

TC Document

I. Basic Information for TC

▪ Country/Region:	REGIONAL
▪ 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); Park, Yaein (IFD/FMM); Roman Sanchez, Susana (IFD/FMM); Vila Saint-Etienne, Sara (LEG/SGO); Zaltsman, Teodoro Ariel (IFD/FMM)
▪ Taxonomy:	Research and Dissemination
▪ Operation Supported by the TC:	.
▪ Date of TC Abstract authorization:	08 Jan 2021.
▪ Beneficiary:	IDB's borrowing member countries
▪ Executing Agency and contact name:	Inter-American Development Bank through its Fiscal Management Division (IFD/FMM)
▪ Donors providing funding:	Public Capacity Building Korea Fund for Economic Development(KPC)
▪ IDB Funding Requested:	US\$350,000.00
▪ Local counterpart funding, if any:	US\$0
▪ Disbursement period (which includes Execution period):	35 months of disbursement (36 months of execution).
▪ Required start date:	April 2021
▪ Types of consultants:	Individual consultats
▪ Prepared by Unit:	IFD/FMM-Fiscal Management Division
▪ Unit of Disbursement Responsibility:	IFD/FMM-Fiscal Management Division
▪ TC included in Country Strategy (y/n):	N/A
▪ TC included in CPD (y/n):	N/A
▪ Alignment to the Update to the Institutional Strategy 2010-2020:	Institutional capacity and rule of law

II. Objectives and Justification of the TC

- 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 the fiscal policy formulation capacities in the Ministries of Finance and 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.
- 2.2 **Justification.** Taxes are a primary source of financing public services, which is essential to any functioning state and society and work as the social contract that binds those states and societies together. In recent years, taxation has garnered increasing attention. For instance, The United Nations' Agenda 2030 has put the mobilization of domestic resources through taxation at the heart of strategies for achieving the Sustainable Development Goals (SDGs), emphasizing the importance

of tax policy as a source of social justice and financing for development.¹ In light of the COVID-19 outbreak, it is expected that more fiscal space would be required to mitigate the deeper recession that would inevitably ensue in the wake of the pandemic.²

- 2.3 Amid the unprecedented health crisis caused by the COVID-19 pandemic, countries around the world are faced with a faltering economy that is expected to last for some years to come. On the tax revenue collection front, a number of unavoidable fiscal challenges will emerge as stay-at-home orders and business closures have put many people out of work, fewer people will be paying income taxes; by the same token, sales tax revenues will continue to drop as many businesses stay closed and unemployment rate remains high. The LAC region is no exception as the global economic downturn will likely reduce public revenues. Such drop in tax revenues is expected to be exacerbated by the recent decline in commodity prices, particularly in Ecuador, Peru, Mexico, Suriname and Trinidad and Tobago.³
- 2.4 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:⁴ Brazil introduced a stimulus package early in the pandemic that includes the deferral of corporate taxes; Chile allowed the postponement of income tax payment; in Costa Rica, tax relief that effectively places a moratorium on Value Added Tax (VAT), profit taxes, selective consumption taxes, and tariffs on imported merchandise has been put into effect; Ecuador put forth the deferral of taxes for the tourism and export sectors and Small and Medium-Sized Enterprises (SMEs); Honduras initiated the delay of income payments for SMEs' employees, which account for 70% of the workforce in the country; Peru put forth a grace period for the payment of income tax for SME; and Uruguay set extended tax payment deadlines to the Uruguayan internal revenue and social security agencies.
- 2.5 However, it should be noted that tax deferral schemes are subject to abuse and revenue leakage if not carefully administered.⁵ 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. Additionally, the removal of tax deferrals should ensure that where tax payments were deferred, large tax liabilities do not generate cliff-edges that could result in solvency problems for recovering businesses and jeopardize recovery.⁶ OECD (2020) suggests such mitigating policies as spreading tax payments over several tax years, averaging tax

¹ ECLAC (2019). Fiscal Panorama of Latin America and the Caribbean.

² Hausmann, R. (2020). [Flattening the COVID-19 Curve in Developing Countries](#), World Economic Forum.

³ OECD. (2020). Revenue Statistics in Latin America and the Caribbean.

⁴ "The postponement of tax payments from the current year to a later year. A number of countries have introduced legislation to counter the kind of tax avoidance whereby a taxpayer obtains a deferment of tax which is not intended by law." OECD. [Glossary of Tax Terms](#).

⁵ Brondolo, J. (2009). Collecting Taxes During an Economic Crisis: Challenges and Policy Options. IMF.

⁶ OECD. (2020). Tax and Fiscal Policy in Response to the Coronavirus Crisis: Strengthening Confidence and Resilience.

bases across several years (for turnover taxes or social security contributions), and ensuring that carry-forward provisions are in place for corporate taxes.

- 2.6 As one of the leading countries in taxation policy and administration, Korea has been taking an active and meticulous approach in its tax relief measures. To relieving the burden of every taxpayer directly and indirectly impacted by COVID-19, the Korean government sanctioned tax deferral of maximum of nine months and postponement of tax return and tax investigation, as well as provided more fiscal leeway for small businesses owners, all of which can be accessed through the Home Tax website. Additionally, seven COVID-19 response units were created across the country specifically to assist with the taxpayer concerns and queries. Such systemic and organized tax relief efforts would be worthy of being replicated in the international community, just as Korea's general COVID-19 response measures have been shared with the world to great acclaim,⁷ with the help of the World Bank.
- 2.7 Another tax measure during the pandemic that needs a closer look is tax expenditures.⁸ Tax expenditure works as a type of revenue waiver,⁹ where the tax system plays a role similar to that of public expenditure, as the government forgoes the revenue that would otherwise be obtained from certain taxpayers or activities. Because of their budgetary treatment, however, tax expenditures are much less transparent than spending on benefit programs. 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 uncertain impact. The current COVID-19 crisis may exacerbate the inherent opacity of tax expenditures,¹⁰ since an overwhelming number of ad-hoc policy measures are being implemented in the context of the pandemic without adequate consideration or review.¹¹
- 2.8 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.¹² Tax expenditure increase is seen most clearly in the group comprising Central America, Mexico, and the Dominican Republic, where the rise in the average tax expenditure between 2015 and 2017 reflects increases in Costa Rica (from 4.9% of GDP in 2015 to 5.5% in 2017) and Mexico (from 2.9% of GDP in 2015 to 3.9% in 2017). In addition, tax expenditures represent a fourth or more of budgetary expenditure in Costa Rica, the Dominican Republic and Honduras. If tax expenditures are viewed as part of public spending policy, a significant portion of this expenditure thus escapes the regular monitoring and evaluation of efficiency and effectiveness that is usually required of budgeted public expenditure. With such

⁷ "Tackling Covid-19: Health, Quarantine and Economic Measures of South Korea". Ministry of Economy and Finance, Republic of Korea.

⁸ "Revenue foregone, attributable to provisions in the tax law that allow special exclusions, exemptions, deductions, credits, concessions, preferential rates, or deferral of tax liabilities for select groups of taxpayers or specific activities. These exceptions may be regarded as alternatives to other policy instruments, such as spending or regulatory programs." IMF. (2018). Fiscal Transparency Handbook.

⁹ Agostini, C. and M. Jorratt (2013), "Política tributaria para mejorar la inversión y el crecimiento en América Latina", Macroeconomics of Development series, No. 130 (LC/L.3589), Santiago, ECLAC.

¹⁰ Council on Economic Policies. (2018). Assessing Tax Expenditure Reporting in G20 and OECD Economies.

¹¹ Redonda, A. (2020). Tax expenditures and the transition to a greener post-Covid -19 economy. Green Growth Knowledge Platform.

¹² International Budgetary Partnership. (2019). Counted but Not Accountable: Tax Expenditure Transparency in Latin America.

pronounced presence of tax expenditures in many of the LAC governments' budgets, it is important to report¹³ them in a precise manner so that they do not constitute too large a burden on the public purse and are managed with transparency and accountability.

- 2.9 Although more developing countries have started reporting on their tax expenditures in recent years, the quality of reporting needs to improve if it were to meaningfully contribute to fiscal transparency and the debate on domestic revenue mobilization. Unlike in most advanced economies, where reporting on tax expenditures has been part of general fiscal reporting for decades, reporting on tax expenditures in developing countries started in the early 2000s, primarily in Latin America. In their evaluation of tax expenditure reporting in developing countries, Kassim and Mansour (2018)¹⁴ find that key good practices are missing in several country reports.¹⁵ While there are established practices across Latin America for regular reporting on tax expenditures, publicly available information is far from sufficient to provide adequate public justification on the foundation and rationale for tax expenditures, and to allow for proper democratic debate and deliberation on their adequacy and impact as fiscal policy tools.¹⁶ Hence, the need to gather more information and conduct further research on the tax expenditures reporting practices in LAC.
- 2.10 As regards the tax relief measures – especially tax deferral – 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. This is where the coordinated international efforts could shine. With respect to tax expenditures best practices, the expertise Korea has in the reporting of tax expenditures could play an exemplary role. According to “Assessing Tax Expenditures Reporting in G20 and OECD Economies (2018)”,¹⁷ Korea is one of the nine most advanced countries that have a detailed and comprehensive tax expenditures report (Group III), versus basic tax expenditures report (Group II) and no tax expenditures report (Group I). Korea, despite having published its very first tax expenditures report in 2010, its 2018 report already fulfills best practice standards in almost all the assessed dimensions.
- 2.11 Additionally, the successful webinar between the Fiscal Management Division (FMM) of the IDB and the Korean Ministry of Economy and Finance (MOEF) which took place on June 11, 2020, is a fitting example of how Korea-LAC fiscal cooperation should move forward. Its shared Korea's fiscal policy responses to COVID-19 by focusing on its various fiscal relief packages, which bear great relevance to the LAC countries grappling with the sharp drop in GDP and shrinking

¹³ The primary goal of reporting on tax expenditures – often referred to as “spending through the tax system” – is to provide transparency into how governments use the tax system to accomplish policy objectives, and the cost, in terms of foregone revenue. This, in turn, allows for assessing the cost-effectiveness of tax policy with regards to non-tax instruments, in particular direct spending, which is normally reported in government budget. IMF Blog. (2019). [Fiscal Transparency: The Case of Tax Expenditures in Developing Countries](#).

¹⁴ Kassim, Lanre and Mario Mansour. (2018). “Tax Expenditures Reporting in Developing Countries: An Evaluation.” *Revenue d'Économie du Développement*.

¹⁵ IMF Blog. (2019). [Fiscal Transparency: The Case of Tax Expenditures in Developing Countries](#).

¹⁶ International Budget Partnership. (2019). *Tax Expenditures in Latin America: A Civil Society Perspective*.

¹⁷ Council on Economic Policies. (2018). *Assessing Tax Expenditure Reporting in G20 and OECD Countries*.

fiscal space. Using this fruitful webinar as a stepping-stone, we could further utilize the Korean experience in tax expenditures to mitigate the effect of reduced public revenue in the LAC region.

- 2.12 Against this backdrop, this TC will help analyze tax relief measures and tax expenditures policies of selected 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 to strengthen the tax systems and increase the effectiveness of tax policies to support sustainable economic growth, 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.
- 2.13 **Strategic alignment.** This TC is consistent with the Second Update to the Institutional Strategy 2020-2024 (AB-3190-2) and is strategically aligned to the cross cutting theme of Institutional Capacity and the Rule of Law, by strengthening the management and planning of public resources which supports an improvement in integrity and transparency, establish more distributive fiscal policies by improving revenue management and designing more progressive tax systems contributing to remediate the structural and emerging development challenges stemmed from social exclusion and inequality and also by improving tax administration in a digitally sustainable manner. The operation contributes to the Corporate Results Framework 2020--2023 (GN-2727-12) through the indicator of support to countries in strengthening the tax and expenditure policy and management. Likewise, it is aligned with the priorities of the Sector Strategy on Institutions for the Promotion of Growth and Social Welfare (GN-2587-2), and is consistent with the Sectorial Frameworks for Fiscal Policy and Management (GN-2831-8) which underscores the importance of institutional capacity-building in the public sector to design and implement fiscal policies that improve efficient mobilization and allocation of resources that improve tax equity and social inclusion, strengthening of institutional capacity to design and implement fiscal policies to improve allocation of resource for investment expenditure in public infrastructure.
- 2.14 In addition, this TC complements the continuous efforts to strengthen the management of fiscal policy to support dealing with the economic and social effects of the pandemic, address the challenges and contribute to achieve a post-pandemic economic recovery in LAC. Such efforts will be complemented with the objectives of the operations "Support to deal with the economic and social effects of COVID-19 through the strengthening of fiscal policy and Management in CAN (RG-T3694)", "Support to deal with the economic and social effects of COVID-19 through the strengthening of fiscal policy and Management in CCB (RG-T3695)", "Support to deal with the economic and social effects of COVID-19 through the strengthening of fiscal policy and Management in CID (RG-T3696)", "Support to deal with the economic and social effects of COVID-19 through the strengthening of fiscal policy and Management in CSC (RG-T3697)" and "Tools to design fiscal transition and recovery policies in response to the COVID-19 pandemic (RG-T3761)" by complementing the research findings and management strategies for the fiscal approach of the pandemic and post pandemic challenges proposed in the above mentioned TCs. It will also complement the continuous efforts undertaken to

strengthen the tax policy and administration in LAC, among which stands out, "Tax Compliance in the Developing Digital Economy: The Case of LAC (RG-T3259)", and "Digital Transformation in Tax Administration (RG-T3456)". This TC also responds to the objective of the KPC (Public Capacity Building Korea Fund for Economic Development) stipulated in the Fund operational guidelines which is to strengthen public sector management in all fiscal related sectors through assistance aimed at facilitating efficient allocation and use of public sector resources to generate higher public value at the national and the sub-national government level.

III. Description of activities/components and budget

- 3.1 **Component I: LAC tax relief measures and tax expenditures policy diagnostics (US\$150,000).** As LAC governments implement stimulus packages and tax relief programs to combat COVID-19, it is important to analyze their potential impact on the economy and their limitations. 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. Furthermore, the challenges and ways to move forward post-pandemic era would be researched. This component will finance a regional discussion paper detailing the tax relief and tax expenditures measures in LAC (output 1.1).¹⁸
- 3.2 **Component II: Tax relief measures institutional capacity-building and tax expenditures methodology development (US\$150,000).** In an unprecedented time like this, it is of utmost importance to offer relevant fiscal policy advice to struggling governments in a timely manner. To this end and to help LAC governments formulate sound policy advice on how to close potential tax loopholes and improve tax collection this component will finance the development of a tax expenditure methodology. It will include the development of a quantitative analysis to account for tax expenditures in the national budget. This methodology will be validated by the Ministries of Finance in LAC. In order to ensure the operability and scalability of the methodology, the team will seek close engagement and peer reviews with the respective units within the MOF and Tax Agencies. Some field experts may be needed to capture the essence of most advanced countries in the region and also Korea regarding how best to manage and monitor tax relief measures and tax expenditures policy. For the later, collaboration with renowned institutes such as the Korea Institute of Public Finance (KIPF) and National Tax Service (NTS) of Korea may be required.
- 3.3 **Component III. Production of knowledge products and dissemination of results (US\$50,000).** The goal of this component is to disseminate findings, recommendations, and lessons learned from the execution of the previous two components. This component will finance a seminar to socialize the findings of this TC with the participation of a broader audience including the Ministries of Finance and Tax Agencies in LAC, and Korean partner institutions. The team will also utilize Bank's channels of communication to further disseminate the findings and recommendations through blogs to a wider audience.

¹⁸ The countries that have expressed interest to participate in the TC are Colombia, Dominican Republic, and Suriname and the IDB will obtain their official request to participate in the study.

- 3.4 By the end of this TC, the Bank will have strengthened its knowledge of various tax relief and tax expenditures measures taken by the LAC countries, as well as reinforced its grasp of how best to close tax loopholes and improve tax revenue collection in the face of COVID-19. Moreover, it will have formed strong ties with the tax authorities of LAC and other regions of the world, thereby improving its ability to provide more relevant and multi-dimensional policy recommendations to the countries hard-hit by the COVID-19 pandemic. Expected products of this TC include research papers and active knowledge sharing on the topic of tax relief and tax expenditures policy.
- 3.5 The estimated budget for the operation amounts to US\$350,000, which will be financed by the KPC fund. The execution period of this TC will be 36 months (including the 35 months of disbursement period).¹⁹ The products, project monitoring report, and project completion report of this TC will be also shared with the Fund Coordinator of KPC.

Indicative Budget

Activity/Component	Description	IDB/Fund Funding	Total Funding
Component I: LAC tax relief measures and tax expenditures policy diagnostics	One regional discussion paper detailing the tax relief and tax expenditures measures in LAC	\$150,000	\$150,000
Component II: Tax relief measures institutional capacity-building and tax expenditures methodology development	Development of a quantitative analysis/methodology to account for tax expenditures in the national budget	\$150,000	\$150,000
Component III: Production of knowledge products and dissemination of results	One dissemination seminar	\$50,000	\$50,000
Total		\$350,000	\$350,000

IV. Executing agency and execution structure

- 4.1 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'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. Given that this TC is regional in nature, before starting a specific activity in any specific country, the non-objection of the corresponding government liaison body with the Bank will be sought. 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. Supervision costs are not foreseen.
- 4.2 The activities will be closely coordinated by the fiscal specialists and country economists in the participating countries, who will present the country's requirement and will evaluate (i) the alignment with the objectives of the TC; (ii) the impact and

¹⁹ Prior approval of the KPC fund has been obtained for the financing of this TC pursuant to article 1.5 of the agreement establishing the KPC.

additionality with the program in the fiscal area in the country; and (iii) the complementarity with other resources. 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, GN2629-1). The sector specialist responsible for the execution of the TC is Gerardo-Reyes-Tagle, Lead Sector Specialist (IFD/FMM).

- 4.3 **Fiduciary regulations.** The financial management of the operation will be governed by the provisions of the Financial Management Guide for Projects Financed by the IDB (OP-273-12).
- 4.4 **Audited reports and financial statements.** Considering that the Bank will be the executing agency, in accordance with the provisions of the Financial Management Guide for Projects Financed by the IDB (OP-273-12), the presentation of financial audit reports is not required.
- 4.5 **Procurement and Contracts.** The activities to be carried out under this operation have been included in the Procurement Plan (Annex IV) and will be executed in accordance with the Bank's established procurement methods, namely: (a) hiring of individual consultants in accordance with the guidelines set out in the AM-650; and (b) hiring of logistics services and other services other than consulting, according to the policy GN-2303-28.
- 4.6 Any studies report or other material, graphic, software or otherwise, prepared as stated in the Procurement Plan (Annex IV) shall belong to and remain the property of the Bank. All intellectual property rights in the outputs produced under this TC are vested in the executing agency, the Fiscal Management Division (IFD/FMM).

V. Major issues

- 5.1 The main risk associated to this TC is related to the availability of quality information from the Ministries of Finance or similar agencies for the development of the different products of the TC given the mitigation measures of the pandemic. To mitigate this risk, the TC will collect extensively existing information, databases, and secondary sources. However, considering the type of this operation is research and dissemination (R&D), the TC should consider a potential slow response from counterparts in collecting primary source of information, likewise it will focus on beneficiary entities that show interest in solving specific problems to face the economic, fiscal, and social crisis, COVID-19, and will seek synergies with operations already approved by the IDB's Fiscal Management Division that allow for updated information. Moreover, the findings of this TC will complement in designing the demand of policy loans as per request of the countries affected by the macro-fiscal shocks.
- 5.2 There is a risk of delay in TC implementation activities given the current restrictions of the pandemic such as travel restrictions. This risk will be mitigated by maintaining an open and fluid dialogue with our counterparts in each participating country, consultancies that can work remotely will be hired, and virtual events will be organized to facilitate the exchange of information.

VI. Exceptions to Bank policy

- 6.1 This TC does not involve exceptions related to Bank's policies.

VII. Environmental and Social Strategy

- 7.1 Given the nature of the TC, no negative environmental impacts are foreseen. The TC will support the strengthening of processes and capacities of the Ministries of Finance and similar agencies, for which reason public works or infrastructure will not be financed. In accordance with the Bank's Environmental and Safeguards Compliance Policy (OP703), this operation has been classified in category "C". See [Safeguards Policy Filter Report \(SPF\)](#) and the [Safeguard Screening Form \(SSF\)](#).

Required Annexes:

[Request from the Client - RG-T3679](#)

[Results Matrix - RG-T3679](#)

[Terms of Reference - RG-T3679](#)

[Procurement Plan - RG-T3679](#)