WORLD BANK DRM Strategy (GRID)

Uses of increased tax revenue: (i) higher government spending (development, as well as social sector spending) necessary for growth; (ii) countervail increasing debt vulnerabilities and enhance debt sustainability; (iii) cover debt service costs which are soaring across countries; (iv) reduce fiscal deficits; (v) reduce the dependence on dwindling foreign assistance; (vi) reinforce the fiscal social contract between citizens and government, with benefits for accountability.

(i) Expanding existing undertaxed bases (indirect tax, property, personal income, capital income) and explore untapped tax bases (carbon emission [GHGs], digital economy).
(ii) Rethink international tax rules to stop tax avoidance by MNEs and HNWIs (PIT, CIT). Replace global tax competition with coordination and harmonization.
(iii) Increase the fairness and progressivity of existing tax systems, especially capital income.
(iv) Increased progressivity builds trust, which increases compliance and reinforces the social contract.
(v) Improve facilitation and enforcement in tax administrations, especially automation.

Good tax design minimises tax avoidance: legal and institutional measures to track and counter profit shifting.

Good implementation and enforcement minimise tax evasion: underdevelopment of capital markets, less digitalization, low trust in government (perception of absence of reciprocity), large informal sectors.

Consumption taxes are generally less progressive than taxes on income or wealth and might sometimes be regressive. It is difficult to make consumption taxes progressive because governments usually cannot observe individual purchases. Attempts to make consumption taxes more progressive are therefore blunter and less efficient than designing progressivity in income and wealth taxes. Consumption taxes are a major revenue source for most governments, in part due to their relative ease of enforcement and collection. If the revenue is used for progressive spending, the net impact on the poor can still be positive. Income and property taxes are harmful to growth but reduce inequality. Consumption-based taxes are conducive to growth but increase inequality.

Table 1: inclusiveness and growth-friendliness

Efficiency (Growth friendliness)	Equity (Inclusiveness)
Goods and services taxes VAT Trade taxes	Personal Income Tax Corporate Income Tax Property/wealth tax Capital income (dividends, interest, capital gains)
Minimize distortions and adverse effects	Progressivity Reduce profit shifting by companies and HNW individuals Other dimensions: gender, opportunity, intergenerational wealth

Taxes and Inequality

- **Directly**: certain taxes can be used by the government as an instrument for redistribution from the 'Haves' to the 'Have-Nots.' For example, higher tax rates on wealthy households would likely increase progressivity of tax system—helping reduce inequality.
- **Indirectly**: tax revenues are also necessary to fund fiscal spending that promotes equity. This makes it increasingly important to assess combined effect of taxation and spending together.
- **By taxing "negative externalities"**: Activities with harmful social consequences (e.g., pollution and environmental degradation resulting in climate change) could harm the poor disproportionally. For example, people living in slums or in more densely populated and highly polluted areas are more likely to develop health issues. Some revenue instruments could curb such activities.
- **By enhancing revenue administration**: too many procedures and complex tax systems may encourage informal activities and less inclusion of disadvantaged groups. Streamlining tax administration can have a positive impact on those group, hence fostering inclusion.

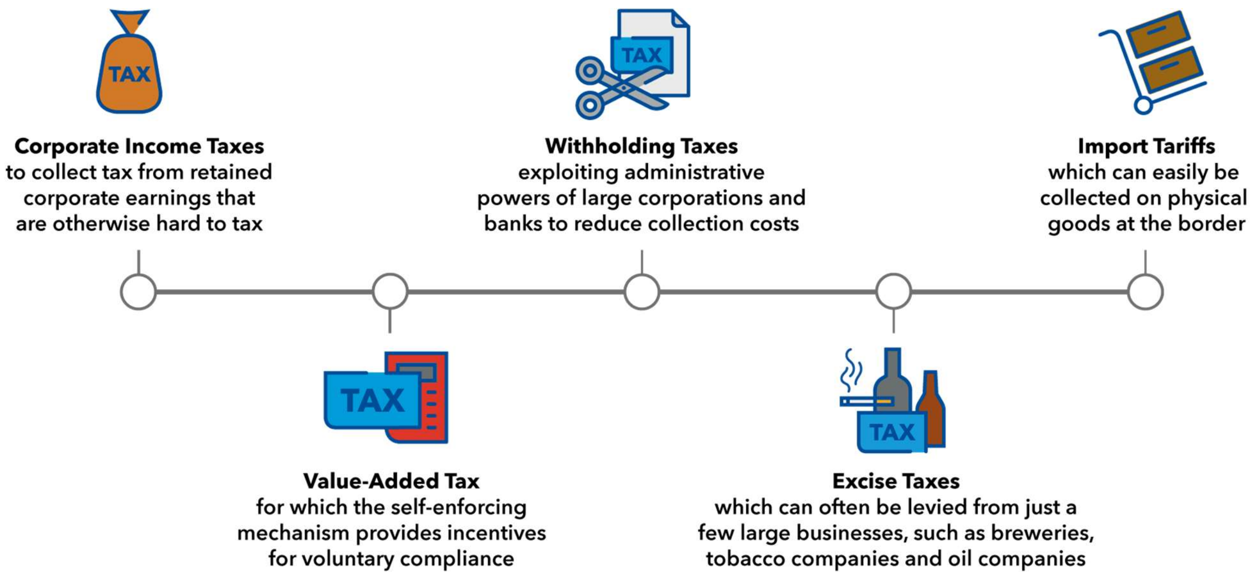
Channels

In developing economies, the redistributive impact of fiscal policy is limited for several reasons:

- **Lower overall levels of taxes:** while average tax ratios for advanced economies exceed 30% of GDP, ratios in developing economies fall in the range 15-20% (see table below). This is mainly due to capacity constraints in administration, the absence of a middle class, and large informal sectors.
- **Lower overall levels of spending:** developing economies rely heavily on easy-to-collect regressive taxes (sales tax, customs revenue). As a result, spending is substantially lower than that in advanced economies (see below), which reduces the redistributive potential of transfers as well.
- **Lack of targeting: a large share of social spending accrues to high income (e.g. fuel subsidies).** In advanced economies, tax-benefit systems achieve significant redistribution. This can be inferred from the difference in the Gini coefficient between market incomes and disposable incomes, i.e., the difference after applying income taxes and social benefits, as shown below. The average reduction in the Gini coefficient is 18 percent, of which around one quarter is due to progressive taxation and three quarters are due to social benefits. Hence, income redistribution comes mainly from the spending side of the budget. Taxes can still efficiently help achieve income redistribution goals. This depends on the progressivity of the

personal income tax (PIT), the taxation of capital income and wealth concentrated among the rich, and the design of indirect taxes.

Simplicity in tax law design, easy tax collection from a limited number of sources, and self-assessment are important to deal with these enforcement constraints and provide a rationale for the following compliance measures:



A) MORE REVENUES: RESILIENCE

Broadening of the tax base: reducing tax exemptions (VAT, PIT); tax incentives (CIT) and deductions and credits (PIT). Adopt a fiscal reference system to facilitate full assessment and rationalization of tax expenditures, enable the authorities to better estimate tax expenditures, and offer the opportunity to eliminate the inefficient and costly ones. Fixing weaknesses in the global tax system (e.g., tax avoidance by MNEs and HNW individuals). See Table 2 for a summary.

PIT – Labour

Direct tax on the earnings/salaries of workers. Mostly done using the PAYE scheme. This can also be through withholding taxes. There must be a trade-off between equity (progressivity) and efficiency: very high marginal tax rates distort incentives to work, inducing tax evasion and avoidance behaviours.

- **Set an appropriate exemption threshold**, reflective of the level of administrative capacity. It can be one of the following: a zero-tax bracket, a basic deduction, or a general tax credit.[1] It shouldn't be too high such that it looks like a top income tax, thereby shrinking the PIT base and discouraging incentives to work. It shouldn't be too low either unless the tax administration can deal with the ensuing compliance costs.

[1] A tax credit is more progressive than a tax deduction or a zero rate since the value of the latter depends on the marginal tax rate that the taxpayer faces.

Table 2: summary of tax instruments

Tax instrument	Poverty & inequality impacts	Revenue, efficiency & others	Reform considerations
VAT	-Broadly regressive and poverty-increasing, explaining why reduced rates and exemptions are palpable. -Can be less regressive in highly informal settings where expenditures are not subject to VAT. -Exemptions and reduced rates are less effective than other policy instruments (such as direct cash transfers)	-Significant source of revenue but mixed findings for SSA. -Efficiency is impacted by the number of rates and tax exemptions. Plethora of rates and exemptions complicate administration and erode efficiency. -More growth-friendly if well designed and minimises distortions to consumption and supply decisions.	-Its design tries to meet other economic & social objectives but it's sub-optimal. Should be designed as a revenue mobilisation instrument. -The VAT should always be considered in conjunction with the overall system of finance. -Where feasible, revenue gained from removing exemptions should be directed towards pro-poor spending. -Addressing administrative weaknesses & compliance gaps.
CIT	-Its contribution to progressivity is unclear as the incidence may fall on workers in the form of lower wages. -If the CIT falls on rents, the incidence is on the investors, and it can contribute to progressivity.	-Contributes significantly to revenue in developing countries. -Different types of investments are taxed differently (incentives, SEZs etc) and it undermines horizontal equity. -The CIT taxes the normal rate of return (not just the rents).	-Scope to better align with PIT so the CIT prevents PIT avoidance by HNWIs, enhancing progressivity of the tax system. -Encourage international efforts to harmonize CIT revenues instead of pushing tax competition.
PIT	-Broadly progressive and they are designed to be progressive and account for most of the redistribution achieved through taxes on average across countries. -Direct impact on income distribution, the scale of which varies by the tax base (influenced by informality & exemptions), tax rate structure &	-Useful but not the most fundamental source of revenue. -Evidence is mixed on the relationship between progressivity and the level of top marginal rates & economic growth.	-Adjust the PIT threshold so that it is above the poverty line, but not so high that number of taxpayers is too small. -Adjust bands for inflation and poverty protection. -Address compliance and administrative challenges.

	compliance. If low-income individuals are taxed it can easily become regressive.		
Excises	-Differential distributional and poverty impact depending on consumption patterns across income distribution in the short-term. -Broadly regressive in most countries, but progressive for some excisable expenditures in LICs (e.g., hydrocarbon products, luxury goods, motor vehicles), although it will likely further impoverish low-income households.	-Efficient at addressing negative externalities and can also be revenue-raising when levied on goods with inelastic demand (e.g., alcohol, tobacco, fuel). -The price inelasticity is more of a short-term phenomenon (price stickiness).	-Enlarge the base by capturing more items where consumption is concentrated on specific clusters of taxpayers and/or economic behaviour. -Scope to increase excises (& additional revenue) on goods harmful to citizens (e.g., health & environment), in line with value of wider damage to society. -Increased taxes on fossil fuels can be progressive in LICs and revenue-neutral.
Trade	-Differential distributional and poverty impact depending on consumption patterns across income distribution in the short-term. -In the long run, impact depends on how income is affected as production patterns may change in response. The effects will be idiosyncratic.	-Considered inefficient due to barriers of trade, therefore overall tariffs have reduced, and rates are broadly aligned to stage in the supply chain (lower for raw materials, higher for finished goods). -Significant (and administratively efficient) revenue source in LICs.	-Ensure dispersion of tariffs is minimised and aim for a more uniform tariff structure on imports with rebates for exporters. -Where feasible (within rules of a trade regime) provide compensatory transfers to lower-income households that are affected by changes in trade tariffs. -Ensure compliance and efficiency as revenue source.
Property tax	-Can be progressive or regressive, depending on tax base definition, distribution of property and tax structure.	-Typically used to collect revenue for local service provision.	-Ensure rate structure and tax base is broadly progressive.

	-More progressive structures are based on property values (rather than size & quantity) and mitigate impoverishing effects by providing relief to lower-income households.	-Generally important but relatively small share of revenue, albeit considered under-used in LICs. -Can incentivise more productive use of land and property but can distort investment decisions between property values versus other assets.	-Consider relief for the poorest and mechanisms to support ability to pay. -Improve administration.
Wealth tax	-Scarce systematic evidence on impact on income inequality. -Indirect effect through ability to earn income from wealth in future periods (capital assets). -Have the potential to raise revenues from individuals with the broadest shoulders, hence enhancing the progressivity of the system.	-Economists disagree on whether a well-designed tax system should include recurrent net wealth broad base taxes due to administrative and compliance challenges, along with potential distortions to savings, evasion and migration behaviour. -Potential to raise revenue, but faces administrative challenges, e.g., in observing stock and value for tax purposes and enforcement.	-A credible one-off net wealth comprehensive tax would be desirable. -Inheritance taxes could also be considered. -To the extent that all taxes are imperfect, they can act as a way to diversifying revenue sources to prevent any given tax becoming too high if administration costs do not outweigh benefits.

In developing countries, the PIT threshold is generally higher as a percentage of the average wage or GDP per capita, which helps ease administration. However, thresholds sometimes significantly exceed the average wage, as shown in the image below, which shrinks the tax coverage and turns the PIT into a tax on top-income earners only. This leads to a very small coverage of the PIT and a low revenue yield (see figure), thus undermining redistributive income taxation. The common advice is not to set the exemption threshold higher than the average wage, although higher levels can be envisaged where it is below a reasonable subsistence level.

- **Provide relief for low-income wage earners** if the administration is sufficiently strong. Subsidizing earnings of low-wage workers contributes to reducing inequality. In many advanced economies, these take the form of refundable tax credits, which constitute a net transfer to the individual when they exceed income tax liabilities. Such benefits are usually phased out as incomes rise, with the steepness of phase-out depending on the primary objective of the program. Tax credits require a strong tax administration and work best if taxpayers are already filing tax returns. This makes them less suitable for many developing countries.
- **Use a progressive marginal tax rate schedule**, calibrated to maximise its revenue potential while increasing equity and efficiency. The choice of the PIT top rate is a politically sensitive one, dependent on a country' aversion to inequality. Progressivity can also be enhanced by changing the zero-bracket threshold (such as in Gambia) or changing the marginal tax rates.
- **Restrict the use of PIT allowances (deductions and credits)** which erode the tax base and result in low PIT productivity. These are for expenses related to children, education, housing and health insurance etc. The benefits accrue disproportionately to the rich, especially when they are designed based on the marginal tax rate of the taxpayer. Streamlining these tax expenditures can simplify the PIT, raise more revenue (or the same revenue at lower rates) and enhance progressivity.
- **Adopt simplified small business regimes**: typically, presumptive taxes based on their turnover/ cash flow. This eases compliance and encourages formalization of small businesses.

PIT – Capital

Direct tax on the capital income of businesses: interest, dividends and capital gains. High marginal tax rates on capital may create relatively large distortions and incentives for avoidance and evasion. While progressive rates apply to labour, flat rates (lower than labour rates) apply to capital incomes.

- **Tax different forms of capital – interest, dividends and capital gains – in a neutral way**. This would help minimise avoidance and strengthen progressive revenue mobilization Differential treatment of types of capital cause distortions in asset portfolios, incentivises higher debt-financing and erodes the capital income base. Some countries tax interest and CG less than dividends while some exempt CG entirely from PIT (due to difficulties in enforcement).[2]

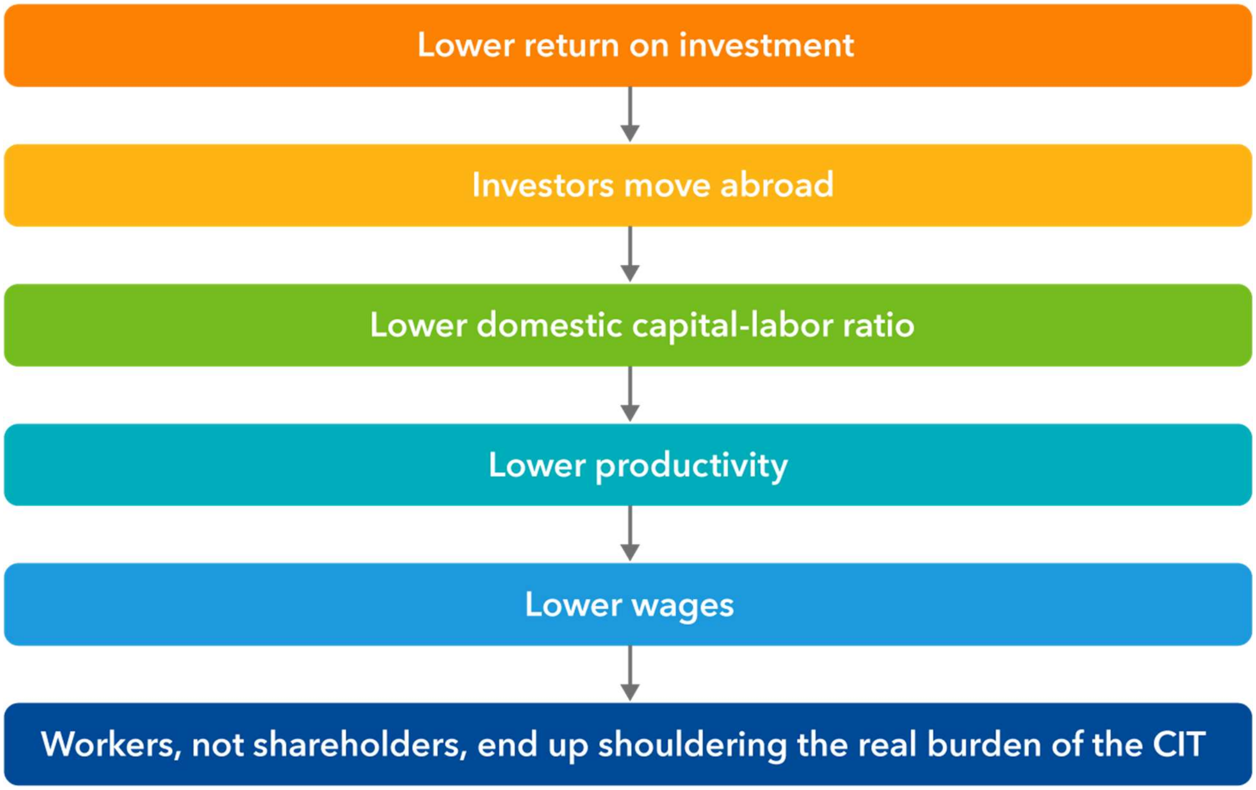
[2] For example, exempting CG is very common in the extractives sector.

- **Set a reasonable tax rate on capital income**, based on the mobility (elasticity) of the base. For equity considerations, higher rates are suggested. In addition, the rates should be very similar to PIT labour rates to avoid arbitrage (especially for self-employed entrepreneurs).
- **Use withholding taxes** where feasible and **exploit third-party information** such as from banks and other large corporations (including the creation of beneficial ownership registries). Automatic exchange of information for tax purposes has improved significantly, contributing to reductions in tax evasion.

CIT

This is a tax on the taxable profits of businesses, governed by the general tax code and investment codes. Sector-induced distortions are palpable here and there is discrimination by sector, level of investment, location etc. The CIT is one of the taxes for which the stability is very crucial: an unusual change in economic activity has far-reaching consequences on the amount of CIT that can be raised. The CIT is under pressure from international spillovers. First, aggressive tax competition has led to sharp declines in statutory CIT rates worldwide. The rates are never uniform, although they've been dwindling considerably over the years. Second, multinational companies often manage to achieve a very low tax bill by shifting profits from high to low-tax jurisdictions, for instance by using transfer pricing techniques, international debt shifting, and treaty shopping. Such tax avoidance is particularly important for developing countries, given outdated legislation and limited capacity to address the issue. International coordination of CIT systems has made some progress in recent years to mitigate these risks.

Workers Bear the Brunt of Corporate Income Tax



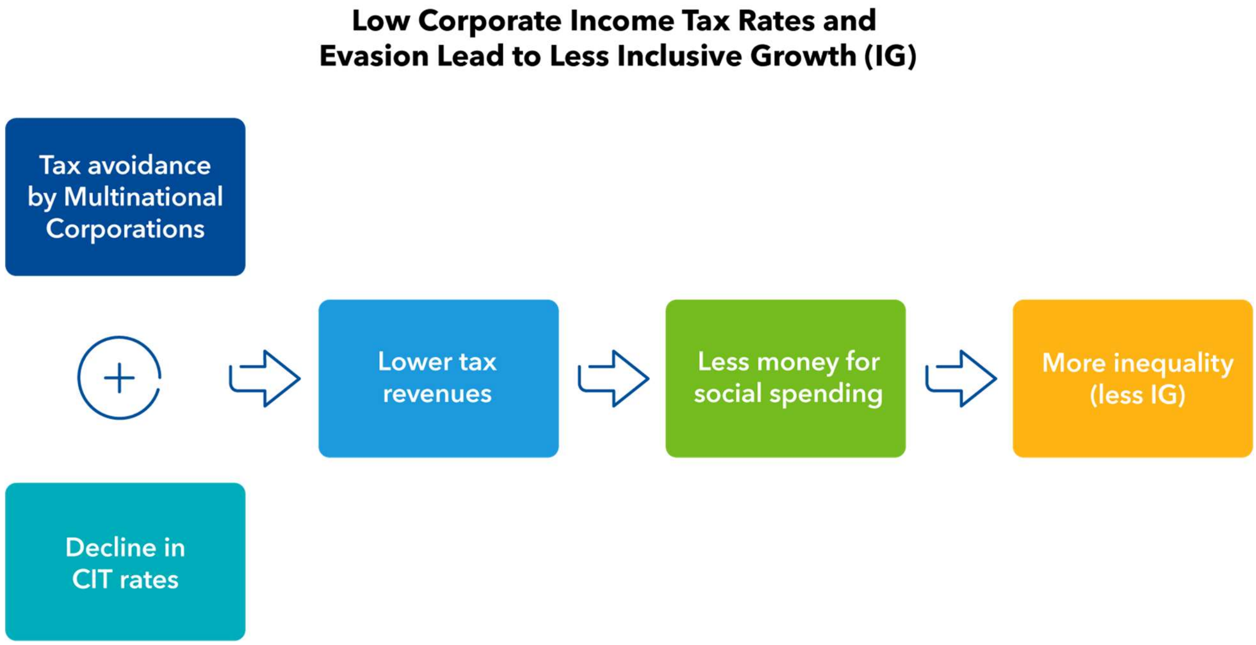
CIT productivity is measured as a ratio of the tax yield to the tax rate. The productivity is influenced by economic activity, the tax bases, as well as the prevailing rates. Furthermore, as they differentiate between debt and equity, they inadvertently induce a bias towards debt finance which threatens financial stability.

- Set a reasonable CIT rate and implement measures to extend the base.
- Design the CIT as a rent tax: i.e., a tax on the net cash flow of respective business. Rent taxes are economically neutral (the tax doesn't influence decisions to go into production).
- To attract FDI, developing countries provide CIT incentives: income tax holidays, accelerated depreciation, investment allowances/tax credits, longer loss carry forward, WHT tax relief, reduced rates, stabilization of fiscal terms. The incentives are **inefficient** (they benefit the largest MNEs who'd have invested anyway, while disproportionately influencing smaller companies who would normally benefit from the incentives) and **ineffective** (especially for location-specific investments). Additionally, the incur high fiscal costs.
  Use cost-based rather than profit-based incentives. Incentives which directly reduce investors' costs of investments (e.g., accelerated depreciation, investment tax credits, expending) are better for the recipient government as profit-based incentives (tax holidays, tax exemptions, reduced rates, SEZs) mix poorly with profit shifting. They should be awarded based on **objective rules-based criteria** embedded in tax law and should include sunset clauses.

- **Design special fiscal regimes for extractive industries** to maximise profitability for investors and revenue collection for governments.[3] This will typically include typical tax/royalty and production-sharing regimes. The appropriate fiscal framework for each country will depend on commodity dependence, net financial asset levels, development needs, macroeconomic circumstances, institution strength, and social preferences.
- Avoid special tax incentives for SMEs such as size-related tax deductions and reduced CIT rates. They discourage firm growth (hence, formalization), benefit wealthy entrepreneurs who own multiple businesses (**undermining progressivity**) and are administratively expensive.
- Adopt tailored anti-tax avoidance rules to protect CIT against profit shifting by MNEs. OECD/G20 BEPS Inclusive Framework (IF) with two pillars.
    - (i) Potential CIT revenues losses because of profit shifting in developing countries (US$ 200 billion per year) are equivalent to the estimated revenue loss caused by the pandemic, and higher than the ODA they receive each year.
    - (ii) Global Minimum Tax (GMT) can help address profit shifting and tax competition. It could increase global CIT and HNWI tax revenues in LICs.
    - (iii) Developing countries should also exercise caution in signing double tax treaties and pay close attention to their terms and conditions. For instance, they should avoid tight restrictions on the use of withholding taxes on foreign payments (for example, on royalties, interest or intra-company services), which can be effective instruments to mitigate tax avoidance, and they should avoid restrictions on the ability to tax indirect sales of immovable assets, especially important in extractive industries.

Pillar TWO, relating to the global minimum effective tax rate of **15 percent** implemented to address tax competition, lowering of tax rates and profit shifting. **Income inclusion rule (IRR)** – focuses on the MNE's branches and affiliates, rather than on payments between them. Charged by home countries on low-tax foreign earnings of MNEs (those that do not pay the minimum effective tax rate). **Undertaxed payment rule** – the host country identifies payments within an MNE that reduce its local taxable profits and are not subject to a minimum rate of tax. Tax could be imposed through a withholding tax or by including the payments in calculating the local company's taxable profits. **Subject to tax rule** – applies a similar principle to tax treaties, permitting source countries under tax treaties to impose withholding taxes.

[3] An economy is typically considered 'resource-rich' when its exhaustible natural resources (e.g., oil, gas and minerals) comprise at least 20 percent of total exports or 20 percent of natural resource revenues.



Wealth Taxes

Revenues raised by wealth taxes – taxes on property, net wealth, and asset transfers – varies between 1 and 4 percent GDP in advanced economies; they are generally (much) lower in developing countries. Such taxes have recently gained increased attention because of high and rising wealth inequality.

VAT

The VAT is imposed on the production of domestic and imported goods and services. The theoretical tax base is total final consumption (comprising government and household consumption). Nonetheless, the effective base depends on the definition of a taxable person (threshold), the definition of a taxable supply (exemptions) and ultimately the tax rates. The VAT comprises the standard rate (applied to most goods and services), reduced rates, increased rates (typically viewed as excises) and the zero rate (typically applied to all exports to avoid tax cascading). Standard VAT policy also allows for a raft of exemptions, inter alia medical supplies, basic foodstuff. VAT systems can best be designed with a high threshold, a broad base, and a single rate. Differential rates significantly complicate VAT administration and cause complexity in defining what goods precisely fall under the reduced rate.

The productivity of the VAT can be gauged through its C-efficiency. It is defined as actual VAT collections as a share of its potential base (total final consumption)[4]: i.e. (VAT revenue)/(total final consumption net of VAT revenue*VAT rate). C-efficiency is 1 when a single rate is applied (no exemptions or other rates), there is no informality and there is total compliance (the absence of tax evasion). C-efficiency can be differentiated into policy and compliance gaps: the former related to effects of rate differentiation and exemption and the latter relating to imperfect implementation.

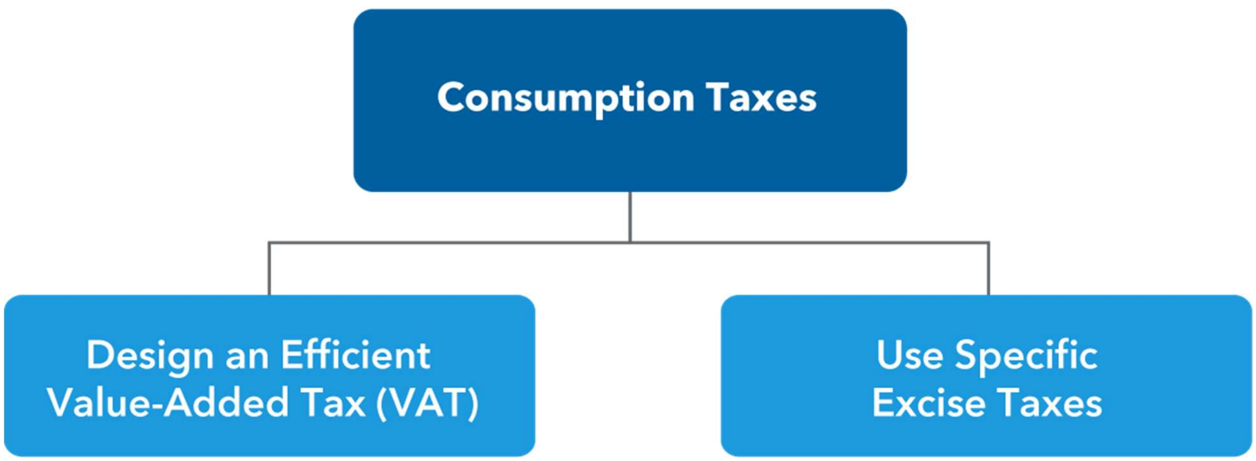
- **Adopt a single VAT rate** and reduce the use of domestic zero rates as they are even more detrimental than VAT exemptions because producers of zero-rated products can claim VAT refunds – when VAT liabilities are less than VAT credits – for the inputs used in production. Multiple rates and exemptions reduce VAT pass through to the final consumer: there are relative price changes and substitution effects, as well as higher profit margins for suppliers.
  Some countries apply reduced rates on certain products in a bid to increase VAT progressivity. Some countries apply reduced rates to pursue redistributive policies, given that the poor spend a large proportion of their income on the goods. However, high-income households spend more on those products in relative terms, so the reduced rates **reduce revenue, create economic distortions, cause administrative complexities (which goods fall under the reduced rate) and increased the compliance burden on firms**.
- **Reduce the use of VAT tax expenditures**, particularly VAT exemptions. VAT tax expenditures are reductions in tax liabilities in comparison with a benchmark VAT regime. VAT exempting provisions; VAT zero-rating provisions beyond exports; reduced VAT rates; and any other VAT rebate or concession. VAT tax expenditures are engaged by governments to deliver socio-economic benefits through the VAT systems. Instead, targeted pro-poor expenditures – such as transfer in cash or kind – should be enforced through the budget as they are more useful than VAT tax exemptions (Warwick et al., 2022).
- **VAT registration thresholds** should be set based on a country's revenue capacity, strengthening the progressivity (inclusiveness) of the VAT. It allows the tax administration tom to focus its enforcement efforts on large traders. Nonetheless, small retailers – from whom the poorest buy – are VAT exempt. To the extent that benefits of non-registration are not passed on the consumer, they likely remain with the seller, who in turn is also likely to be of relatively low income.
- **Handling of VAT refunds and/or credits is very important**. The level of refunds typically depends on the structure of the economy and VAT policy design. The higher the share of exports and the share of gross capital formation (investment) in gross output, the higher the share of gross VAT collections that must be refunded. Reduced rates, VAT withholding and reverse charge mechanisms, zero rates on domestic supplies also influence refunds.

[4] The main base should be total household consumption. Nonetheless, total final consumption can be used if government spending on goods and services is not exempt from the VAT base.

Limit the amount of input VAT that can be recovered; input VAT restrictions; robust refund management (vigorous audits based on risk assessment).

- **Modernization of VAT on e-commerce**. Introducing a VAT on e-commence will (i) protect tax revenue (growing VAT revenue losses & indirect impact on tax revenues); and (ii) level the playing field between digital and traditional trade suppliers). Online vendors should register for VAT, digital platforms should collect VAT on their sales, and the threshold for VAT on small, imported consignments should be reduced.

Consumption Taxes: VAT and Excise



Excises

They are widely used to tax consumption of selected goods and services, generally motivated by a desire to internalise externalities and restore the market to equilibrium and deal with health concerns associated with addictive behaviour. They don't pose compliance challenges: they are easy to collect and from easy sources. In the case of goods like tobacco products and alcoholic drinks and goods that pollute the environment such as motor fuels, fertilizers, and plastic bags, the private sector does not consider the external costs imposed on the economy and consequently overproduces such goods. Excise taxes are applied to minimise economic distortions, **especially for products that are price inelastic**.

- **Exploit excises on alcohol, tobacco and unhealthy foods**: this internalises externalities. They can be specific (on a per-product basis) rather than *ad valorem* (on value) to (i) achieve behavioural and health objectives; (ii) indexed annually to prevent erosion by inflation; and (iii) ease tax administration. Behavioural responses – including through smuggling and bootlegging – constrain the revenue-raising ability of these taxes (for example, in Mozambique). Excises on luxury goods contribute little to progressivity, raise little revenue and add administrative costs: the exception being excises on motor vehicles (they could raise substantial amounts in a progressive way).

- **Cautiously use emerging service taxes**.[5] Incidence analysis is important here – revenues weighed against the distortions they create – as the burden (pass through) can easily be shifted to consumers. This is particularly true for telecommunications licenses, reflected by increasing costs of mobile data and airtime. Digital services taxes are also important but their equity concerns still palpable. Nonetheless, the pandemic has shown the price inelasticity of online content consumption. For example, digital platforms like Netflix and Amazon Prime are reaching soaring levels of price inelasticity.
- **Avoid higher trade taxes**. They provide for easy tax collection mechanism at the border and therefore remain an important source of revenue for many developing countries – often more than 2 percent of GDP. However, tariffs are inconsistent with inclusive growth. For instance, empirical studies find that they exert adverse effects on growth and increase inequality.

B) BETTER REVENUES: INCLUSIVE

Increasing vertical and horizontal equity. Vertical equity is based on progressivity of taxes (taxpayers paying taxes based on their ability to pay; the tax burden increasing with a taxpayer's income and wealth) and horizontal equity is based on the absence of distortions across sectors.

Commitment to Equity (CEQ) methodology on fiscal incidence and income distribution for PIT and VAT, simulated based on quintiles in household surveys. It assesses the incidence of tax and expenditure systems to make informed policy decisions. Gender focused CEQ (e.g., in Ethiopia).[6]

- For PIT, quintiles are based on **real market income plus pensions per capita** while for VAT, it is **real household consumption per capita**. PIT tends to be progressive (due to high levels of informality and pervasive tax exemptions), consistent with tax codes with different income brackets and increasing marginal tax rates. For the VAT, progressivity is linked to pervasive tax exemptions for basic food stuff, consumed by the poorest (financially constrained households) and high VAT registration thresholds. Gambia PER shows that VAT is progressive, as well as Togo and Ghana (IMF, 2019).

Increasing economic and technical efficiency. **Economic efficiency** relates to the distortions imposed by taxes. Taxes influence work effort, consumption, savings and investment decisions, so apply rates which introduce less distortions as possible. Furthermore, there shouldn't be large differentials in rates across sectors (especially for substitutes). Economic efficiency can be measured by GDP per worker; consumer prices; economic growth. **Technical efficiency** refers to the costs of tax administration and transactions (for the government) and costs of compliance (for the private sector). These costs must be minimised, and they are a function of the multitude of taxes, each with separate tax rates. Higher technical efficiency can be achieved by streamlining administrative procedures and simplifying the tax structure.

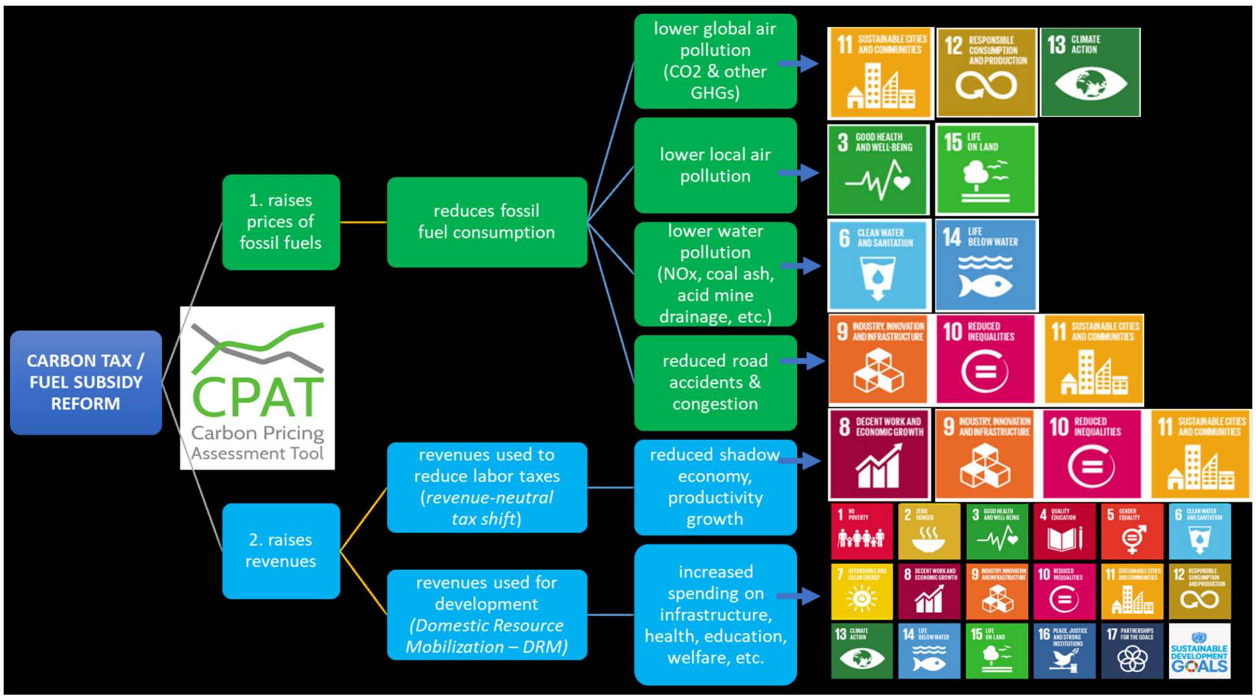
- PIT: more progressivity, including taxing capital income.
- Wealth taxation: greater reliance on property taxation and other taxes on wealth.
- CIT: reducing exemptions; removing opportunities for tax avoidance.

[5] E.g., excises on telecommunication licenses.
[6] $2 million funding from the FCDO for the gender equality and taxation workstream.

- Indirect taxation: broad bases and offset by direct subsidies and/or cash transfers.
- Sector-specific taxes: addressing climate change and health-related issues.

C) BETTER ENVIRONMENTAL OUTCOMES AND BROADER OBJECTIVES: GREEN

Climate change: carbon taxes, phasing out of fossil fuel subsidies and green investment. Strong connections to various SDGs.



Raising environmental taxes can create an environment-economic 'double dividend'. (i) revenues are raised at a relatively low cost; and (ii) reducing asset exposure to climate transition risks and producing development co-benefits, such as health gains from reduced air pollution, cleaner water and transport externalities.

Environmental taxation can contribute to multiple Sustainable Developing Goals (SDGs). Environmental tax reforms can have multiple co-benefits beyond climate.

- For example, the reduction in fossil fuel consumption induced by excise taxes on fuels or carbon reduces local air pollution, contributing to SDG3 (Good Health and Well-Being and SDG15 on Life and Land). Similarly, there is evidence of the effectiveness of gasoline taxes in controlling the growth of motor transport, reducing road congestion and road accidents; thus, supporting SDG11 (Sustainable Cities and Communities).
- There is increasing evidence, too, that environmental taxes can raise revenue at lower costs to the economy than some conventional taxes. For example, using taxes on carbon and fuel instead of payroll taxes can reduce the shadow economy and support formal employment, influencing SDG8 (Decent work and Economic Growth).

Carbon taxes[7]: a fee imposed on the consumption of carbon-based fuels, raising prices of fossil fuels and changing relative prices to incentivise lower carbon investment/innovation while raising revenues (raising revenue at a lower cost). They can be imposed per unit of emissions, at a level directly related to the external costs, such as the social cost of carbon (for climate externalities). They mostly benefit sectors like renewables while they discriminate against others like coal mining.

- Carbon taxes can be used to reduce other more distortive taxes and providing targeted transfers to the most vulnerable and those most affected by the transition, ensuring revenue-neutrality/equity and a **reduction in carbon emissions (fossil fuel consumption)**.[8]
- Distributional concerns regarding carbon taxes can be addressed through compensation measures for those who are disproportionately affected and economically viable. This can be through lump-sum payments of a green cheque ex-post[9] or reduced rates ex-ante.[10]
- Depends on income levels and economic structure (coal dependence for energy).
- Utilizing existing tax collection mechanisms, a carbon tax is paid "upstream," i.e., at the point where fuels are extracted from the Earth and put into the stream of commerce or importation. Fuel suppliers and processors are free to pass along the cost of the tax to the extent that market conditions allow. **Placing a tax on carbon gives consumers and producers a monetary incentive to reduce their carbon dioxide emissions**.

Fossil fuel subsidies: very expensive, regressive (they benefit mostly the rich) and generate economic inefficiencies; and distort energy prices.

- Lack of transparency, especially for those financed through SOEs; political economy entrenchment makes it difficult to reform.
- Indirect subsidies.

The Hidden Costs of Subsidies

Subsidies – especially on energy products – impose welfare costs by distorting relative prices in the economy and by promoting overconsumption and resource misallocation. There are three reasons:
1. Energy subsidies encourage the excessive consumption and production of energy-based products, which accelerates the depletion of natural resources and accelerates climate change.
2. By encouraging the wasteful use of fuel energy, energy subsidies delay the adoption of greener forms of energy that are both more sustainable and more cost-efficient
3. Generalized subsidies crowd-out investment in education and public infrastructure.

Green public investment depends on macroeconomic conditions, fiscal space, capacity to incorporate climate considerations and the importance placed on other policy objectives.

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[7] Although carbon taxes tend to be moderately regressive in advanced economies (but not in low-income countries), these effects can be offset by using part of their revenue for pro-poor expenditures.

[8] Denmark, Finland, Sweden and the UK showed positive impacts on GDP. France showed a positive impact on manufacturing jobs.

[9] A tax credit paid out by tax authorities as a transfer in connection with an income declaration, providing support the most vulnerable.

[10] Higher administrative and compliance issues with benefits accruing inadvertently to higher-income groups.

- Boost climate-smart infrastructure (improving digital infrastructure, renewable energy).
- Avoid carbon-intensive investments (e.g., high-emission vehicles).
- Support climate adaptation (flood protection, resilient infrastructure).
- Debt guarantees extended to green sectors/industries in preference to others.
- Make support to carbon-intensive industries dependent on making progress on climate (commitment to emissions reduction; re-training packages for mine workers; paying to close mines).
- Green bonds and green investment (through targeted and transparent guarantees).

B) Harmful consumption: sin/health related taxes[11]

In the case of goods like tobacco products and alcoholic drinks and goods that pollute the environment such as motor fuels, fertilizers, and plastic bags, the private sector does not take into account the external costs imposed on the economy and consequently overproduces such goods. Excise taxes are applied to minimise economic distortions, **especially for products that are price inelastic**. They are motivated by the desire to internalize externalities and restore the market equilibrium to its optimal level, and they don't pose compliance challenges: they are easy to collect and from easy sources. The taxes enhance economic efficiency.

- Expand the base by introducing new excises and tax all brands of the product proportionately to avoid substitution. Product-based and unit excises are better than *ad valorem* (value) excises as the latter can induce substitution effects (they are more revenue elastic).
- Exploit excises on alcohol, tobacco and unhealthy foods: this internalises externalities.

D) PROMOTE DIGITALIZATION/REFORM OF REVENUE ADMINISTRATIONS

1. Extend the scope of e-filing and e-payment (mobile payment) of taxes, as well as electronic drop boxes for collecting returns. This reduces compliance and administrative costs, as well as interactions with taxpayers and trade entities (collusion).

2. Enhance the use of third-party data (individual banking information, beneficial ownership registries) and data analytics (customs reform in Niger). Third-party information is useful in mitigating capital tax evasion, increasing tax compliance and enforcing tax arrears collection.

- Customs reform in Niger focused on the transformational impact of data analysis. The analysis monitored changes in trade volume, trade routes and customs revenue during the pandemic. Niger Customs Data Analysis and Reform Unit (CADRE).

3. Incorporate international tax issues as part of the ICT (data) and compliance strategies.

4. Use technological advancements and tools for digital audits and taxpayers' services.

[11] $4 million additional funding from Bloomberg Philanthropies.

- The World Bank is helping TAK by providing technical assistance through the ongoing Enhancing the Quality and Scope of Taxpayer Registration (EQSTR) project. A key reform objective for TAK (Tax Administration of Kosovo) and KBRA (Kosovo Business Registration Agency) is the creation of a fully digital, one-stop process for businesses registration, information updates, and deregistration. Moreover, the project has recommended a fully paperless certification process and imposing fines for violating requirements to update tax information. To underpin these recommendations, Kosovo has adopted the legal basis for the implementation of e-signature.

5. Strengthen tax compliance strategies

- Building trust (reciprocity and accountability); strengthen enforcement and communications; develop risk-based management mechanisms; simplification of tax procedures and measures to tackle informality.

6. Strengthen VAT management

- Developing strong refund mechanisms; strategy and action plan (e.g., ease registration, filing [electronic VAT invoice], payment and refunds).

7. Simplify regulations and procedures: improve administration; improve facilitation and formality by reducing compliance costs (digital development).

- Develop strategy and action plan for the design and implementation of new measures.

REVENUE MOBILIZATION IN SSA

Mobilizing tax revenue is key if developing countries are to finance the investments in human capital, health and infrastructure necessary to achieve the World Bank Group's goals of ending extreme poverty and boosting shared prosperity by 2030.To achieve the Sustainable Development Goals, low-income countries face an estimated annual financing gap of half a trillion dollars, 0.5 percent of global Gross Domestic Product (GDP). The International Monetary Fund (IMF) estimates that extra tax revenues could finance one-third of this gap.

Sub-Saharan Africa remains the region with the largest number of economies below the minimum desirable tax-to-GDP ratio of 15%. At that level, revenues are inadequate to finance basic state functions. Non-oil-rich countries in the region saw their tax-to-GDP ratios increase to 16% in 2018 from 15.3% in 2010. Due to fluctuating oil prices, tax collections are more volatile in oil-rich states. In these countries, tax revenues increased from 9.2% of GDP in 2010 to 15.2% in 2015, after which taxes fell back to 10.2% in 2018.

Relatively low tax collections in the region reflect weaknesses in revenue management, including widespread tax exemptions, corruption, and shortfalls in the capacity of tax and customs administrations. Given the region's relatively large agricultural sectors and less open economies, the capacity to raise tax revenues is also lower. The maximum tax revenue potential for countries in the region is estimated to average 19.6% of GDP, which is 7.5 points lower than in the rest of the world.

Most African economies have the potential to mobilize more in taxes. This can be done through better tax administration (including value-added taxes), broadening the tax base by removing cost-ineffective tax expenditures, and increasing excise taxes (including on alcohol, tobacco, and soft drinks). In addition, it's important to introduce efficient carbon-pricing policies and effective property taxation while and closing international tax loopholes that permit aggressive tax avoidance and evasion by multinationals and wealthy individuals. Reducing structural bottlenecks is also part of suite of tools to consider in improving revenue outcomes, including by improving taxpayers' trust and by moving tax administrations to the digital frontier.

Tackling Aggressive International Tax Planning and Evasion. World Bank Group technical assistance (now under the Global Tax Program) has allowed to introduce strengthened anti-abuse rules in several countries, including Senegal, Nigeria, Liberia, Cape Verde, Mauritania, and Kenya. Revenue collections from audits have been substantial. In Kenya, tax officials who received training successfully negotiated transfer-pricing audit adjustments that brought in additional tax revenue of $135 million in 2016. In the Economic Community of West African States (ECOWAS) region, additional assessments from international tax audits exceeded $100 million in pilot countries in a single year (2017).

The World Bank Group is the largest provider of development finance for Domestic Resource Mobilization (DRM), supporting more than 100 countries and territories through an active portfolio of $1.8 billion in loans and technical assistance (as of May 2019). The Bank is active in 22 of the 36 countries and territories in fragile situations, 48 of the 76 poorest countries and economies eligible to receive concessional IDA resources, and in the 16 middle-income countries with very low tax collections (below 15 percent of GDP.)

Since 2017, the Global Tax Program (GTP) has provided an umbrella framework for DRM support across the Bank Group. It builds upon ongoing programs focused on strengthening tax institutions and mobilizing revenues at the international and domestic level. The program is currently funded by eight development partners (Australia, Denmark, Japan, Luxembourg, Netherlands, Norway, Switzerland and the United Kingdom) and, as of today, total secured contributions amount to more than US$ 60 million (2017-2022). Sub-Saharan Africa is one of the program's priority regions.