

TC ABSTRACT

I. Basic Project Data

▪ Country/Region:	REGIONAL/IDB
▪ TC Name:	Securing Fiscal Space in the Time of COVID-19: Tax Relief and Tax Expenditures Capacity Building in LAC
▪ TC Number:	RG-T3679
▪ Team Leader/Members:	REYES-TAGLE, GERARDO (IFD/FMM) Team Leader; ASTUDILLO, KAREN (IFD/FMM) Alternate Team Leader; PARK KWON, YERY (IFD/FMM); ROMAN SANCHEZ, SUSANA (IFD/FMM); CHOI, JAE YOUNG (IFD/FMM)
▪ Taxonomy:	Research and Dissemination
▪ Number and name of operation supported by the TC:	N/A
▪ Date of TC Abstract:	08 Jan 2021
▪ Beneficiary:	Regional
▪ Executing Agency:	INTER-AMERICAN DEVELOPMENT BANK
▪ IDB funding requested:	US\$350,000.00
▪ Local counterpart funding:	US\$0.00
▪ Disbursement period:	36 months
▪ Types of consultants:	Individuals; Firms
▪ Prepared by Unit:	IFD/FMM - Fiscal Management Division
▪ Unit of Disbursement Responsibility:	IFD - Institutions for Development Sector
▪ TC included in Country Strategy (y/n):	No
▪ TC included in CPD (y/n):	No
▪ Alignment to the Update to the Institutional Strategy 2010-2020:	Institutional capacity and rule of law

II. Objective and Justification

- 2.1 The objective of this technical cooperation (TC) is to support LAC governments by strengthening their institutional capacity to implement efficient tax policies in the face of growing fiscal constraints triggered by the Covid-19 pandemic. This TC is designed to support tax authorities in: (i) identifying tax relief and tax expenditures policy challenges in LAC countries; and (ii) seeking solutions to the shrinking fiscal space by helping them close the tax loopholes through sound tax policy advice, in a way that promotes fiscal transparency and sustainability in the region.
- 2.2 Mobilizing domestic resources remains a matter of grave importance for the LAC countries. The following statistics illustrates this point: tax burden in the LAC region averaged the equivalent of 23.1% of GDP in 2018, compared to the OECD average of 34.3%. In addition to the low tax burden and the resulting low tax revenue, the use of preferential tax treatments without much discretion in the region is a cause for concern, which ultimately undermines fiscal transparency and efficacy.
- 2.3 In response to the crisis, governments in the LAC region have been adopting special fiscal relief policies such as direct government spending, tax cuts, tax deferral, etc. Among them, the most common type of tax measure in the region, as well as among OECD and G20 countries, has been the deferment of tax payments. However, it should be noted that tax deferral schemes are subject to abuse and revenue leakage if not carefully administered. The supposed abuse of tax payments deferral may include schemes to dispose of assets before debts can be collected, or where deferred payments are siphoned off in fraudulent schemes. Therefore, careful formulation of tax

deferral policies both during and post the Covid-19 pandemic should be a priority for most governments in the region.

- 2.4 Another tax measure during the pandemic that needs a closer look is tax expenditures. It raises concerns that tax expenditures, i.e. tax breaks that benefit specific groups of taxpayers are being adopted with little scrutiny despite their huge price tags and impact. The current Covid-19 crisis may exacerbate the inherent opacity of tax expenditures since an overwhelming number of ad-hoc policy measures are being implemented in the context of the pandemic without adequate consideration or review. In LAC, there is a growing need to publicly address tax expenditures in depth. Across the LAC region, government revenues reduced by tax expenditures amounted to between 10 and 20 percent, and a proper assessment of their impact is lacking.
- 2.5 As regards the tax relief measures, it is important for the countries to consider the broad range of policy tools available to them in order to provide the most effective responses against Covid-19, both during and after the crisis. They could benchmark their support measures against those of other countries on an ongoing basis and consider whether they are making use of the full set of policy levers available to them.
- 2.6 In this context, this TC will help analyze tax relief measures and tax expenditures policies of select LAC countries in the face of Covid-19. In addition, active sharing of knowledge and best practices from other parts of the world would benefit the LAC tax administrations that wish to better address the fiscal challenges and formulate sound tax policies in the time of unprecedented crisis, where fiscal space and available public revenue is severely limited. The lessons learned will be disseminated in a way that more sustainable tax policies can be formulated, all the while ensuring fiscal transparency and resilience. The countries in the region are expected to strengthen their tax systems, which will help secure more financing and the fiscal space required to mitigate potential domestic and external shocks caused by the pandemic.

III. Description of Activities and Outputs

- 3.1 **Component I: LAC tax relief measures and tax expenditures policy diagnostics .** This component aims to research in depth how LAC countries have been dealing with Covid-19 on the fiscal policy front, with a special focus on their tax relief and tax expenditures measures and how those measures have impacted their tax revenue.
- 3.2 **Component II: Tax relief measures institutional capacity-building and tax expenditures methodology development .** This component will support the formulation of sound policies on how to close potential tax loopholes and improve tax collection by conducting studies on tax relief measures and tax expenditures monitoring in the context of Covid-19. A methodology to account for tax expenditures in the national budget will be developed and policy papers to aid in better tax collection in the time of Covid-19.
- 3.3 **Component III: Production of knowledge products and Dissemination of results .** The goal of this component is to disseminate findings, recommendations, and lessons learned from the execution of previous two components. It entails the following: (i) publication of the research papers and blog posts disseminating the lessons learned; and (ii) a dissemination seminar / webinar to share the lessons learned from the study.

IV. Budget

Indicative Budget

Activity/Component	IDB/Fund Funding	Counterpart Funding	Total Funding
LAC tax relief measures and tax expenditures policy diagnostics	US\$150,000.00	US\$0.00	US\$150,000.00

Tax relief measures institutional capacity-building and tax expenditures methodology development	US\$150,000.00	US\$0.00	US\$150,000.00
Production of knowledge products and Dissemination of results	US\$50,000.00	US\$0.00	US\$50,000.00
Total	US\$350,000.00	US\$0.00	US\$350,000.00

V. Executing Agency and Execution Structure

- 5.1 Given the regional dimension of this technical cooperation and the lack of a regional entity with the capacity to execute and supervise it, the Bank, through its Fiscal and Municipal Management Division (IFD/FMM) will be the executing agency. The Bank will contract individual consultants, consulting firms, and non-consulting services in accordance with the Bank's current procurement policies and procedures. Prior to the initiation of any project activities, the project team (PT) will obtain a non-objection letter from the corresponding official entity in each country. This TC will utilize the contracting services of the Korea Institute of Public Finance, a globally recognized institution in tax and public finance area. In addition, Korea's Ministry of Economy and Finance (MOEF), National Tax Service, and KIPF may provide in-kind contributions in the execution of the components.
- 5.2 The Bank's execution is justified by the regional nature of the response to the crisis caused by COVID-19 where the Bank is expected to receive multiple demands from different actors and with different coordination needs. The execution by the Bank has the additional benefit of taking advantage of lessons learned and collecting results from different experiences to disseminate knowledge to the region. The activities will be closely coordinated by the fiscal specialists in the countries, who will present the country's requirement and will evaluate (i) the alignment with the objectives of the TC; (ii) the impact and additionality with the program in the fiscal area in the country; and (iii) the complementarity with other resources. In addition, FMM will closely coordinate with other areas in the Bank to ensure that there is no duplicity nor overlap in the research that is planned to be carried out with this TC. Given this TC is Research and Dissemination (RD) and a Bank initiative, hence it is responsible for the selection and hiring of consultancy services requiring no justification (Annex 10, GN-2629-1).

VI. Project Risks and Issues

- 6.1 The main challenges of the project are: (i) prolonged Covid-19 situation which might preclude the research from being conducted in a timely manner, which will be mitigated by resorting to online means as much as possible and postponing the activities if need be; (ii) the risk of not enough interest being engendered among the LAC countries, which will be reduced by the careful design of research and logistics scheme; and (iii) the risk of weakened replicability of the results and lessons learned, which will be alleviated by a carefully designed dissemination seminar / webinar.

VII. Environmental and Social Classification

- 7.1 The ESG classification for this operation is "C".