation of tax expenditures; and
- (10) Preparation of an interim report on the budgetary evaluation of tax expenditures.

(III) Drafting the final report on tax expenditures is the responsibility of the two sub-groups, drawing on the interim reports. The draft final report is then sent for approval to a decision-making entity, a “tax policy committee” that reports directly to the Minister of Finance.

The approved report is then published. It should accompany the finance bill in order to allow parliamentarians to debate budget trade-offs. The process is therefore yearly.

Box 1. Institutional arrangements for monitoring and analyzing tax expenditures

To make tax expenditure evaluation an ongoing process, it should be co-opted by a specific entity. To this end, it is recommended that a tax policy unit (TPU) be created within the Ministry of Finance. This TPU is strongly recommended, in particular, to re-anchor the tax policy decision-making process at the level of the Ministry of Finance.

Several publications have summarized international experience in this area (Wales and Wales, 2012; IMF, 2017). They provide guidance on the mission, location, size, and composition of such a unit.

The TPU should have the following objectives: 1) improve coordination between the tax administration and customs; 2) draft tax and customs revenue forecasts; 3) analyze initiatives to reform tax policy, in particular their impact; and 4) carry out annual estimates of tax expenditures and their economic and social impact.

It is not mandatory that the TPU, a technical structure, be set up within the Ministry of Finance; it may also be placed in the Directorate General of Taxation (DGI) or of Customs (DGD). The key is that it be steered by a decision-making body chaired by the Minister of Finance or a representative and that it includes the heads of tax administration and customs. This committee determines the main tax policy orientations, decides on the studies to be undertaken by the TPU, and approves its findings. Regarding tax expenditures, it will be tasked, for example, with approving the benchmark tax system (BTS) and the evaluation report prepared by the TPU.

Under the authority of the Minister of Finance, the TPU carries out all the technical studies required to inform tax policy decision-making and monitor the impact of existing tax measures. It produces background notes and documentation to accompany the Finance Act, in particular the tax expenditure evaluation report.

The TPU may be small initially and incorporate a larger group of experts over time. Five or six permanent staff may be sufficient initially, including tax specialists (tax and customs inspectors), economists or statisticians,

and a legal expert. The head of the TPU, preferably from an academic background, must have strong experience in tax theory and be up to speed with current debates in the area. To initiate discussions, it is vital to identify the guidance and studies likely to lead to progress in tax policy. To automate the exchange of information and data from the outset, a protocol should be signed with the Directorate General of Taxation, the Directorate General of Customs, and the National Statistical Institute. Focal points should be designated in these different administrations. Stability in the composition of this technical structure is a precondition to the satisfactory fulfilment of the tasks entrusted to it and the reliability of its analyses and findings.

Regarding the division of its work, two operational sub-groups should be formed within the TPU: one responsible for legal aspects, that is, monitoring the inventory of legislation and the BTS, the other tasked with compiling the information required to evaluate tax expenditures, define their scope, estimate their cost, and analyze their potential impact. The final report is then prepared jointly by the two sub-groups. The two sub-groups require different skills: The former should be staffed with representatives from the legal administration (Directorates General of Taxation and of Customs), the second with IT specialists and statisticians (Directorates General of Taxation and of the Customs and National Statistical Institute). These two sub-groups work separately, each under the authority of a designated manager; their work is overseen and coordinated by the head of the TPU. The two sub-groups should meet monthly to share their work and coordinate their actions. The minutes of these meetings should be recorded and communicated to the tax policy committee responsible for tracking the project's progress, making the necessary trade-offs, and approving the findings, in particular the evaluation report.

Section 1.

Identification of Tax Expenditures

Any tax expenditure study first requires an understanding of the legal aspects of taxation. This is the task of the Legislation sub-group. It consists in defining, for a given year, a benchmark (BTS) for each tax, drawing up a matrix of measures that deviate from this benchmark, and identifying the measures that constitute tax expenditure based on two criteria: deviation from the benchmark tax, and definitive loss of receipts for the state. This matrix subsequently forms the basis for the Evaluation sub-group to estimate tax expenditures.

► I. Inventory of Legislation

The first step is to list and gather all legislation needed to describe the legal tax framework. The large number of legislative texts requires care in order to be as comprehensive as possible. It is vital for the success of this work that the relevant departments make available all the relevant texts, bearing in mind that this work is first undertaken separately by each of the administrations concerned (the Directorates General of Taxation and Customs) then pooled together and approved by the combined Legislation sub-group.

At the national level, this mainly concerns:

- The general tax code.
- Finance Acts.
- The customs code.
- The tariff schedule.
- The investment code.
- The mining code.
- The oil code.
- The gas code.
- Specific agreements.

At the international level, it mainly concerns:

- The revised Kyoto Convention.
- The Vienna Conventions on Diplomatic and Consular Relations.

- The Chicago Convention.
- The Florence Agreement and its Protocol of Nairobi.

The provisions contained in these texts must be updated every year as tax policy changes.

▶ II. Description of General Regime

The second step is to describe the general regime of each tax based on the legal information gathered. The main objective here is to define the taxable base and specify the tax rate or rates. Most of the necessary information for this work is contained in the general tax code, Finance Acts, the customs code, and the tariff schedule. It is essential that a summary of the general regime be made in order to identify the relief measures in the next step.

Table 1. Sample descriptions of the general regime in Madagascar and Guinea

	Madagascar (2015)	Guinea (2015)
Personal income tax		
Name	Tax on wage and equivalent incomes	Impôt sur le revenu (IR)
Tax base	Salaries, wages, compensation, fees, alimony and life annuities, as well as value of benefits in kind ¹	Total category net income ²
Rate	Sliding scale based on income ³ : – Below MGA 250,000: 0% – Above MGA 250,000: 20%	Sliding scale based on income ⁴ : – Below GNF 0.1 million: 0% – Between GNF 0.1 and 1 million: 10% – Between GNF 1 and 1.5 million: 15% – Between GNF 1.5 and 3 million: 20% – Between GNF 3 and 6 million: 25% – Between GNF 6 and 10 million: 30% – Between GNF 10 and 20 million: 35% – Above GNF 20 million: 40%
Minimum	MGA 2,000 for the income bracket above MGA 250,000 ⁵	

Withholding Tax		
Tax base	Taxable income ⁶ : <ul style="list-style-type: none"> – Interest and other income from bonds and loans – Interest from savings bonds – Directors’ and attendance fees, lump-sum payments, and any other remuneration paid to members of boards of directors – Payments and redemption premiums to creditors – Income from claims, deposits, and guarantees – Income from investments in financial institutions – Interest on shareholders’ or partners’ current accounts in credit 	Taxable income ⁷ : <ul style="list-style-type: none"> – Income from variable-rate investments, stocks and shares, and related income – Income from fixed-rate investments, claims, deposits, guarantees, current accounts, state funds, from bonds and other marketable securities, and savings bonds
Tax	20 % ⁸	10 % ⁹
Corporate income tax (CIT)		
Tax base	Taxable income ¹⁰ consists of net income determined on the basis of overall earnings from operations of any kind performed by companies, including income from disposals of any assets either in progress or retired from active use, ancillary profits, or miscellaneous gains. The following are also deductible: <ul style="list-style-type: none"> – Straight-line depreciation – Deferred depreciation – Losses carried forward for 5 years¹¹ 	Taxable income ¹² consists of net income determined on the basis of overall earnings from operations of any kind performed by companies, including income from disposals of any assets either in progress or retired from active use. The following are also deductible: <ul style="list-style-type: none"> – Straight-line depreciation – Deferred depreciation – Losses carried forward for 3 years¹³
Rate	20 % ¹⁴	35 % ¹⁵
Minimum tax		
Tax base	Revenue net of tax for year ¹⁶	Revenue in year prior ¹⁷
Rate	0,5 % ¹⁸	3 % ¹⁹
Minimum	+ MGA 320 000 ²⁰	GNF 15 million ²¹
Maximum		GNF 60 million ²²
Customs duties		
Tax base	Customs value or transaction value ²³	Customs value or transaction value ²⁴
Rate	0 %, 5 %, 10 % et 20 % ²⁵	0 %, 5 %, 10 % et 20 % ²⁶

Excise duties, excluding petroleum products		
Internal tax base	Production value plus industrial margin ²⁷	
Tax base for import	CIF value of goods plus customs duties ²⁸	Customs value ²⁹
Products and rates	<ul style="list-style-type: none"> – Alcoholic beverages (ad valorem excise duty at rate of between 50% and 200% or amount-specific excise duty between MGA 75 and 1,450 per litre) – Tobacco (e.g., 325% for cigarettes) – Imported vehicles and motorcycles (10%) – Mobile telephone communications (7%)³⁰ 	<ul style="list-style-type: none"> – Alcoholic beverages (45%) – Tobacco (15%) – Cosmetic products (5%) – Wigs (15%) – Jewellery items and parts, goldsmiths' and silversmiths' wares (15%) – Used passenger cars over 5 years' old (5%)³¹
Value-added tax (VAT)		
Taxable threshold	MGA 200 million ³²	GNF 500 million ³³
Tax base for import	Value of imports, including fees and taxes other than value-added tax ³⁴	Customs value plus duties and fees of any kind levied by the customs administration with the exception of value-added tax ³⁵
Normal rate	20 % ³⁶	18 % ³⁷
Zero rate	Exports of goods and services ³⁸	Exports and international transport ³⁹

Notes:

1. Articles 16 to 19 of the 2015 General Tax Code • 2. Articles 01.03.07 to 01.03.09 of the 2015 General Tax Code • 3. Article 01.03.16 of the 2015 General Tax Code • 4. Article 32 of the 2015 General Tax Code • 5. Article 01.03.16 of the 2015 General Tax Code • 6. Articles 01.03.16 and 01.04.03 of the 2015 General Tax Code • 7. Article 171 of the 2015 General Tax Code • 8. Article 01.04.04 of the 2015 General Tax Code • 9. Articles 187, 189, and 190 of the 2015 General Tax Code • 10. Article 01.01.10 of the 2015 General Tax Code • 11. Paragraph 11 of article 01.01.10 of the 2015 General Tax Code • 12. Paragraph 1 of article 224 of the 2015 General Tax Code • 13. Paragraph 2 of article 224 of the 2015 General Tax Code • 14. Article 01.01.14 of the 2015 General Tax Code • 15. Article 229 of the 2015 General Tax Code • 16. Article 01.01.14 of the 2015 General Tax Code • 17. Article 244 of the 2015 General Tax Code • 18. Article 01.01.14 of the 2015 General Tax Code • 19. Article 244 of the 2015 General Tax Code • 20. Article 01.01.14 of the 2015 General Tax Code • 21. Article 244 of the 2015 General Tax Code (for companies under actual profit regime) • 22. Article 244 of the 2015 General Tax Code (for companies under actual profit or regime) • 23. Article 23-1 of the 2015 Customs Code • 24. Article 30 of the 2015 Customs Code • 25. 2015 tariff schedule • 26. 2013 tariff schedule • 27. Article 03.01.04 of the 2015 General Tax Code • 28. Article 03.01.04 of the 2015 General Tax Code • 29. Article 6 of the 2013 tariff schedule • 30. Table of excise duties in the 2015 General Tax Code • 31. Article 6 of the 2013 tariff schedule • 32. Article 06.01.04 of the 2015 General Tax Code • 33. Article 359 of the 2015 General Tax Code • 34. Article 06.01.11 of the 2015 General Tax Code • 35. Article 369 of the 2015 General Tax Code • 36. Article 06.01.12 of the 2015 General Tax Code • 37. Article 373 of the 2015 General Tax Code • 38. Article 06.01.12 of the 2015 General Tax Code • 39. Article 373 of the 2015 General Tax Code.

► III. Identification of Relief Measures

The third step is to identify all provisions that deviate from the general regime for each tax as defined above. For example, this is the case for deductions that erode the tax base, reduced rates, exemptions, relief arrangements, and special regimes. These relief measures may be legislative, regulatory, contractual, or exceptional.

This list should be as comprehensive and accurate as possible in order to help the work of the Evaluation sub-group. It takes the form of a table or matrix, each line of which contains a relief measure. As a minimum, its columns should include the following information⁴ :

- Type of tax (personal income tax, capital gains tax and withholding tax, corporate income tax, minimum tax, customs duties, excise duties, VAT);
- The position of the good concerned in terms of the Harmonized System (HS) when specified for indirect taxes;
- A description of the legal provision, preferably quoted verbatim from the legal text; and
- A reference to the source legal text and the article number.

Additional information is generally added, such as:

- Type of relief measure (deduction, reduced rate, exemption, etc.);
- Goal of the measure (social, economic, environmental, etc.);
- The sector or sectors of activity concerned (agriculture, mining, industry, banking, insurance, tourism, etc.);
- The beneficiary or beneficiaries of the measure (households, companies, government, etc.).

For the sake of readability, this list should be organized in a logical order: by law, tax, and goal and theme. Built in Microsoft Excel, the matrix may take the following form:

4. See in particular Myles et al. (2014); Redonda (2016).

Table 2. Example matrix of relief measures

Tax	HS	Legal provision	Legal text	Article	Type	Goal	Sector	Beneficiaries
I) CORPORATE INCOME TAX (CIT)								
1) Exemptions from the General Tax Code								
CIT		Not-for-profit organizations	General Tax Code	10-1	Exemption	Develop the social sector	Social	Associations and NGOs
CIT		Government	General Tax Code	10-2	Exemption	Avoid taxation	Sovereign	State and public entities
CIT		...	...	...	...	...	...	...
2) Mining code								
CIT		Mining permit holders are subject to 25% corporate income tax	Mining code	50	Reduced rate	Develop the mining sector	Mines	Companies
II) VALUE-ADDED TAX (VAT)								
1) Exemptions from the General Tax Code								
VAT		Postal and tax stamps	General Tax Code	100-1	Exemption	Support purchasing power	Social	Households and companies
VAT	10.06.10	Rice	General Tax Code	100-2	Exemption	Support purchasing power	Social	Households
VAT		...	...	...	...	...	...	...
2) Exemptions from the customs code								
VAT		Religious objects used in the exercise of worship	Customs code	71	Exemption	Develop the social sector	Social	Associations and NGOs
VAT		Articles intended for the official use of diplomatic missions and consular posts	Customs code	72	Exemption	Promote cooperation	Diplomatic	Diplomatic and consular missions
VAT		...	...	...	...	...	...	...

This list concerning legislative and regulatory exemptions must be supplemented by a list of contractual and exceptional exemptions, as benefits that are not provided for by a law may be granted by discretion to companies or individuals and thus constitute tax expenditures. This work relies on access to the special enterprise agreements of the companies in question and on an itemized analysis of customs data extracted from the Customs' IT system.

Highlighting changes to relief measures identified from one year to the next helps improve the transparency and monitoring of tax expenditures.

▶ IV. Choice of Benchmark Tax System and Identification of Tax Expenditures

The fourth step is to decide for each of the relief measures previously listed whether they constitute a tax or a non-tax expenditure. To this end, it is important to: i) define in advance the benchmark tax system (BTS), and ii) determine whether the relief measure gives rise (or not) to a definitive loss of revenue for the state.

A. Choice of Benchmark Tax System

There are two approaches to defining the BTS: A normative approach and a positive approach⁵. The normative approach views the benchmark as an ideal to be attained, namely the tax or tax system that the tax policy should aim for in accordance with best practice. However, in the absence of internationally recognized tax standards, the positive approach, which is based on existing ordinary tax law, is the method most commonly used. However, the dichotomy between the normative and positive approaches requires nuance. Strictly speaking, a perfectly positive analysis would be free from any value judgement and would merely constitute a descriptive account of “what is”. However, the process of identifying relief measures inevitably entails some normativity as it involves listing all the provisions that deviate from the norm represented by the general regime. Moreover, regarding indirect taxation, a best-practice normative approach makes it possible to define the benchmark base, in the case of VAT on imports, for example, the customs value topped up by customs and excise duties⁶. The approach used can therefore be described as pragmatic.

For example, two options are possible for the treatment of free-zone status. The first is to include this free-zone status in the BTS in accordance with international best practice, that is, suspension of customs duties and fees on all imported goods (capital goods, office equipment and supplies, spare parts, etc.) and the collection of duties and fees only on inputs involved in the manufacturing process of products released for consumption in the local market⁷. The second is to consider the suspensive inward processing regime as the tax norm for the local processing of products for the purpose of re-export. Under this regime, import duties and fees are suspended only on products intended to be processed locally for re-export, that is, imported inputs involved in the manufacturing process of the finished product. In

5. See in particular Altshuler and Dietz (2008); Villella et al. (2010).

6. In some cases, it is possible to refer to a regional legal text to define the BTS.

7. Within the authorized percentage (5% in Madagascar).

the event the finished product is released for consumption in the local market, the amount of these duties and fees is levied in proportion to the quantities of inputs concerned. This second option is the one used, for example, in the evaluation of tax expenditures in Madagascar.

The choice of BTS is a national tax policy decision, and it is vital that it be approved and validated by the Ministry of Finance. The BTS can be very narrow or quite broad, including relief measures considered normal by the authorities. This is why it is difficult to make international comparisons of tax expenditures. However, at the national level, it is important that the BTS be as stable as possible so as to enable comparisons over time, that is, based on stable principles and reflecting only tax policy changes.

The choice of BTS is made on the basis of five criteria: i) the general tax regime; ii) national tax policy choices; iii) bilateral agreements; iv) regional directives; and v) international agreements.

1. General regime

The BTS can be based fully or partially on the general tax regime as defined by the general tax code, the customs code, or the tariff schedule. The main factors to keep in mind are the scope, the definition of the taxable base, and the tax rate(s). All those African countries that have started evaluating their tax expenditures as well as those of Latin America (CIAT, 2011) have defined their BTS on the basis of their ordinary legal regime. In other words, they have opted for a positive approach. This is also the pragmatic choice (see above) presented in CREDAF's 2015 methodological guide on tax expenditure evaluation.

2. National Tax Policy Choices

The BTS may also consider national tax policy choices. The authorities may decide to consider some relief measures as normal, for example as integral to a policy of support to a particular sector of the economy such as health or education. However, it should be noted that considering such measures within the definition of the BTS precludes any estimation of their budgetary cost⁸ and therefore any analysis of their effectiveness compared to their initial goal. It is therefore preferable to evaluate all relief measures even if they are part of a social or sectoral policy regarded as fully justified in order to inform policymakers in their effort to optimize relief measures and select the right instruments. The estimation of tax expenditures in no way amounts to their systematic elimination. In fact, a measure that deviates from the tax norm (i.e., that falls outside of the BTS) may be politically or socially justified.

3. Bilateral Agreements

Some tax provisions contained in bilateral agreements may be included in the BTS, while others may be considered tax expenditures. For example, double taxation

⁸ Les DD sont entendus ici au sens large, c'est-à-dire toutes les taxes perçues en douane qui ont un effet équivalent à un DD.

treaties limit the state's power to tax some international transactions. In principle, these provisions are intended to prevent the double taxation of income. If the rate provided for is that of the ordinary legal regime, there is no deviation from the BTS. However, if both countries agree on a preferential tax relative to the general regime, the reduction in some tax rates can be identified as a tax expenditure since any bilateral agreement can be renegotiated. The same holds for specific agreements signed between the state and a company.

4. Project aid

The tax treatment of projects financed by development partners requires particular attention. Since 2004, the taxation of aid has been debated in official circles and proposed in several international forums, notably as part of the International Tax Dialogue (ITD, 2006; 2007). Many technical and financial partners have adopted official positions in favour of the taxation of their projects, albeit without as yet acting on their official declarations. The controversy and debate this elicits leaves little doubt that the non-taxation of aid can no longer be considered a non-negotiable standard. Governments should therefore include the taxation of external aid in the BTS and treat its exemption as a tax expenditure. An evaluation of the cost of this exemption would shed light on its impact and could persuade the authorities to encourage those technical and financial partners that have committed to paying taxes to do so. Beyond the loss of tax revenue, tax exemptions for project aid have particularly damaging effects, particularly on the formalization of the economy in recipient countries and on the efficiency of their tax and customs administrations (Caldeira et al., 2017).

5. Regional Agreements

The BTS can also be based fully or partially on regional agreements in the context of trade blocs. The goal is then to evaluate tax expenditures not just against a national norm but also against a community norm. This is the case in a customs union, where the common external tariff is the norm for customs duties.

6. International Agreements

It is essential that the BTS take into account the provisions in international agreements as exemptions can be decided at the international level. According to the hierarchy of norms, international law takes precedence over regional and national law. These measures must therefore be considered in the tax norms and included in the BTS.

However, the comparison between national taxation and international agreements should be made to the letter and not by interpreting the text or extrapolating from it. For example, the Nairobi Protocol exempts only some books from domestic taxes, notably those intended for public libraries or for blind people and other physically or mentally disabled persons. Similarly, under the Chicago Convention, only aircraft flying from or to another country, including fuel, oil, spare

parts, and aircraft stores, are exempt from duties. Domestic flights are not covered by the Convention's tax provisions. Elsewhere, in the case of mere recommendations, such as those made by the revised Kyoto Convention, the authorities may choose to consider any exemptions as tax expenditures.

The Revised Kyoto Convention

The International Convention on the Simplification and Harmonization of Customs Procedures (1973, revised 1999), also known as the Kyoto Convention, was initiated by the World Customs Organization (WCO).

It recommends exempting from import duties and taxes:

- Therapeutic substances of human origin, blood grouping, and tissue typing reagents where consigned to institutions or laboratories approved by the competent authorities;
- Samples of no commercial value regarded by Customs as being of negligible value and to be used only for soliciting orders for goods of the kind they represent;
- Removable articles other than industrial, commercial, or agricultural plant or equipment intended for the personal and professional use of a person or members of that person's family and brought into the country along with that person or separately for the purpose of removal of that person's residence to the country;
- Effects inherited by a person who, at the time of the death of the deceased, resides primarily in the country of importation and provided that such personal effects were for the personal use of the deceased;
- Personal gifts, excluding alcohol, alcoholic beverages, and tobacco goods, not exceeding a total value to be specified in national legislation on the basis of retail value;
- Goods such as foodstuffs, medication, clothing, and blankets sent as gifts to an approved charitable or philanthropic organization for distribution free of charge to needy persons by the organization or under its control;
- Awards to persons resident in the country of importation subject to the production of supporting documents required by the Customs;
- Materials for the construction, upkeep, or ornamentation of military cemeteries, coffins, funerary urns, or ornamental funerary articles imported by organizations approved by the competent authorities;
- Documents, forms, publications, reports, and other articles of no commercial value specified in national legislation;
- Religious objects used for worship;
- Products imported for testing provided that the quantities imported do not exceed those strictly necessary for testing and that the products are used up during testing or that remaining products are re-exported or rendered commercially valueless under Customs control.

The Vienna Conventions

The Convention on Diplomatic Relations (1961) and the Convention on Consular Relations (1963), also known as the Vienna Conventions, were initiated by the United Nations (UN) for the “promotion of friendly relations among countries”.

Diplomatic agents, consular officers and their family members as well as consular employees and their family members are exempt from all taxes and fees, personal or real, national, regional, or municipal, except:

- Indirect taxes of a kind normally incorporated in the price of goods or services;
- Taxes and fees on private immovable property situated in the territory of the receiving state, unless the person holds it on behalf of the sending state for the purposes of the mission;
- Estate, succession, or inheritance duties levied by the receiving state, subject to certain provisions;
- Taxes and fees on private income having its source in the receiving state and capital taxes on investments made in commercial undertakings in the receiving state;
- Taxes and fees levied for specific services rendered;
- Registration, court, mortgage, or stamp duties with respect to immovable property.

Diplomatic and consular premises are exempt from all taxes and fees other than those in respect of payment for specific services rendered.

Monies received by diplomatic missions and consular posts in respect of duties and charges for official acts are exempt from all taxes and fees.

The following goods are exempt from import duties and taxes:

- Articles for the official use of diplomatic missions and consular posts;
- Articles for the personal use of diplomatic agents and family members as well as consular officers and family members, including imported articles intended for their settlement;
- Articles imported by members of the administrative and technical staff of diplomatic missions and their family members for settlement as well as by consular staff.

The Chicago Convention

The Convention on International Civil Aviation (1944), also known as the Chicago Convention, is the founding text of the International Civil Aviation Organization (ICAO), one of the objectives of which is to promote the planning and development of international air transportation.

The following items are exempt from import duties and taxes:

- Aircraft on a flight to or from another member state as well as fuel, lubricating oils, spare parts, regular equipment, and aircraft stores remaining on board;
- Spare parts and equipment imported for incorporation in or use on an aircraft of another contracting state.

The Florence agreement

The Agreement on the Importation of Educational, Scientific, and Cultural Materials (1950), also known as the Florence Agreement, was initiated by the United Nations Educational, Scientific, and Cultural Organization (UNESCO) to “promote the free flow of ideas by word and image” as per the first article of its constitution.

Contracting states undertake to not apply customs duties on imports of:

- Books, publications, and documents;
- Works of art and collector’s items of an educational, scientific, or cultural character;
- Visual and auditory materials of an educational, scientific, or cultural character;
- Scientific instruments and apparatus;
- Articles for the blind.

A detailed list of such goods is included in the Annex.

The Nairobi Protocol

The Protocol to the Agreement on the Importation of Educational, Scientific, and Cultural Materials (1976), also known as the Nairobi Protocol, was also initiated by UNESCO. Its purpose is to expand and modernize the Florence Agreement.

Contracting states undertake to extend exemption from customs duties to imports of:

- Books, publications, and documents;
- Works of art and collector’s items of an educational, scientific, or cultural character;
- Visual and auditory materials;
- Visual and auditory materials of an educational, scientific, or cultural character;
- Articles for the blind and other persons with disabilities;
- Sports equipment;
- Musical instruments and other musical equipment;
- Material and machines used for the production of books, publications, or documents.

A detailed list of such goods is included in the Annex.

Contracting states also undertake to not levy any internal taxes on:

- Books and publications consigned to the libraries referred to in Paragraph 5 of this protocol;
- Official, parliamentary, and administrative documents published in their country of origin;
- Books and publications of the United Nations or any of its Specialized Agencies;
- Books and publications received by the United Nations Educational, Scientific, and Cultural Organization (UNESCO) and distributed free of charge by it or under its supervision;
- Publications intended to promote tourism-related travel outside the importing country, sent and distributed free of charge;
- Articles for the blind and other physically or mentally disabled persons: (i) books, publications, and documents of all kinds in raised characters for the blind; (ii)

other articles specially designed for the educational, scientific, or cultural advancement of the blind and other physically or mentally disabled persons imported directly by institutions or organizations concerned with the education of or assistance to the blind and other physically or mentally disabled persons approved by the competent authorities of the importing country for the purpose of duty-free entry of these types of articles.

However, this commitment is not binding as contracting states reserve the right to declare that they will not be bound by all of the protocol's provisions.

B. Definitive Revenue Loss as a Criterion for Tax Expenditure Identification

Some relief measures do not result in a definitive loss of revenue for the state either because of the nature of the exempted beneficiary—for example a public entity—or because of the tax mechanism affecting the exempted good—for example VAT exemptions on an input or capital good, bearing in mind that, in theory, VAT is only charged on final consumption. These relief measures are not tax expenditures. It is therefore necessary to keep in mind the normal, or theoretical, function of each tax.

1. Personal Income Tax

Personal income tax (PIT) applies to income categories comprising land income, salaries, wages, annuities, industrial and commercial profits, non-commercial profits, and investment income.

Progressive personal income tax scales fall under the BTS.

2. Capital Gains Tax and Withholding Tax

Capital Gains Tax (CGT) and Withholding Tax apply to income from financial investments, including income from shares and equivalent incomes, gains on share disposals, income from claims, guarantees, and current accounts, income from bonds, income from savings bonds, etc.

Payment of capital gains tax relieves the taxpayer of the payment of income tax.

3. Corporate Income Tax and Minimum Tax

Corporate Income Tax (CIT) applies to the earnings of for-profit organizations.

Minimum tax (MT) is the minimum corporate income tax payment. It is based on a company's revenue. It can entail a minimum or maximum tax payment.

4. Customs Duties⁹

Customs duties are a tax designed to protect national economic activity. Goods that enter or leave the customs territory are subject to import or export duties, depending on the case, as per the customs schedule. The rate may be ad valorem, i.e. calculated on the basis of a percentage of the value of the goods, or specific, when the taxable base is the quantity, weight, volume, or number of the goods.

9. Customs duties are considered here in the broad sense, that is, any tax levied by customs with an effect equivalent to customs duties..

5. Excise Duties

Excise duties are indirect taxes that normally apply to a limited number of goods or services with low price elasticity as regards demand. Excise duties can pursue several goals. They may try to internalize—or at least reduce—the negative externalities generated by the consumption of the goods taxed. For example, excise duties on tobacco, alcohol, or sugary drinks fall under public health policy. They are designed to reduce the consumption of these products as well as the social problems they cause. Similarly, excise duties on petroleum products or vehicles pursue environmental and public health goals. Excise duties can also be used to introduce progressiveness into indirect taxation or simply to increase the mobilization of tax revenue (oil products, telecommunications). Excise duties usually apply to both local production and imports according to a principle of non-discrimination. Their rates may be ad valorem, when they tax a percentage of the value of the goods or services, or specific when they tax quantities (as a set value per cigarette, bottle, litre, text message, etc.).

6. Value-Added Tax (VAT)

Value-added tax (VAT) is an ad valorem tax included by companies in the sales price of each transaction. Companies pay the state the difference between the amount of tax they charge and the amount they pay on their own purchases. The implication of this deduction principle is that VAT is collected by registered companies on behalf of the state but charged to the final consumer. VAT applies to both imports and local production, while it is zero-rated on exports.

The deduction mechanism is available only to companies with revenue above a certain threshold set by the tax authorities or to those that opt to register for it. Thus, companies that are not registered for VAT do not charge their customers VAT but no longer have access to the deduction or refund mechanism for the VAT they pay on their purchases (intermediate consumption and investment). The residual VAT they pay is therefore final.

Goods sold by VAT-registered companies may be taxed at a zero rate. This is the case for exports but seldom for domestic transactions. In this case, VAT-registered companies are entitled to claim a refund from the state for the VAT paid on their purchases. This results in a lack of revenue for the state but also in no additional VAT charge for these companies.

In the case of VAT exemptions, the mechanism is different from that of the zero rate. VAT-registered producers no longer charge their customers VAT but are also no longer entitled to claim a refund for the VAT paid on their own purchases. Here, VAT on purchases is a final expense for registered companies, as in the case of non-registered companies.

According to these principles, final VAT receipts (net VAT) consist merely of VAT collected on:

- Final consumer goods sold by registered companies;
- Inputs and equipment used by non-registered companies; and

– Inputs and equipment used by registered companies that sell VAT-exempt goods.

Thus, only those VAT exemptions on the goods listed above result in a definitive loss of VAT revenue and can therefore be considered tax expenditures. Similarly, according to this definition, any VAT exemption that does not generate a loss of VAT revenue is excluded from tax expenditures, notably exemptions on inputs used by VAT-registered companies.

Some countries use the concept of “negative” tax expenditures (see Box 2).

Box 2. Negative tax expenditures

Some provisions in the benchmark tax system (BTS) could be interpreted as negative tax expenditures since they result in an increase in tax revenue. This notion is generally not included in tax expenditure evaluation reports despite its importance in the assessment of the merits (or otherwise) of certain provisions.

Any measure or practice that has the effect of collecting VAT on inputs or capital goods by taxpaying companies corresponds to a negative tax expenditure. Examples of such provisions include: (i) time limits to the right to deduct VAT; (ii) limits to investment amounts eligible for VAT credit refunds; and (iii) deadlines for credit refund claims. Last, non-reimbursement of VAT credits should also be considered a negative tax expenditure insofar as: (i) it runs counter to the objective of VAT, which is to tax final consumption; and (ii) it unduly increases VAT revenues by considering temporary revenue as definitive revenue.

7. Registration Duties

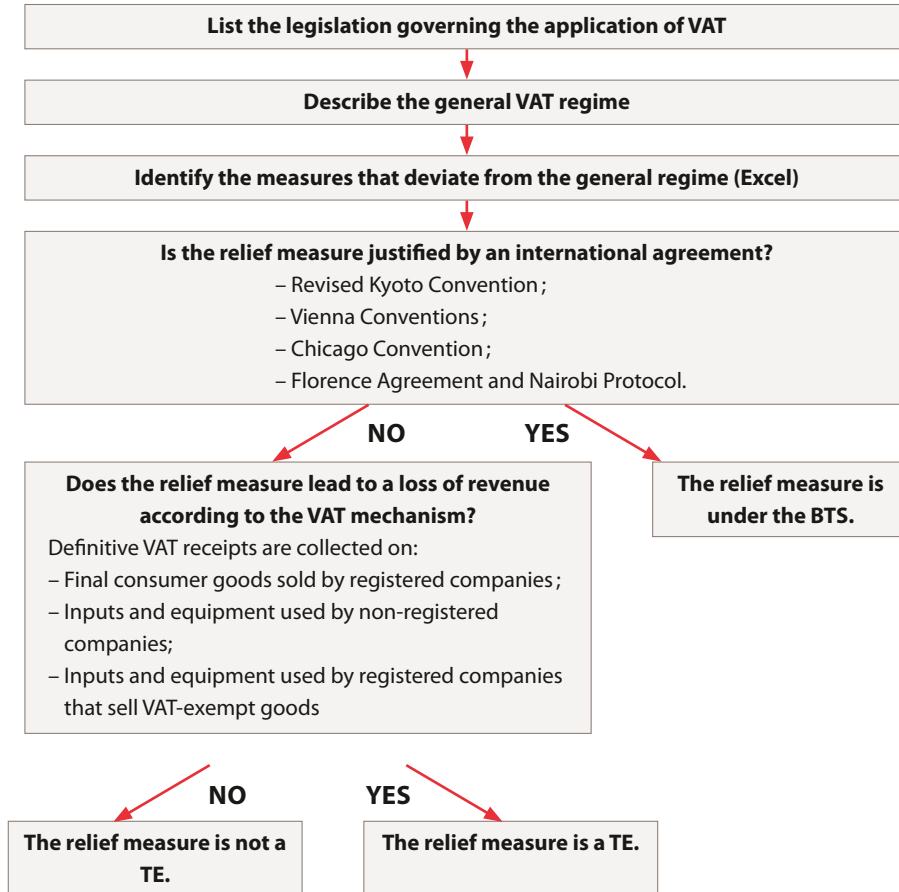
Registration duties are collected on legal acts. They concern a very large number of notarial acts such as the transfer of real estate or succession processes following death as well as legal acts arising from court proceedings. While some acts are required to be registered, others may be registered voluntarily to provide legal value to a process (for example for an acknowledgement of debt, lease of property, etc.). Registration duties may be fixed or proportional, depending on the nature of the act.

C. Classification of Each Relief Measure

In the Excel file mentioned above, a column should specify whether the relief measure is identified as a tax expenditure (TE) or non-tax expenditure (NTE). Some relief measures are easier than others to identify as tax expenditures. For this reason, the classification of each measure in the Excel table must be justified by the Legislation sub-group.

In the case of VAT, for example, the choice between tax expenditure and non-tax expenditure can be summarized by the following decision-making flowchart:

Figure 1. Classification of VAT relief measures as TEs or NTEs



D. Codification of Each Relief Measure

To easily identify each tax measure, the simplest method is to number them according to the order of the rows in the matrix. However, it is also possible to imagine a true codification of relief measures in order to make these easier to monitor over the years. The most obvious codification method consists in using the reference in the legal text and the provision's article number. This option has the advantage of simplicity and clarity. However, other classification methods may be considered if they meet a specific need, for example by goal or by sector of activity. A codification that aligns with the budgetary nomenclature in force may also be considered.

► V. Preparation of the Legislation Sub-group's Interim Report

The fifth step is to draft an interim report encapsulating the work of the Legislation sub-group, to be approved by the steering committee and Minister of Finance and then sent to the Evaluation sub-group. This report contains:

- The BTS and its justification (national, regional, and international law);
- The matrix listing the relief measures and classifying them as tax or non-tax expenditures;
- Potentially a description of the provisions that changed from one year to the next.

Section 2.

Evaluation of the Budgetary Cost of Tax Expenditures

Once tax expenditures have been identified at the legal level by the Legislation sub-group, the Evaluation sub-group is tasked with drawing up a quantitative estimate of the budgetary cost of these expenditures. To this end, it calculates the difference between the tax the state should have received in the absence of relief measures and the tax that was actually paid to the state (zero in the case of full exemptions). Tax expenditures should be estimated at the most disaggregated level possible in order to identify the budgetary cost of each measure resulting in a tax expenditure. Obviously, this level of disaggregation depends on data availability.

► I. Evaluation Methodology

There are various methods for estimating tax expenditures¹⁰. One approach is to estimate the revenue loss (or shortfall). This consists in estimating ex-post the revenue loss arising from tax expenditures, *ceteris paribus*, that is, assuming no behaviour change among beneficiary agents. The second method is to estimate the final revenue gain. This consists in estimating the revenue gain that would result from the abolition of a tax expenditure, taking into account the effect it would have on the behaviour of beneficiary agents. Finally, a third method is to estimate outlay equivalence. This approach aims to estimate the amount of direct expenditure that would be required to provide an equivalent financial benefit to the beneficiaries of the tax expenditure.

The revenue loss method is the most commonly used because of its simplicity. It requires a smaller quantity of data, as the estimate is made all things being equal, that is, under the assumption that the behaviour of economic agents would remain the same in the absence of the relief measure. In other words, the tax base is considered stable. Taking into account the effects of tax expenditures on behaviour would require estimating the effect of the relief measures on the tax base. Effects could be direct (when the rate influences the tax base) or indirect (via consumption, production, or the labour market). The complexity of the

10. See in particular Altshuler and Dietz (2008); Vilella et al. (2010); Redonda (2016).

mechanisms at work would require a very large dataset in order to estimate these effects. This methodological guide will therefore use the revenue loss method.

The formulas used for calculating tax expenditures vary depending on the function of the tax, although the idea is always to try to estimate the difference between the revenue the state should have received in the absence of the relief measure and what it actually received. The following estimation method is designed to be generic and must be adapted to take into account the realities of each country, notably its legislation and available tax and customs information.

▶ II. Data to be Collected

The collection of the data necessary for the evaluation of tax expenditures is an essential step since the scope of evaluation, that is, the number of tax expenditures to be costed, generally depends directly on the quantity and quality of the data available.

The source of the data used in the evaluation depends on the relief measure and on the administration responsible for the tax. In the case of tax expenditures under the Directorate General of Taxation (DGI), this is the Directorate of Large Enterprises (DGE) and the Directorate of Small and Medium Enterprises (DPME). For those under the General Directorate of Customs (DGD), it is the Directorate of Information Technology (DIT) that manages the Automated System for Customs Data (ASYCUDA).

All the data required should be provided to the Evaluation sub-group in Excel format. A sample questionnaire that can be used to collect data from the tax and customs administrations is available in the Annex.

Clearly, the quantity and quality of data depend on each country and the information system of each administration. DGD data are generally the most reliable because they are necessary for the customs clearance of goods. Indirect taxes (customs duties, excise duties, VAT) are therefore systematically entered into the customs clearance computer system. Conversely, DGI data are not always computerized. As a result, they are more likely to contain errors or suffer from missing information. Regarding individual taxes, data for corporate income tax (and the minimum tax) and VAT are more readily available and usable than those for personal income tax, capital gains tax, or internal excise duties. As access to data from the DPME is often not possible, the evaluation generally concerns only those companies registered with the DGE.

It is helpful to identify within each administration a contact point responsible for information in order to facilitate verification by the tax policy unit and monitoring from one year to the next. Logically, these contacts should be part of the Evaluation sub-group.

A. Data from the Directorate General of Taxation

Data to be collected from the Directorate General of Taxation (DGI) concern the income of natural persons (personal income tax), corporate activity (corporate income tax or minimum tax, VAT, capital gains tax, and withholding tax), acts subject to registration duties, and goods subject to excise duties.

Data on natural persons for the calculation of personal income tax:

The personal income tax base varies considerably from one country to the next. The tax can be family- or individual-based and subject to many deductions and allowances. Information may be collected by the taxpayer, anonymously, or aggregated. Whatever the complexity of this tax, the information system must be able to contain or reconstruct the following data:

- Taxable income before the various allowances and deductions;
- Amounts of allowances and reductions by measure;
- Taxable income after the various allowances and deductions; and
- Personal income tax paid.

DGI information systems do not always make it possible to isolate the different measures included in the calculation of the tax. In this case, it is possible to use the remuneration records (Ministry of the Budget) for public sector employees and those of the social security funds for private sector workers in order to collect data on wage incomes as well as certain allowances and deductions, notably for family support.

Information on companies for the calculation of corporate income tax or minimum tax, VAT, capital gains tax, and withholding tax:

- Tax identification number;
- Company name;
- Date of foundation;
- Sector of activity;
- Tax regime (specifying, if possible, whether the company is subject to a special regime, such as the investment code, the mining code, the petroleum code, or a specific agreement);
- Company sales revenue;
- Minimum tax paid;
- Taxable profit;
- Corporate Income Tax paid;
- Sales revenue from exports;
- Local sales revenue exempt from VAT;
- Local sales revenue subject to VAT;
- VAT collected, excluding withholdings at source, i.e., VAT charged by the company to its customers on taxable transactions;

- Deductible VAT on local sales revenue subject to VAT;
- VAT to be paid, i.e., VAT paid to the state corresponding to the difference between VAT collected and deductible VAT paid by the company;
- Capital gains tax and withholding tax bases;
- Capital gains tax and withholding tax rates;
- Capital gains tax and withholding tax paid.

Data for the calculation of excise duties, for each good subject to excise duties:

- Excise duty base;
- Excise duty rates or specific amounts;
- Excise duties paid.

Data for the calculation of registration duties, for each category of legal act subject to registration duties:

- Registration duty base;
- Registration duty rates or specific amounts;
- Registration duties paid.

B. Data from the Directorate General of Customs

Data to be collected from the Directorate General of Customs (DGD) concern imports. The customs clearance information system (for example ASYCUDA) contains all the elements of declarations:

- Tax identification number;
- Company name;
- Declaration type and number;
- Customs regime, with description;
- Additional code, with description;
- Harmonized System (HS) code, with description;
- Import value;
- Customs duty rate;
- Customs duties paid;
- Excise duty rate;
- Excise duties paid;
- VAT rate;
- VAT paid;
- Rates and amounts paid in respect of any other import taxes.

► III. Calculation of Tax Expenditures

In general, the calculation of tax expenditures aims to estimate the shortfall between the tax that should have been collected in the absence of relief measures and the tax that was actually paid. Using the available data collected from the various administrations, the idea is to recalculate a theoretical tax assuming full compliance with the BTS and then subtract the tax actually paid. The exact formula for the calculation of the theoretical tax differs depending on the tax. It must also be tailored to the specific needs of each country.

In the case of systematic and automated calculations, small differences can sometimes emerge between the theoretical tax and the tax paid even though these differences are not necessarily tax expenditures. They may simply arise from approximations or from rounding, so it is best not to take them into account. It is common, for example, for the income tax base to be rounded for both personal income tax and corporate income tax. In Guinea in 2015, the personal income tax base was rounded to the lowest thousand Guinean francs¹¹. In Madagascar in 2015, the personal income tax base was rounded to the lowest hundred MGA¹², while the corporate income tax base was rounded to the lowest thousand MGA¹³.

It is always preferable to measure tax expenditures at the most disaggregated level possible. For DGI data, this is the household (personal income tax) or company (corporate income tax or minimum tax, VAT, capital gains tax) level. For customs data from the Directorate General of Customs, it is possible to work at the scale of the import transaction and by product. Using the finest scale has the advantage of subsequently enabling the results of total tax expenditures to be broken down from several angles, for example by relief measure, tax, legal text, beneficiary, sector of activity, etc.

A. Direct taxes

1. Personal Income Tax

Personal income tax (PIT) is levied on different categories of income for natural persons. The theoretical personal income tax is calculated by multiplying the taxable base by the personal income tax rate used in the BTS. Personal income tax expenditure (PIT TE) is the difference between the theoretical personal income tax and the personal income tax actually paid.

$$\begin{aligned} \text{Theoretical PIT} &= \text{Tax base} \times \text{PIT rate in the BTS} \\ \text{PIT tax expenditure} &= \text{theoretical PIT} - \text{PIT paid} \end{aligned}$$

This principle, which appears relatively simple, masks numerous different cases

11. Paragraph 1, Article 32 of the 2015 General Tax Code

12. Article 01.03.16 of the 2015 General Tax Code.

13. Article 01.01.14 of the 2015 General Tax Code.

because the personal income tax base is often complex and varies depending on the individual as well as the individual's family, wealth, and occupational situation. There is therefore no standard formula for the calculation of personal income tax expenditures. The following box illustrates the calculation for a particular measure—family support credits—in the case of personal income tax in Madagascar.

Box 3. Personal income tax in Madagascar

In Madagascar in 2015, wages, compensation, and other income resulting from an employed activity gave rise to the levying of a withholding tax, representative and in discharge of personal tax on wage income and similar¹⁴. Cette retenue à la source est effectuée mensuellement par l'employeur ou l'organisme payeur¹⁵. This withholding tax was deducted monthly by the employer or paying organization¹⁶. The personal income tax scale contains two income brackets: income in the first bracket, up to MGA 250,000, is not taxed; income in the second bracket, above MGA 250,000, is taxed at 20%¹⁷.

If taxable income \leq 250,000: theoretical PIT = taxable income \times 0% = 0

If taxable income $>$ 250,000: theoretical PIT = MAX ((taxable income – 250,000) \times 20%; 200)

Taxpayers whose taxable income is greater than MGA 250,000 are entitled to a tax reduction of MGA 2,000 per month for each dependent¹⁸. However, for these taxpayers, despite the reduction, the tax cannot be lower than MGA 200.

If taxable income \leq 250,000: PIT paid = taxable income \times 0% = 0

If taxable income $>$ 250,000: PIT paid = MAX ((taxable income – 250,000) \times 20% – number of dependents \times 2,000; 200).

Personal income tax expenditure is the difference between the theoretical personal income tax and the personal income tax actually paid.

PIT TE = theoretical PIT – PIT paid

Assuming constant taxable income, the monthly tax expenditure can be extrapolated over a year as:

Annual PIT TE = PIT TE \times 12

In the calculation of the personal income tax, three cases are therefore possible:

1) Taxpayers pay no tax if their taxable income is less than MGA 250,000 regardless of the number of dependents. In this situation, the monthly personal income tax expenditure is zero:

14. Article 01.03.10 of the 2015 General Tax Code.

15. Article 01.03.21 of the 2015 General Tax Code.

16. Article 01.03.16 of the 2015 General Tax Code.

17. Article 01.03.16 of the 2015 General Tax Code.

18. Article 01.03.19 of the 2015 General Tax Code.

Theoretical PIT = 0

PIT paid = 0

PIT TE = 0

2) Taxpayers pay the minimum personal income tax, i.e., MGA 200, if their taxable income is between MGA 250,000 and MGA 251,000 ($250,000 + 200/20\%$) plus 10,000 times the number of dependents ($2,000/20\%$). In this situation, the monthly personal income tax expenditure varies between zero and MGA 2,000 per dependent. This is the case, for example, for a taxpayer who earns MGA 260,000 with two dependents:

Theoretical PIT = MAX $((260,000 - 250,000) \times 20\%; 200)$

= MAX $(10,000 \times 20\%; 200)$

= MAX $(2,000; 200)$

= MGA 2,000

PIT paid = MAX $((260,000 - 250,000) \times 20\% - 2 \times 2,000; 200)$

= MAX $(10,000 \times 20\% - 4,000; 200)$

= MAX $(-2,000; 200)$

= MGA 200

PIT TE = 2,000 - 200 = MGA 1,800

3) Taxpayers pay more than the minimum personal income tax if their taxable income is more than MGA 251,000 ($250,000 + 200/20\%$) plus 10,000 times the number of dependents ($2,000/20\%$). In this situation, the monthly personal income tax expenditure is MGA 2,000 per dependent. This is the case, for example, for a taxpayer who earns MGA 300,000 with two dependents:

Theoretical PIT = MAX $((300,000 - 250,000) \times 20\%; 200)$

= MAX $(50,000 \times 20\%; 200)$

= MAX $(10,000; 200)$

= MGA 10,000

PIT paid = MAX $((300,000 - 250,000) \times 20\% - 2 \times 2,000; 200)$

= MAX $(50,000 \times 20\% - 4,000; 200)$

= MAX $(6,000; 200)$

= MGA 6,000

PIT TE = 10,000 - 6,000 = MGA 4,000

2. Capital Gains Tax and Withholding Tax

Capital gains tax (CGT) and Withholding tax (WT) are levied on income from financial investments. The theoretical capital gains tax and withholding tax are calculated by multiplying the taxable base by the capital gains tax rate and withholding tax rates used in the BTS. The capital gains tax/withholding tax expenditure (CGT/WT TE) is the difference between the theoretical tax and the tax actually paid.

Theoretical CGT/WT = tax base × CGT/WT rate in the BTS
 CGT/WT TE = theoretical CGT/WT – CGT/WT paid

Unfortunately, the data necessary for the calculation of capital gains tax and withholding tax expenditures are seldom available as tax forms often only contain data concerning the investment income being taxed. Most of the time, the exempt income base is not reported, which does not allow for the resulting tax expenditure to be calculated. Consequently, it is often only possible to estimate tax expenditures resulting from reduced capital gains tax and withholding tax rates. For example, it is common to find provisions in double taxation treaties that cap the withholding tax rates applied by a contracting state on investment income that exits its territory to be paid to a resident in the other contracting state. When the ceiling rates are lower than the national capital gains tax rate, these measures give rise to tax expenditures.

Box 4. The example of Madagascar's tax treaties

In Madagascar in 2015, the standard withholding tax rate on gross dividends and interest was set at 20% under the General Tax Code¹⁹. However, the government signed double taxation treaties with France (1983) and Mauritius (1994). Investment income paid by a company residing in one contracting state to a resident in the other contracting state was therefore taxable in this second state. In the tax treaty with France²⁰, the tax could not exceed 25% of gross dividends²¹ and 15% of gross interest²². In the tax treaty with Mauritius²³, the contracting state in which the company paying financial income resided retained the right to tax, but the tax could not exceed 10% of gross dividends²⁴ or interest²⁵.

19. Article 01.04.04 of the 2015 General Tax Code.

20. Treaty of 22 July 1983 between the Government of the French Republic and the Government of the Democratic Republic of Madagascar to avoid double taxation, to inform on tax evasion, and establish rules for administrative assistance in tax matters.

21. The ceiling tax rate is reduced to 15% of gross dividends if the actual beneficiary is a company that directly owns at least 25% of the capital of the company that pays the dividends (Article 10 of the tax treaty with France).

22. Article 11 of the tax treaty with France.

23. Treaty of 30 August 1994 between the Government of the Republic of Madagascar and the Government of the Republic of Mauritius.

24. The ceiling tax rate is reduced to 5% of gross dividends if the company that pays the dividends is eligible for the Investment Code or a private equity or venture capital company (Article 10 of the tax treaty with Mauritius).

25. Article 11 of the tax treaty with Mauritius.

3. Corporation Tax and Minimum Tax

Corporate Income Tax (CIT) is levied on a company's taxable profits. It often contains a minimum tax (MT) on revenues. The minimum tax generally contains a minimum amount payable and, in some countries, can be capped by a maximum amount.

Tax expenditures are calculated at the company level from data from the Directorate of Large Enterprises (DGE) and the Directorate of Small and Medium Enterprises (DPME). The theoretical corporate income tax is calculated by multiplying taxable profits by the corporate income tax rate used in the BTS. The theoretical minimum tax rate is calculated by multiplying revenues by the minimum tax rate used in the BTS, keeping in mind that it cannot be either below the minimum amount or above the maximum amount. The theoretical corporate income tax or minimum tax is then the greater of the theoretical corporate income tax and the theoretical minimum tax. Corporation tax or minimum tax expenditure is the difference between the theoretical corporate income tax or minimum tax and the corporate income tax or minimum tax actually paid.

Theoretical CIT = taxable profit × CIT rate in the BTS
 Theoretical MT = MIN (MAX (revenue × MT rate in the BTS; minimum amount); maximum amount)
 Theoretical CIT/MT = MAX (theoretical CIT; theoretical MT)
 CIT/MT TE = theoretical CIT/MT – CIT/MT paid.

Box 5: Corporate income tax/minimum tax in Guinea

In Guinea in 2015, the corporate income tax was set at 35%²⁶ and the minimum tax at 3%²⁷. In addition, for companies under the actual profit regime, the minimum tax could not be less than GNF 15 million or more than GNF 60 million²⁸. In the calculation of the theoretical tax, four cases were therefore possible:

1) A company pays the minimum amount of MT, i.e., GNF 15 million, if its revenue is less than GNF 500 million (15,000,000/3%) and if its taxable profit is less than GNF 42,857,142 (15,000,000/35%). For example, this is the case for a company that has a revenue of GNF 300 million and a taxable profit of GNF 40 million:

Theoretical CIT = 40,000,000 × 35% = GNF 14,000,000

*Theoretical MT = MIN (MAX (300,000,000 × 3%; 15,000,000); 60,000,000)
 = MIN (MAX (9,000,000; 15,000,000); 60,000,000)*

26. Article 229 of the 2015 General Tax Code.

27. Article 224 of the 2015 General Tax Code.

28. Article 224 of the 2015 General Tax Code.

$$= \text{MIN} (15,000,000; 60,000,000)$$

$$= \text{GNF } 15,000,000$$

$$\text{Theoretical CIT/MT} = \text{MAX} (14,000,000; 15,000,000) = \text{GNF } 15,000,000.$$

2) A company pays the maximum amount of MT, i.e., GNF 60 million, if its revenue is more than GNF 2 billion (60,000,000/3%) and if its taxable profit is less than GNF 171,428,571 (60,000,000/35%). For example, this is the case for a company that has revenue of GNF 2.5 billion and a taxable profit of GNF 100 million:

$$\text{Theoretical CIT} = 100,000,000 \times 35\% = \text{GNF } 35,000,000$$

$$\text{Theoretical MT} = \text{MIN} (\text{MAX} (2,500,000,000 \times 3\%; 15,000,000); 60,000,000)$$

$$= \text{MIN} (\text{MAX} (75,000,000; 15,000,000); 60,000,000)$$

$$= \text{MIN} (75,000,000; 60,000,000)$$

$$= \text{GNF } 60,000,000$$

$$\text{Theoretical CIT/MT} = \text{MAX} (35,000,000; 60,000,000) = \text{GNF } 60,000,000.$$

3) A company pays the minimum tax at the rate of 3% if its revenue is between GNF 500 million (15,000,000/3%) and GNF 2 billion (60,000,000/3%) and its taxable profit is less than 8.57% of its revenue (revenue \times 3%/35%). For example, this is the case for a company that has revenue of GNF 1 billion and a taxable profit of GNF 80 million:

$$\text{Theoretical CIT} = 80,000,000 \times 35\% = \text{GNF } 28,000,000$$

$$\text{Theoretical MT} = \text{MIN} (\text{MAX} (1,000,000,000 \times 3\%; 15,000,000); 60,000,000)$$

$$= \text{MIN} (\text{MAX} (30,000,000; 15,000,000); 60,000,000)$$

$$= \text{MIN} (30,000,000; 60,000,000)$$

$$= \text{GNF } 30,000,000$$

$$\text{CIT/MT} = \text{MAX} (28,000,000; 30,000,000) = \text{GNF } 30,000,000.$$

4) A company pays corporate income tax at the rate of 35% in all other cases. For example, this is the case for a company that has revenue of GNF 1 billion and a taxable profit of GNF 200 million:

$$\text{Theoretical CIT} = 200,000,000 \times 35\% = \text{GNF } 70,000,000$$

$$\text{Theoretical MT} = \text{MIN} (\text{MAX} (1,000,000,000 \times 3\%; 15,000,000); 60,000,000)$$

$$= \text{MIN} (\text{MAX} (30,000,000; 15,000,000); 60,000,000)$$

$$= \text{MIN} (30,000,000; 60,000,000)$$

$$= \text{GNF } 30,000,000$$

$$\text{Theoretical CIT/MT} = \text{MAX} (70,000,000; 30,000,000) = \text{GNF } 70,000,000.$$

Box 6 : Corporation tax and Minimum tax in Madagascar

In Madagascar in 2015, the corporate income tax rate was set at 20%²⁹ and the minimum tax was calculated as 0.5% of revenue plus MGA 320,000³⁰. The formula for the calculation of the theoretical minimum tax therefore differed somewhat from that generally found in francophone African countries:

Theoretical MT = revenue × MT rate in the BTS + minimum amount

Two cases were possible in the calculation of the theoretical tax:

1) A company pays the minimum tax when its taxable profit is less than 2.5% of its revenue plus MGA 1.6 million. For example, this is the case for a company that has revenue of MGA 1 billion and a taxable profit of MGA 20 million:

Theoretical CIT = 20,000,000 × 20% = MGA 4,000,000

Theoretical MT = 1,000,000,000 × 0.5% + 320,000 = 5,000,000 + 320,000 = MGA 5,320,000

Theoretical CIT/MT = MAX (4,000,000; 5,320,000) = MGA 5,320,000.

2) A company pays the corporate income tax when its taxable profit is more than 2.5% of its revenue plus MGA 1.6 million. For example, this is the case for a company that has revenue of MGA 1 billion and a taxable profit of MGA 100 million:

Theoretical CIT = 100,000,000 × 20% = MGA 20,000,000

Theoretical MT = 1,000,000,000 × 0.5% + 320,000 = 5,000,000 + 320,000 = MGA 5,320,000

Theoretical CIT/MT = MAX (20,000,000; 5,320,000) = MGA 20,000,000.

B. Indirect taxes

Two preliminary remarks should be made about the estimation of tax expenditures relating to indirect taxes: 1) the codification system used to manage exemptions in the customs computer system is vital; and 2) mechanisms designed to cover tax exemptions generate problems.

Codification of Customs Exemptions

A new system for codifying customs exemptions often needs to be adopted before tax expenditures can be evaluated. When existing codes do not allow for a thorough monitoring of exemptions, they hinder the evaluation of tax expenditures. In general, the easiest tax expenditures to evaluate are those that arise from indirect

29. Article 01.01.14 of the 2015 General Tax Code.

30. Article 01.01.14 of the 2015 General Tax Code.

taxes precisely because information about imports is contained in customs computer systems. A customs computer system is a vital source of information for assessing tax expenditures relating to indirect taxation because it records all data relating to import transactions. However, these data do not always provide detailed and reliable information on exemptions. For example, an additional code is used to define the tax treatment for each declaration of release for consumption in ASYCUDA: ordinary law, or total or partial exemptions from one or several taxes. Yet these codes are defined first in order to clear imports based on existing taxation provisions (fully taxed or totally or partially exempt). In principle, they also make it possible to rapidly identify the main exemption categories. Unfortunately, the codification used does not always meet the purposes of evaluating tax expenditures (see Box 7).

Box 7. Additional codes used in Madagascar

In 2013, 30 additional codes were used beside the additional code 000 identifying operations taxed under ordinary law. There is no consistent logic in the descriptions of these three-digit codes between their heading and three constituent digits, except with regard to the first digit, with 1 corresponding to duty-free regimes and 2 and 3 to partial exemptions. For duty-free regimes, the second and third digits are used sequentially to distinguish different categories, ranging from 0 to 18. The downside is that as the number of possible categories is limited, few details are given about beneficiaries; for example, exemptions granted by the Council of Ministers all come under the code 109. For partial exemptions, the description for most codes only specifies the tax treatment, for example, "exemption from customs duty" for code 201 or "exemption from customs duty and VAT" for code 205 without reference to a legal basis or a beneficiary category.

The codes used to manage customs exemptions should be defined to facilitate and secure the extraction of the data needed to evaluate tax expenditures. As this is done by relief measures, each relief measure must correspond to a specific code. However, this objective requires a complete overhaul of the additional codes. It is also important to provide for a specific code for VAT exemptions on certain imported products under general tax codes and considered by customs as part of ordinary law. The VAT revenue shortfall that results from these exemptions is a tax expenditure as these exemptions apply in principle to goods intended for final consumption.

The codification of customs exemptions should be defined in a rational manner. To improve their identifiers and facilitate the analysis of exemptions data, particular attention should be given to this review work, which is to be undertaken

in collaboration with the tax policy unit as part of the tax expenditure evaluation project. Based on the inventory of relief measures relating to indirect taxes, logical and sequential identifiers should be defined for each of the three digits that form the ASYCUDA additional code: for example, the main exemption categories (diplomatic exemptions, investment incentives, external financing, exceptional exemptions, etc.) for the first digit, while the second and third digits can be used for further specification according to the legal basis and the relief measure granted to each beneficiary category.

Mechanisms for Covering Tax Exemptions

In many countries, payment systems have been set up to ensure better follow-up of taxation taken on by the state, for example in the context of externally-financed projects. This is the case of Treasury checks issued by the state to beneficiaries of an exemption with which to pay their taxes. This payment method is generally considered by the administrations as a cash receipt. However, amounts received at customs are not accounted for as a revenue loss, and it is difficult to gauge the amount corresponding to this tax expenditure. In such cases, information should be sought from the revenue units of the administrations in question, which in principle track in detail any amounts received.

In this guide, oil products (HS Chapter 27) are excluded from the scope of evaluation. This is because the price of oil products remains regulated in many countries, where a price structure is determined mostly by inter-ministerial decree. This structure sets the consumer price, the margins of the various intermediaries, and the charges levied by the state for a given period. In most cases, the price structure uses a state subsidy to stabilize the consumer price, which then becomes decoupled from changes to global prices. Calculating a tax expenditure on the various duties and taxes that constitute a component of the subsidized price structure therefore makes little sense and in no case serves to inform public choices. Evaluation of tax expenditures on oil products is therefore only possible if the consumer price is free and if a standard tax system can be determined so as to be included in the BTS.

1. Customs Duties³¹

Customs duties (CD) are a tax designed to protect national economic activity. Goods that enter the customs territory are subject to import duties under the tariff schedule. The calculation of tax expenditures aims to estimate the difference between the customs duties actually paid and the customs duties that should have been paid under the rate used in the BTS, that is, the rate provided for in the tariff schedule. The necessary information is contained in the customs clearance computer system (most often ASYCUDA, the automated system for customs data used in 85 countries), which is not strictly speaking a customs information system but one that contains all data belonging to each transaction.

The calculation is carried out at the HS heading level, that is, at the level of the good in question, using customs data. First, the imports that are the subject of a relief measure must be identified, using the HS heading (for goods temporarily exempt from customs duties), the customs regime, or any additional codes (for special regimes: the investment code; the mining, oil, or gas codes; free zones, etc.). Theoretical customs duties are then calculated by multiplying the customs value by the customs duty rate in the BTS. Customs duty tax expenditure (CD TE) is simply the difference between theoretical customs duties and customs duties actually paid.

$$\begin{aligned} \text{Theoretical CD} &= \text{customs value} \times \text{CD rate in the BTS} \\ \text{CD TE} &= \text{theoretical CD} - \text{CD paid} \end{aligned}$$

Where it is not possible to know the tariff rate that ought to have been included in the BTS (for example a customs duty exemption granted for a given period to cover certain goods and recorded in the customs computer system as a zero rate overriding the previous tariff rate in the customs clearance system), it is advisable to use the United Nations' Broad Economic Categories (BEC). This classification assigns a code, specifying the nature or economic use of the good, to the corresponding HS heading. This makes it possible to assign a customs duty rate to each BEC code and therefore each HS heading, following the rates structure in force in the country, for example by distinguishing between capital goods, inputs, and goods for final consumption. If, for example, an intermediate good is subject to an exemption in a Member State of the West African Economic and Monetary Union (WAEMU) and the rate applied to it prior to the exemption period cannot be identified, the BTS rate will be 10%, as per the WAEMU's Common External Tariff (CET) structure.

31. And taxes of equivalent effect.

Table 3. BEC codes and proposed rate structure

BEC code	Rate structure
1. Food and beverages	
11. Primary	
111. Mainly for industry	Inputs
112. Mainly for household consumption	Final consumption
12. Processed	
121. Mainly for industry	Inputs
122. Mainly for household consumption	Final consumption
2. Industrial supplies not specified elsewhere	
21. Primary	Inputs
22. Processed	Inputs
3. Fuels and lubricants	
31. Primary	Inputs
32. Processed	
321. Motor spirit	Final consumption
322. Other	Final consumption
4. Capital goods (except transport equipment) and parts and accessories thereof	
41. Capital goods (except transport equipment)	Capital goods
42. Parts and accessories	Capital goods
5. Transport equipment and parts and accessories thereof	
51. Passenger motor vehicles	Capital goods
52. Other	
521. Industrial	Capital goods
522. Non-industrial	Final consumption
6. Consumer goods not specified elsewhere	
61. Durable	Final consumption
62. Semi-durable	Final consumption
63. Non-durable	Final consumption
7. Goods not specified elsewhere	Final consumption

2. Excise Duties

Excise duties (ED) are indirect taxes that normally apply to a limited number of goods or services with low price elasticity in demand. These duties can be specific or *ad valorem*.

Specific excise duties tax quantities of goods or services. They are expressed as a monetary amount per physical unit: cigarette, bottle, litre, etc. :

$$\text{Theoretical specific ED} = \text{quantity of goods or services} \times \text{ED amount in the BTS}$$

Ad valorem excise duties tax the value of goods or services. They are expressed as a percentage rate:

$$\text{Theoretical ad valorem ED} = \text{value of the goods or services} \times \text{ED rate in the BTS}$$

Excise duty tax expenditure is simply the difference between theoretical excise duties and excise duties actually paid:

$$\text{ED TE} = \text{theoretical ED} - \text{ED paid}$$

For customs data, the calculation is carried out at the HS heading level, that is, at the level of the good, using DGD data. First, only release for consumption regimes need to be retained. Among these imports, each import subject to a relief measure must be identified, using its HS heading, the customs regime, or any additional codes. For the calculation of *ad valorem* excise duties, the amount of customs duties is then added to the taxable base for the imported good. The customs duties used for estimating excise duty tax expenditures are not those actually paid but the theoretical customs duties, recalculated from the BTS, in order to take into account any reductions in the base caused by customs duty tax expenditures. In some countries, the customs excise duty base can also include other import taxes.

$$\text{Theoretical ad valorem ED} = (\text{customs value} + \text{theoretical CD}) \times \text{ED rate in the BTS}$$

Excise duties usually apply to both local production and imports, according to a principle of non-discrimination. However, countries often seek to protect their local production with tax base allowances or reduced rates. This discrimination results in tax expenditures.

Box 8. Measures designed to protect local production

In Congo in 2015, all goods subject to excise duties paid a single rate set at 25% for imports and reduced to 10% for locally-made products³².

In Madagascar in 2015, a 5% base allowance was granted to cigarettes provided at least 70% of the total tobacco weight was of Malagasy origin³³.

In Guinea in 2015, imported alcoholic beverages were charged an excise duty of 45%³⁴, while beverages produced in the country were subject to a specific tax of GNF 300 per bottle or can up to 50 cl and GNF 450 per bottle or can for volumes greater than 50 cl³⁵.

For example, the tax expenditure for a 33 cl beer sold for GNF 7,000 would amount to GNF 2,850.

<https://www.evaneos.fr/guinee/voyage/informations-pratiques/12241-budget/>

$ED\ TE = 7,000 \times 45\% - 300 = GNF\ 2,850.$

Perhaps more so than for other taxes, the situation can differ markedly for excise duties from one country to the next. The calculation method must therefore be tailored to each case.

3. Value-Added Tax (VAT)

Regarding VAT, the tax expenditure estimation method differs between domestic VAT data from the DGI and customs VAT data from the DGD.

Domestic VAT Exemptions

Domestic VAT tax expenditure is calculated per company that benefits from a VAT exemption based on data from the Directorates of Large Enterprises and of Small and Medium Enterprises. This calculation requires identifying the VAT the company should have collected as well as the VAT that would have been deductible if its revenue were not exempt. However, given the difficulties involved in obtaining some information, notably the VAT that would have been deductible if the company's revenues were not exempt, DGI data should be used sparingly in the estimation of tax expenditures.

First, among companies under the Directorates of Large Enterprises and of Small and Medium Enterprises, only production that leads to a tax expenditure should be retained, that is, it should exclude:

- Companies for which not all the necessary information for the calculation of tax expenditures is available, namely VAT-exempt local revenue, VAT paid to the

32. Article 36 A of Law no. 12-97 of 12 May 1997 establishing a value-added tax, updated in 2015.

33. Article 03.01.04 of the 2015 General Tax Code.

34. HS headings 22.03 to 22.06 of the tariff schedule.

35. Article 8 of Law L/2011/007/CNT of 19 October 2011 including the amending finance bill for 2011.

state, and VAT collected;

- Companies whose exempt local sales revenue is zero, that is, companies that export at a zero rate or sell fully-taxed products locally that are therefore not a source of tax expenditures. Exporting companies do not collect VAT and receive refunds for the VAT paid upstream on inputs used to produce the exported goods. The application of a zero rate on exported goods therefore does not generate a tax expenditure. For companies that sell products both locally and abroad, the estimation of tax expenditures should be carried out only on their revenue generated locally;
- Companies in specific sectors considered under the BTS (such as banking, finance, or insurance).

Second, once companies that do not generate any tax expenditures have been excluded, tax expenditures can be evaluated for the remaining companies. The idea is to calculate the difference between the amount of VAT actually paid to the state and the amount of VAT that should have been paid to the state if products sold locally were not the subject of exemptions. Strictly speaking, only the net VAT difference is a tax expenditure, that is, the amount of VAT paid to the state (VAT collected on sales less VAT deducted, i.e., paid on purchases). However, the VAT that would have been deductible if sales revenue were not exempt is generally not known. To approximate this amount, one solution is to apply to the exempt sales revenue the ratio of VAT paid to the state over VAT collected, calculated on the basis of taxed revenue:

$$\text{VAT TE} = \text{exempt sales revenue} \times \text{VAT rate in the BTS} \times (\text{VAT paid/VAT collected})$$

The ratio of VAT paid to VAT collected should be between 0 and 1.

However, the ratio of VAT paid to VAT collected can only be used for companies that pay tax on at least some of their sales revenue, which excludes companies that sell only tax-exempt goods. In the case of the latter, the average ratio of the sector can be applied to the company in question. The use of these ratios also assumes that the VAT that would be deductible if production were not exempt would be of the same order of magnitude as the deductible VAT on taxed production. Although simplistic, this assumption makes it possible to take into account the cost structure of each company and avoid excessively overestimating tax expenditures.

Box 9. Domestic VAT in Madagascar

In Madagascar in 2015, the full VAT rate was 20%³⁶. For example, a company generated sales revenue of MGA 1 billion, MGA 400 million of which is exempt from VAT. It also collected MGA 120 million and paid 30 million to the state. Based on this information, it is possible to approximate VAT tax expenditures of MGA 20 million.

$$\text{VAT TE} = 400,000,000 \times 20\% \times (30,000,000 / 120,000,000) = \text{MGA } 20,000,000.$$

Customs VAT

The calculation of customs VAT tax expenditures is carried out at the HS heading level, that is, at the level of the good, using customs data. First, all VAT-registered companies must be removed from the file extracted from the customs computer system. Since it is deductible, VAT levied at customs on the imports of VAT-registered companies does not constitute definitive revenue for the state. Registered companies can be identified by their tax identification number (TIN) from data from the Directorates of Large Enterprises and of Small and Medium Enterprises. Only consumption-related regimes are to be retained. Last, those imports that are the subject of a relief measure must be identified, using the HS heading (for VAT-exempt goods), the customs regime, or any additional codes (for special regimes, the investment code, the mining, oil, or gas codes, free zones, etc.). Tax expenditures are then evaluated only on those remaining imports.

Theoretical VAT is calculated by multiplying the taxable base by the VAT rate used in the BTS. The customs VAT base corresponds to the customs value plus the amount of customs duties and excise duties. The customs duties and excise duties used for estimating VAT tax expenditures are not the amounts actually paid but the theoretical amounts, recalculated from the BTS, in order to take into account any reductions in the base caused by customs or excise duty tax expenditures. Thus, if customs or excise duties are the subject of a relief measure, the VAT tax expenditure will not be underestimated due to a cascade effect. In some countries, the customs VAT base can also include other import taxes. VAT tax expenditures are simply the difference between the theoretical VAT and the VAT actually paid to the state.

$$\text{Theoretical VAT} = (\text{customs value} + \text{theoretical customs duty} + \text{theoretical excise duty}) \times \text{VAT rate in the BTS}$$

$$\text{VAT TE} = \text{theoretical VAT} - \text{VAT paid}$$

36. Article 06.01.12 of the 2015 General Tax Code.

Box 10. VAT at customs in Guinea

In Guinea in 2015, the full VAT rate was 18%³⁷. The customs VAT base corresponded to the customs value plus an import tax duty (DFI)³⁸, excise duties (ED), a processing fee (RTL), and a regressive protection tax (TDP).

Theoretical VAT = (customs value + theoretical DFI + theoretical ED + theoretical RTL + theoretical TDP) × VAT rate in the BTS

Wheat imports³⁹ were subject to a 20% DFI, 0% excise duty, a 2% RTL, and a 10% TDP, but were exempt from VAT⁴⁰. The importation of GNF 1 million of wheat by a non-VAT-registered company or by a natural person would therefore give rise to a VAT tax expenditure of GNF 237,600.

Theoretical DFI = 1,000,000 × 20% = GNF 200,000

Theoretical ED = (1,000,000 + 1,000,000 × 20%) × 0% = GNF 0

Theoretical RTL = 1,000,000 × 2% = GNF 20,000

Theoretical TDP = 1,000,000 × 10% = GNF 100,000

Theoretical VAT = (1,000,000 + 200,000 + 0 + 20,000 + 100,000) × 18% = GNF 237,600

VAT TE = 237,600 – 0 = GNF 237,600.

4. Registration Duties**50**

Registration duties (RD) tax a diverse array of legal acts determined according to one of two methods: fixed or proportional.

Fixed registration duties tax the registration of a legal transaction regardless of the pecuniary interest at stake. They are expressed as a monetary amount, fixed by legal act:

Theoretical fixed RD = number of legal acts × amount of RD in the BTS.

Proportional registration duties tax the value of movable or immovable property recognized in the legal act. They are expressed as a percentage:

Theoretical proportional RD = value of assets × RD rate in the BTS.

37. Article 373 of the 2015 General Tax Code.

38. The import tax duty is equivalent to a customs duty.

39. HS heading 11.01.00.00.00 of the tariff schedule: wheat or meslin flour.

40. Article 362-f of the 2015 General Tax Code and Article 7 of the 2015 tariff schedule.

Registration duty tax expenditure is simply the difference between theoretical registration duties and registration duties actually paid:

$$\text{RD TE} = \text{theoretical RD} - \text{RD paid}$$

▶ IV. Drafting the Legislation Interim Report

The next step consists in drafting an interim report that summarizes the work done by the Evaluation sub-group, to be approved by the tax policy committee. This report presents the scope and method of evaluation selected on the basis of available data as well as the findings of the estimation. For improved readability, the findings of the estimation should be presented in the national currency, as a percentage of GDP, and as a percentage of tax revenue.

Section 3.

Preparation of the Final Report

The final report is the culmination of the work of the Legislation and Evaluation sub-groups. It is the responsibility of both sub-groups, and must be approved by the tax policy committee and finally by the Minister of Finance before being published as an annex to the finance bill. This report contains four sections:

- The first section introduces the general regime for each tax and the BTS used in accordance with the interim Legislation report. The matrix of relief measures is generally published in the annex to the document;
- The second section presents the methodology, notably the method and scope of evaluation selected, in accordance with the interim budget evaluation report;
- The third section provides a costing of tax expenditures, with possible categorizations as required by the analysis. To facilitate the interpretation of the findings, they may be expressed as a percentage of GDP and tax revenue;
- The annex provides the full matrix, containing: (i) an inventory of all relief measures identified; (ii) a classification of each of these measures as tax expenditures or non-tax expenditures; (iii) a costing of each measure identified as a tax expenditure in the scope of evaluation.

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► I. Goods under the Florence Agreement and the Nairobi Protocol

A. The Florence Agreement

A. Books, publications, and documents:

- (i) Printed books;
- (ii) Newspapers and periodicals;
- (iii) Books and documents produced by duplicating processes other than printing;
- (iv) Official, parliamentary, and administrative documents published in their country of origin;
- (v) Travel posters and travel literature (pamphlets, guides, time-tables, leaflets and similar publications), whether illustrated or not, including those published by private commercial enterprises, whose purpose is to stimulate travel outside the country of importation;
- (vi) Publications whose purpose is to stimulate study outside the country of importation;
- (vii) Manuscripts, including typescripts;
- (viii) Catalogues of books and publications offered for sale by publishers or booksellers established outside the country of importation;
- (ix) Catalogues of films, recordings, or other visual and auditory material of an educational, scientific, or cultural character, being catalogues issued by or on behalf of the United Nations or any of its Specialized Agencies;
- (x) Music in manuscript or printed form, or reproduced by duplicating processes other than printing;
- (xi) Geographical, hydrographical, or astronomical maps and charts;
- (xii) Architectural, industrial, or engineering plans and designs, and reproductions thereof, intended for study in scientific establishments or educational institutions approved by the competent authorities of the importing country for the purpose of duty-free admission of these types of articles.

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The exemptions provided by Annex A shall not apply to:

- a.** Stationery;
- b.** Books, publications, and documents (except catalogues, travel posters, and travel literature referred to above) published by or for a private commercial

enterprise, essentially for advertising purposes;

c. Newspapers and periodicals in which the advertising matter is in excess of 70% by space ;

d. All other items (except catalogues referred to above) in which the advertising matter is in excess of 25% by space. In the case of travel posters and literature, this percentage shall apply only to private commercial advertising matter.

B. Works of art and collectors' pieces of an educational, scientific, or cultural character :

(i) Paintings and drawings, including copies, executed entirely by hand, but excluding manufactured decorated wares;

(ii) Hand-printed impressions, produced from hand-engraved or hand-etched blocks, plates, or other material, and signed and numbered by the artist;

(iii) Original works of art of statuary or sculpture, whether in the round, in relief, or in intaglio, excluding mass-produced reproductions and works of conventional craftsmanship of a commercial character;

(iv) Collectors' pieces and objects of art consigned to public galleries, museums, and other public institutions, approved by the competent authorities of the importing country for the purpose of duty-free entry of these types of articles, not intended for resale;

(v) Collections and collectors' pieces in such scientific fields as anatomy, zoology, botany, mineralogy, palaeontology, archaeology, and ethnography, not intended for resale;

(vi) Antiques, being articles in excess of 100 years of age.

C. Visual and auditory materials of an educational, scientific, or cultural character:

(i) Films, filmstrips, microfilms, and slides, of an educational, scientific, or cultural character, when imported by organizations (including, at the discretion of the importing country, broadcasting organizations), approved by the competent authorities of the importing country for the purpose of duty-free admission of these types of articles, exclusively for exhibition by these organizations or by other public or private educational, scientific, or cultural institutions or societies approved by the aforesaid authorities;

(ii) Newsreels (with or without sound track), depicting events of current news value at the time of importation, and imported in either negative form, exposed and developed, or positive form, printed and developed, when imported by organizations (including, at the discretion of the importing country, broadcasting organizations approved by the competent authorities of the importing country for the purpose of duty-free admission of such films, provided that free entry may be limited to two copies of each subject for copying purposes.

(iii) Sound recordings of an educational, scientific, or cultural character for use exclusively in public or private educational, scientific, or cultural institutions

- or societies (including, at the discretion of the importing country, broadcasting organizations) approved by the competent authorities of the importing country for the purpose of duty-free admission of these types of articles;
- (iv) Films, filmstrips, microfilms, and sound recordings of an educational, scientific, or cultural character produced by the United Nations or any of its Specialized Agencies;
 - (v) Patterns, models, and wall charts for use exclusively for demonstrating and teaching purposes in public or private educational, scientific, or cultural institutions approved by the competent authorities of the importing country for the purpose of duty-free admission of these types of articles.

D. Scientific instruments and apparatus:

Scientific instruments or apparatus, intended exclusively for educational purposes or pure scientific research, provided:

- a.** That such scientific instruments or apparatus are consigned to public or private scientific or educational institutions approved by the competent authorities of the importing country for the purpose of duty-free entry of these types of articles, and used under the control and responsibility of these institutions;
- b.** That instruments or apparatus of equivalent scientific value are not being manufactured in the country of importation.

E. Articles for the blind:

Books, publications, and documents of all kinds in raised characters for the blind. Other articles specially designed for the educational, scientific, or cultural advancement of the blind, which are imported directly by institutions or organizations concerned with the welfare of the blind, approved by the competent authorities of the importing country for the purpose of duty-free entry of these types of articles.

B. The Nairobi Protocol

A. Books, publications, and documents:

- (i) Printed books, irrespective of the language in which they are printed and whatever the amount of space given over to illustrations, including the following:
 - a.** Luxury editions;
 - b.** Books printed abroad from the manuscript of an author resident in the importing country;
 - c.** Children's drawing and painting books;
 - d.** School exercise books (workbooks) with printed texts and blank spaces to be filled in by the pupils;
 - e.** Crossword puzzle books containing printed texts;
 - f.** Loose illustrations and printed pages in the form of loose or bound sheets

and reproduction proofs or reproduction films to be used for the production of books.

- (ii) Printed documents or reports of a non-commercial character;
- (iii) Microforms of the articles listed under items (i) and (ii) of this Annex, as well as of those listed under items (i) to (vi) of Annex A to the Agreement;
- (iv) Catalogues of films, recordings, or other visual and auditory material of an educational, scientific, or cultural character;
- (v) Maps and charts of interest in scientific fields such as geology, zoology, botany, mineralogy, palaeontology, archaeology, ethnology, meteorology, climatology, and geophysics, and also meteorological and geophysical diagrams;
- (vi) Architectural, industrial, or engineering plans and designs and reproductions thereof;
- (vii) Bibliographical information material for distribution free of charge.

B. Works of art and collectors' pieces of an educational, scientific, or cultural character:

- (i) Paintings and drawings, whatever the nature of the materials on which they have been executed entirely by hand, including copies executed by hand, but excluding manufactured decorated wares;
- (ii) Ceramics and mosaics on wood, being original works of art;
- (iii) Collectors' pieces and objects of art consigned to galleries, museums, and other institutions approved by the competent authorities of the importing country for the purpose of duty-free entry of those types of materials, on condition they are not resold.

C.1. Visual and auditory materials:

- (i) Films (1), filmstrips, microforms, and slides;
- (ii) Sound recordings;
- (iii) Patterns, models, and wall charts of an educational, scientific, or cultural character, except toy models;
- (iv) Other visual and auditory materials, such as:
 - a.** Video-tapes, kinescopes, video-discs, videograms, and other forms of visual and sound recordings;
 - b.** Microcards, microfiches, and magnetic or other information storage media required in computerized information and documentation services;
 - c.** Materials for programmed instruction, which may be presented in kit form, with the corresponding printed materials, including video-cassettes and audio-cassettes;
 - d.** DTransparencies, including those intended for direct projection or for viewing through optical devices;
 - e.** Holograms for laser projection;
 - f.** Mock-ups or visualizations of abstract concepts such as molecular structures or mathematical formulae;

- g.** Multi-media kits;
- h.** Materials for the promotion of tourism, including those produced by private concerns, designed to encourage the public to travel outside the country of importation.

The exemptions provided for in the present Annex C.1 shall not apply to:

- a.** Unused microform stock and unused visual and auditory recording media and their specific packaging such as cassettes, cartridges, reels;
- b.** Visual and auditory recordings with the exception of materials for the promotion of tourism covered by paragraph (iv) (h), produced by or for a private commercial enterprise, essentially for advertising purposes;
- c.** Visual and auditory recordings in which the advertising matter is in excess of 25% by time. In the case of the materials for the promotion of tourism covered by paragraph (iv) (h), this percentage applies only to private commercial publicity. (1) The duty-free entry of exposed and developed cinematographic films for public commercial exhibition or sale may be limited to negatives, it being understood that this limitation shall not apply to films (including newsreels) when admitted duty-free under the provisions of Annex C.2 to this Protocol.

C.2. Visual and auditory materials of an educational, scientific, or cultural character:

Visual and auditory materials of an educational, scientific, or cultural character, when imported by organizations (including, at the discretion of the importing country, broadcasting and television organizations) or by any other public or private institution or association, approved by the competent authorities of the importing country for the purpose of duty-free admission of these types of materials or when produced by the United Nations or any of its Specialized Agencies and including the following:

- (i) Films, filmstrips, microforms, and slides;
- (ii) Newsreels (with or without sound track) depicting events of current news value at the time of importation, and imported in either negative form, exposed and developed, or positive form, printed and developed, it being understood that duty free entry may be limited to two copies of each subject for copying purposes;
- (iii) Archival film material (with or without sound track) intended for use in connection with newsreel films;
- (iv) Recreational films particularly suited for children and youth;
- (v) Sound recordings;
- (vi) Video-tapes, kinescopes, video-discs, videograms, and other forms of visual and sound recordings;
- (vii) Microcards, microfiches, and magnetic or other information storage media required in computerized information and documentation services;
- (viii) Materials for programmed instruction, which may be presented in kit form, with the corresponding printed materials, including video-cassettes and

- audio-cassettes;
- (ix) Transparencies, including those intended for direct projection or for viewing through optical devices;
- (x) Holograms for laser projection;
- (xi) Mock-ups or visualizations of abstract concepts such as molecular structures or mathematical formulas;
- (xii) Multi-media kits.

D. Scientific instruments and apparatus:

- (i) Scientific instruments or apparatus, provided:
 - a.** That they are consigned to public or private scientific or educational institutions approved by the competent authorities of the importing country for the purpose of duty-free entry of these types of articles, and used for non-commercial purposes under the control and responsibility of these institutions;
 - b.** That instruments or apparatus of equivalent scientific value are not being manufactured in the country of importation;
- (ii) Spare parts, components, or accessories specifically matching scientific instruments or apparatus, provided these spare parts, components, or accessories are imported at the same time as such instruments and apparatus, or if imported subsequently, that they are identifiable as intended for instruments or apparatus previously admitted duty-free or entitled to duty-free entry;
- (iii) Tools to be used for the maintenance, checking, gauging, or repair of scientific instruments, provided these tools are imported at the same time as such instruments and apparatus or, if imported subsequently, that they are identifiable as intended for the specific instruments or apparatus previously admitted duty-free or entitled to duty-free entry, and further provided that tools of equivalent scientific value are not being manufactured in the country of importation.

E. Articles for the blind and other handicapped persons:

- (i) All articles specially designed for the educational, scientific, or cultural advancement of the blind which are imported directly by institutions or organizations concerned with the education of, or assistance to, the blind, approved by the competent authorities of the importing country for the purpose of duty-free entry of these types or articles, including:
 - a.** Talking books (discs, cassettes, or other sound reproductions) and large-print books;
 - b.** Phonographs and cassette players, specially designed or adapted for the blind and other handicapped persons and required to play the talking books;
 - c.** Equipment for the reading of normal print by the blind and partially sighted, such as electronic reading machines, television enlargers, and optical aids;
 - d.** Equipment for the mechanical or computerized production of Braille and recorded material, such as stereo-typing machines, electronic Braille, transfer,

and pressing machines; Braille computer terminals and displays;

e. Braille paper, magnetic tapes, and cassettes for the production of Braille and talking books;

f. Aids for improving the mobility of the blind, such as electronic orientation and obstacle detection appliances and white canes;

g. Technical aids for the education, rehabilitation, vocational training, and employment of the blind, such as Braille watches, Braille typewriters, teaching and learning aids, games, and other instruments specifically adapted for the use of the blind;

- (ii) All materials specially designed for the education, employment, and social advancement of other physically or mentally handicapped persons, directly imported by institutions or organizations concerned with the education of, or assistance to, such persons, approved by the competent authorities of the importing country for the purpose of duty-free entry of these types of articles, provided that equivalent objects are not being manufactured in the importing country.

F. Sports equipment:

Sports equipment intended exclusively for amateur sports associations or groups approved by the competent authorities of the importing country for the purpose of duty-free entry of these types of articles, provided that equivalent materials are not being manufactured in the importing country.

G. Musical instruments and other musical equipment:

Musical instruments and other musical equipment intended solely for cultural institutions or music schools approved by the competent authorities of the importing country for the purpose of duty-free entry of these types of articles, provided that equivalent instruments and other equipment are not being manufactured in the importing country.

H. Material and machines used for the production of books, publications, and documents:

- (i) Material used for the production of books, publications, and documents (paper pulp, recycled paper, newsprint, and other types of paper used for printing, printing inks, glue, etc.);
- (ii) Machines for the processing of paper pulp and paper and also printing and binding machines, provided that machines of equivalent technical quality are not being manufactured in the importing country.

▶ II. Sample Data Collection Form

Legal texts

1. List of all the legal texts necessary for making an inventory of tax expenditures (general tax code, finance bills, customs code, tariff schedule, investment code, mining code, oil code, gas code, tax treaties, special enterprise agreements, implementing decrees, orders, circulars, etc.).

Tax revenue

1. Amount of tax revenue broken down by tax (showing at least personal income tax, capital gains tax, corporate income tax, minimum tax, customs duties, excise duties, and VAT) in recent years.

Personal Income Tax

1. For each taxpayer (anonymized), taxable income, the number of dependents, the various measures that reduce the tax base (one column per measure), tax due and tax paid, in Excel format (see model below).

Taxpayer	Taxable income before various allowances	Number of dependents	Measure 1 base reduction	Measure 2 base reduction	Measure base reduction	Income tax due	Income tax paid
AAAA							
BBBB							
...							

Capital Gains Tax

1. The amount of income exempted by the measures identified, in Excel format;
2. For each company managed by the Directorates of Large Enterprises and of Small and Medium Enterprises that has paid capital gains tax (CGT), income amounts subject to the capital gains tax (base), tax paid, and especially the relief measures that benefit the company, in Excel format (see model below).

TIN	Company name	Income subject to CGT	CGT rate	CGT paid	Relief measures
147321	AAAA				None
432790	BBBB				Oil code
...

Corporation Tax and Minimum Tax

3. For each company managed by the Directorates of Large Enterprises and of Small and Medium Enterprises, information about its registration, sector of activity, date of establishment, revenue, minimum tax, taxable profit, corporate income tax, potential benefits, and especially references to the relief measures that benefit the company, in Excel format (see model below).

TIN	Company name	Sector of activity	Establishment date	Sales revenue	Minimum tax paid	Taxable profit	Corporation tax paid	Relief measures
245637	AAAA							None
125674	BBBB							Investment code
544562	CCCC							Special Enterprise Agreement
...

Excise Duties on Local Production

4. For each company managed by the Directorates of Large Enterprises and of Small and Medium Enterprises that sells a good subject to excise duties, the tax identification number (TIN), the base, amounts paid, and references to the relief measures that benefit the company, in Excel format (see table below).

TIN	Company name	Products subject to excise duty	Tax base	Rate	Excise duties paid	Relief measures
245637	AAAA					None
125674	BBBB					General Tax Code
544562	CCCC					General Tax Code
...

Value-Added Tax (VAT)

5. List of all departments or directorates that levy VAT;
 6. Revenue collected by these departments in recent years;
 7. Basic data on VAT, combining data from all aforementioned departments, in Excel format (see model below).

	2013	2014	2015	2016	2017	2018
Gross domestic receipts						
Gross customs receipts						
Total gross receipts						
VAT refunds						
Net VAT receipts						
Non-refunded VAT credits						

8. For each company managed by the Directorates of Large Enterprises and of Small and Medium Enterprises, information on registration, sector of activity, VAT collected, VAT paid to the state, and especially references to the relief measures that benefit the company, in Excel format (see model file below).

TIN	Company name	Sector of activity	Sales revenue	Export sales revenue	Taxed local sales revenue	Exempt local sales revenue	VAT collected	VAT paid	Relief measures
245637	AAAA								None
125674	BBBB								Mining code
544562	CCCC								General Tax Code
...

Directorate General of Customs

9. List of regime codes and additional codes used in ASYCUDA, with descriptions;
10. For the releases for direct and indirect consumption of each company listed in ASYCUDA, information on registration, sector of activity, and import operations (customs value, import regime, duties and taxes collected, etc.), in Excel format (see model below—ASYCUDA extraction and tariff file).

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TIN	Company name	HS code	Customs duty rate	Excise duty rate	VAT rate	Other tax rate 1	Other tax rate 2	Regime code	Additional code	Customs value	Total duties and taxes settled	Customs duties received	Excise duties received	VAT received	Other tax 1 received	Other tax 2 received
245637	AAAA	...	...			...		...	...	...	...	...			...	...
125674	BBBB	...	...			...		...	...	...	...	...			...	...
...

11. Value of direct levies by company and HS codes.

Tax Expenditure Assessment : From Principles to Practice Methodological guide

This guide details the methodology for the evaluation of tax expenditure in terms of personal income tax, capital gains tax and withholding tax, corporate income tax and minimum tax, customs duties, excise duties, value-added tax and registration duties. This method is based on the use of available tax data in the two administrations concerned by the management of these taxes : customs and tax administrations. This guide was produced by a team coordinated by Anne-Marie Geourjon and composed of Bertrand Laporte, Emilie Caldeira, Céline de Quatrebarbes and Yannick Bouterige. It draws on Ferdi's tax expenditure evaluation experiences in several developing countries.

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FerDi

63, boulevard François-Mitterrand
CS 50320
63009 Clermont-Ferrand Cedex
www.ferdi.fr
+33 (0)4 73 17 75 30