

Report
on the
Coordinated Audit
of Tax Subsidies



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1 Summary

The VI EUROSAL Congress held in Bonn from 30 May to 2 June 2005 dealt with the audit of public revenues by Supreme Audit Institutions (SAIs).

The analysis of the country papers submitted by EUROSAL's members prior to the congress has shown a number of cases where cash flows that, strictly speaking, have the nature of expenditures are transferred to revenue budgets, especially in the form of tax subsidies. Tax relief schemes of this kind have reached a considerable magnitude in some countries. However, up to now, there has still been insufficient knowledge about the effectiveness of tax subsidies. SAIs should develop more reliable findings about the volume and target achievement of such tax subsidies. Some country papers noted the extent and complexity of tax legislation that can lead to tax shortfalls and tax exceptions. The Congress therefore advocated conducting a coordinated audit of tax subsidies that was open to all EUROSAL members.

Shortly after the Congress, 11 SAIs met to implement the project including the Netherlands as an observer. They formed an international Working Group, whose membership increased to eighteen in the course of time: Cyprus, Denmark, Finland, France, Germany, Hungary, Iceland, Italy, Latvia, Lithuania, Poland, Romania, the Russian Federation, Slovak Republic, Sweden, Switzerland, the United Kingdom and the Netherlands.

To obtain comparable results, a checklist was drafted that addressed all stages of a tax subsidy from legislation via implementation up to reporting. At the same time, this checklist formed the non-binding framework for an audit of transparency and reporting.

The project started with a seminar, where more than 60 participants from 22 EUROSAL member countries and the European Court of Auditors discussed subsidy policies, the effectiveness and the audit of subsidies with subject matter experts from the OECD, the University of Cologne, the Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ) and the Algemene Rekenkamer.

After completing audit work, the Working Group came to the conclusion that, concerning tax subsidies, improvements were needed in the fields of legislation, evaluation and reporting in all participant states in order to create the overall transparency which it considered necessary both for the legislator and the general public.

It was found that, already in draft legislation, the objectives of tax subsidies were not adequately described and that the information on the costs and benefits of a tax subsidy were completely inadequate. As a result, there is a lack of reliable data on which to base monitoring, analyses and evaluation of tax subsidies. Statements on evaluation after adopting legislation are often not made or are at least insufficient. Furthermore, as to tax subsidies, there is usually no time limit imposed with respect to the subsidies nor are there arrangements to reduce the subsidy amounts over time. After the introduction of a tax subsidy there is a patent lack of any systematic monitoring, analysis and evaluation. Reporting of tax subsidies as part of the budgetary process or in a separate report is completely inadequate. The budget legislator and the general public are largely left uninformed about the objectives of tax subsidies and their accomplishment, their financial, economic and environmental impact and the results of evaluations.

Furthermore, three Working Sub-Groups were set up to deal with specific tax subsidies. The Working Sub-Group on Corporate Income Tax looked for comparable themes and agreed to audit tax relief themes for micro-enterprises, small and medium sized enterprises and – where relevant – tax relief for regional development, which exist in all countries that participate in this Working Sub-Group. It developed a questionnaire on which the design of the audits of the participating SAIs was to be based.

The Working Sub-Group on Corporate Income Tax addressed corporate tax allowances for small and medium-sized enterprises which in all countries must be based on legislation. In the majority of participating countries there is no corporate income tax subsidy which can be utilized solely by these companies. The participating SAIs looked especially into the legislation process, monitoring procedures and the use of IT systems. In all participating countries, preliminary evaluations are required in the course of the legislative procedure, but were not or were just partially fulfilled by the Ministries of Finance. The practice of defining the objectives of the corporate income tax subsidies is different and the possibility of replacing corporate tax subsidies by direct financial aids was not evaluated in any participating country by their financial governments. Generally, the data supply on corporate income tax subsidies is insufficient to compare and assess the impacts of this kind of subsidy.

In most participating countries the objectives of the corporate income tax subsidies were defined clearly and measurably and there are regulations to determine that the impacts of tax subsidies and the achievement of the objectives have to be evaluated. However, in generally, there is no sufficient monitoring of the achievement of these objectives. The regulations do not prescribe compulsory controls as well. In all participating countries the tax authorities have developed and applied IT systems to process corporate tax returns' data and to assist tax controls by the common procedure in all local tax authorities

There are five groups of recommendations by this Working Sub-Group. It is recommended to conduct both a preliminary and a concurrent regulatory impact assessment and considering alternative options in the legislative procedure: to design eligibility rules for tax subsidies, to publish relevant information and to evaluate the target achievements of tax subsidies periodically. Also IT systems should be used more often, i. e. to set up a register of tax subsidies and to link this register up to other available data bases.

The Working Sub-Group on VAT addressed the reduced VAT rate. As agreed the Working Group members collected audit evidence on the reduced VAT rate in their respective countries. The audit was designed to establish for example whether individual VAT rate reductions in the member states covered were still justified or generated unintended side-effects. Furthermore, the Working Group members were requested to compile information about the problems existing in connection with the application of reduced VAT rates, the aggregate loss of VAT revenue caused by a reduced VAT rate, the effectiveness of the subsidy and the procedures to assess the effectiveness of reduced VAT rates.

As a result of national auditing and reporting, the members of the VAT Working Sub-Group arrived at some common conclusions about the effect and the effectiveness of lower VAT rates. For example, the imposition of a lower VAT rate should be of direct benefit to consumers by lowering the prices for goods and services. Also, there is a disproportionate

relation between detailed regulations for rate differentiation and available resources of tax authorities to enforce them.

Therefore, the members of VAT Working Sub-Group recommend that monitoring and evaluation of the application and effects of lower VAT rates should be introduced on a systematic basis and an annual report of the actual amount of state budget revenue lost as a result of VAT concessions should be published. Also, it needs to be assessed as to whether the number of VAT concessions by reduced tax rates on specific goods and services could be decreased and alternative instruments could be chosen.

On the whole, the three Working Sub-Groups looked at tax subsidies from differing perspectives but still produced similar audit findings. The Working Group has derived some common recommendations. Draft Bills should document objectives sought by introducing tax subsidies in a clear and well structured way. Tax subsidy reporting should include data on the tax losses incurred as a result of tax subsidies. Such reports should be issued at regular intervals, preferably on an annual basis. Evaluations should be carried out at regular intervals to provide assurance on the efficiency, effectiveness and target achievement of tax subsidies. Within the framework of their procedures the participating SAIs discussed the audit findings and recommendations with the competent national bodies – as a rule with the governments or ministries. Subsequently, most of the audit reports were made accessible to the general public.

Although diverging tax systems were examined, the SAIs involved in the coordinated audit have still found comparable problems and shortcomings in tax subsidy schemes. In addition, the SAIs also pursued soft goals such as sharing experience, expanding informal networks and enhancing communication with other external institutions.

2 Introduction

Currently, rapid change is taking place in Europe accelerated by major geopolitical initiatives such as the EU enlargement process and ongoing globalisation. This development does not fail to have an impact on the Supreme Audit Institutions (SAIs), that increasingly have to face similar challenges in this economic area, in which borders are steadily declining.

Apart from this, European unity has to be filled with life. After all, European unity is a continuing process that relies on citizens and public bodies approaching one another, a process that sometimes moves at a slow pace. Seen against this background, this coordinated audit of tax subsidies has brought in a small but valuable puzzle piece.

The coordinated audit in which all EUROSAI members might participate was therefore designed to meet the growing need for SAIs to become acquainted with each other in the course of an audit and to share their lessons learnt by it. The purpose of the audit mission was to produce best practice information and strengthen informal networks. Also, the SAIs wished to enhance cooperation with the academic community. In addition, congress participants intended to develop a sound methodology for programme results evaluation and improve the impact of tax relief schemes.

The German SAI responded to this desire when hosting the VI EUROSAI Congress. The

choice of the audit theme was governed largely by the objective of presenting to the Congress a theme of substance and importance. The choice made was the audit of tax subsidies, i.e. special arrangements in tax law which in general considerably reduce public revenue all over Europe and at the same time make tax law rather complex. The representatives of the European SAIs welcomed the proposal made by the German SAI at the Petersberg Conference Centre near Bonn on 2 June 2005. While cooperation between the members of EUROSAI is nothing new and is generally growing, the level of cooperation envisaged by this coordinated audit project still has been exceptional.

The design of the national audits was left to the individual SAIs. This permitted a parallel audit by a large number of SAIs in a rather short period of time without being detracted by questions about the scope of each SAI's responsibilities. Each SAI assigned its own audit team to look into the same field from each SAI's particular perspective, taking into account its relevant legal mandate. Experiences were shared during joint meetings and served as input into each SAI's own work. The participating SAIs will submit their final reports independently to their respective Parliament or responsible ministry.

It was agreed that each Working Group member should produce its own project report reflecting the national SAI's perspective. That means a national report, not a common report of the Working Sub-Groups. The *available* report was to *be* a survey of the national audit findings and recommendations. This overall report on the coordinated audit mission was finished by year-end 2007 submitted to the next EUROSAI Congress.

Since each SAI audited independently on its national territory, the first task addressed was to agree on a questionnaire for the survey and on the timetable. Lists of questions were drafted in joint meetings that provided the participating SAIs with a structure facilitating a comparative presentation of results in the final report. Each SAI was free to adopt this structure wholly or in part for its own audit design and schedule.

International Working Group

To develop a sound methodology for programme results evaluation and improve the impact of tax relief schemes the international Working Group met for the first time in Bonn on 10-11 November 2005 (cp. Table 1).

The delegates who attended that meeting decided to place audit focus on transparency and reporting on subsidies. Many SAIs advocated looking into the efficiency and effectiveness. Apart from that, the German SAI also wished to address the topic of fiscal policy decisions. Many members made statements as to any specific audit assignments proposed for the years 2006 and 2007. Others wished to determine the themes at a later point in time. Based on the proposed tax subsidy missions, three Working Sub-Groups were set up (cp. Section 3).

Enhancing transparency was the first priority of all Working Group members. The development and implementation as valid mechanisms for programme results evaluation and thus the demand for comprehensive and complete information about the objectives and impact of tax subsidies, their financial volume and success have become the primary goal of the activities undertaken by the international Working Group. The results generated by the

Table 1

Date	Place	Participating SAI		
10-11 November 2005	Bonn	Denmark Lithuania Slovak Republic United Kingdom	Germany Poland Sweden	Hungary Romania Switzerland
22 February 2006	Bonn	Cyprus Finland Hungary Poland Slovak Republic United Kingdom	Czech Republic France Latvia Romania Sweden	Denmark Germany Lithuania Russian Federation Switzerland
28 August 2006	Copenhagen	Denmark Germany Latvia Romania Switzerland	Finland Hungary Lithuania Slovak Republic	France Iceland Poland Sweden
16 February 2007	Warsaw	Denmark Hungary Poland Slovak Republic	Finland Latvia Romania	Germany Lithuania Russian Federation
12 September 2007	Bratislava	Denmark Germany Lithuania Slovak Republic	Finland Hungary Poland	France Latvia Romania
30-31 January 2008	Bonn	Denmark Germany Italy Netherlands Russian Federation Switzerland	Finland Hungary Latvia Poland Slovak Republic	France Iceland Lithuania Romania Sweden

coordinated audit have shown that the objectives and requirements of tax subsidies are not always specified adequately. The potential impact of tax subsidies and their potential economic and social impact and alternative options for achieving the same objectives are not adequately studied. The same applies to the impact which their implementation could have on our environment. Thus, Parliament is lacking the most important information base for its decisions. In exceptional cases only, the legal provisions by which tax subsidies are created involve a time limit for the validity of the legislation that would give Parliament a chance to decide about the subsidy on the basis of the knowledge already available about the impact of the subsidy noted so far. The actual impact of the subsidy after the coming into force of the relevant legal provision is not identified. Legislators usually do not provide for programme results evaluations although these might contribute to the mitigation of the clash of political opinions about their reduction or abolition.

Three Working Sub-Groups

A total of three Working Sub-Groups was set up, with each of which addressing one particular aspect of tax subsidy auditing.

The Working Sub-Group “Transparency and Subsidy Report” composed of the SAIs of Germany (chair), Denmark, Finland, France, Iceland, Lithuania, Poland, Romania, the Russian Federation, the Slovak Republic, and Sweden dealt with issues of transparency of tax subsidies and relevant reporting.

Two other Working Sub-Groups were set up to look into individual tax subsidies. The Working Sub-Group “Corporate Income Tax” led by the Hungarian SAI audited the efficiency and effectiveness of tax subsidies in the field of corporate income tax that are granted to small and medium-sized enterprises. In this case also a common list of questions was developed by the SAIs of Hungary, Latvia, the Russian Federation, Slovakia and Germany. Another Working Sub-Group studied the granting of a reduced VAT rate for particular deliveries or services. This Working Sub-Group encompassed the SAIs of Latvia, Lithuania, Switzerland and Germany (chair).

Questionnaires as a common base

The international Working Group agreed to develop a questionnaire – especially for the Working Sub-Group on “Transparency and Subsidy Report” – in order to facilitate later comparison of the results. An auditor that proceeded along the lines of the questionnaire produced by this Working Sub-Group was to be guided to the core issues of transparency during the life cycle of a subsidy from its introduction and implementation to reporting about the subsidy and assessing its impact.

The questionnaire was designed to be dealt with in two steps. Firstly, it was agreed to complete the questionnaire where alternative options for the responses were given. If none of the options was applicable, further details were requested. Secondly, the questionnaire drafted by the international Working Group provided a basis for designing audit work.

Furthermore, the Working Sub-Group on “Corporate Income Tax” drafted an additional detailed questionnaire for its coordinated audit on tax subsidies in the field of corporate income tax.

Starting with a Seminar on “Tax Subsidies”

To work out this questionnaire, a seminar organised by the EUROSAI Chairman was held on the subject of tax subsidies in Bonn on 21-22 February 2006.

Any interested EUROSAI members not participating in the Working Group were also invited to attend. The workshop was designed to establish a professional basis for the EUROSAI-wide coordinated audit of tax subsidies as approved by the VI EUROSAI Congress. More than 60 participants from 22 EUROSAI member countries and the European Court of Auditors discussed subsidy policies, the effectiveness and the audit of subsidies. The workshop was to provide a scientific basis for the EUROSAI-wide coordinated audit of tax subsidies.

Presenters from Cologne University’s Institute of Fiscal Studies and from OECD helped create a common knowledge base which was to serve as a sound point of departure for the success of the common project. The seminar addressed both the definition of tax subsidies and the Swiss Subsidies Act in which the most important provisions for transparency in this field have been laid down. The requirement made was proactive reporting about tax subsidies and their better integration into the budget process. In their presentation, the Netherlands SAI pointed out that, after an audit, more emphasis was placed on the

effectiveness and the results of the measures and that tax subsidies were reported in an annex to the annual budget. One representative of *Deutsche Gesellschaft für Technische Zusammenarbeit* (a technical cooperation company owned by the German Federal Government) emphasised that foreign investors' choice of location did not depend so much on tax subsidies but rather on good governance and a sound tax system. Another issue discussed was the abolition of nearly all tax subsidies implemented in New Zealand in the course of an overall tax and economic reform in the mid-80s (cp. Table 2).

Table 2

Author	Organisation	Presentation
Dr. David Nguyen-Thanh	GTZ	Tax incentives in developing and transition countries
Dr. Michael Thöne	Cologne University	Overview and insight on subsidy control for tax expenditures
Christian Valenduc	OECD	Tax expenditure reporting and effectiveness analysis
Jan H. Velthoven	Algemene Rekenkamer	Taxes as a policy instrument

Common information platform

The Working Group members kept abreast of current developments by having access to a password-protected section on the website of VI EUROSAI Congress (www.eurosai-2005.de).

That section of the website provided information about the current status of the project, minutes of the meetings and the questionnaires (checklists) submitted by the SAIs, progress reports, timetable and audit information of the three Working Sub-Groups, also audit concepts (audit design outlines), audit reports and useful web links.

Audit work

Since May 2005, the SAIs of Cyprus, Denmark, Germany, Finland, France, Hungary, Iceland, Italy, Latvia, Lithuania, Poland, Romania, the Russian Federation, the Slovak Republic, Sweden, Switzerland and the United Kingdom have been members of the Working Group while the Netherlands participated in the capacity of an observer.

At their meetings, the participating SAIs continuously coordinated their audit work. In doing so, they agreed on common audit questions and audit focuses and informed the other participants of their latest audit findings.

The present final report about the coordinated audit on tax subsidies highlights the audit findings generated by the three Working Sub-Groups.

It is supplemented by a separate report of each Working Sub-Group that informs in greater detail about the audit findings generated by the SAIs that participated in the work of the Working Sub-Groups. The national reports are incorporated in this report as annexes in the form of electronic documents.

3 Definition

3.1 Common Understanding

To prepare their audits, which also had the purpose of generating comprehensive findings about the granting of tax subsidies in the respective countries, a common understanding of the concept of “tax subsidies” had to be developed by the participating SAIs.

There is no generally acknowledged definition either nationally or internationally. As a rule, the term “subsidy” is defined in a narrower or wider sense depending on the objective pursued by applying such definition.

However, a definition was important especially for the Working Sub-Group on “Transparency and Subsidy Report”, since that Working Sub-Group’s audit approach was to be cross-cutting, covering subsidies under all types of taxes and tax systems and analysing their transparency, particularly in the form of any subsidy reports.

After the seminar and an in-depth discussion of this point the Working Group came to the conclusion that they understood tax subsidies in a broad sense covering all kind of tax expenditures. Definition of the latter is taken from Best Practice Guidelines – Off Budgets and Tax Expenditures published by OECD¹. According to this paper, a tax expenditure can be defined as a transfer of public resources that is achieved by reducing tax obligations with respect to a benchmark tax, rather than by a direct expenditure. Further, in the paper the following classification of tax subsidies is included:

- exemptions: amounts excluded from the tax base;
- allowances: amounts deducted from the benchmark to arrive at the tax base;
- credits: amounts deducted from tax liability;
- rate relief: a reduced rate of tax applied to a class of tax payers or taxable transactions;
- tax deferral: a relief that takes the form of a delay in paying tax.

The Working Group concurred that all types of tax subsidies mentioned above were to be covered by the audits of the participating SAIs.

3.2 National Input by SAIs

There is neither a generally acknowledged international definition of the term “tax subsidy”, nor is there a national legal definition in the participating countries. The SAIs therefore looked into legal provisions that were classified as tax subsidies by the respective government in their national environment. In the course of their audits, nevertheless the SAIs also addressed alternative definitions discussed in economic research nationally and internationally. In particular, they highlighted national deviations that influenced the reporting of the respective governments on the volume and importance of tax subsidies.

¹ Best Practice Guidelines – Off Budgets and Tax Expenditures, OECD, GOV/PGC/SBO(2004)6, 19-May-2004.

3.3 Relevance of Definition

Definitions of the terms “tax subsidy”, “tax privilege”, “exceptional provision of tax law” or similar terms in the respective national context differed in importance among the three Working Sub-Groups.

The two Working Sub-Groups on “Corporate Income Tax” and “VAT” looked into exceptional provisions of tax law which could be considered as tax subsidies at the national level. The Working Sub-Group on “Corporate Income Tax” concentrated on corporate income tax subsidies that are granted in the participating countries in the same or a largely similar way. Eventually, the SAIs agreed on looking into tax relief for micro-enterprises, small and medium-sized enterprises and – where relevant – into tax relief for regional development. The SAIs participating in the Working Sub-Group on “VAT” agreed to generally deal with the problems of a reduced VAT rate. In almost all countries, some types of supplies and services are subject to a reduced VAT rate differing from the general rate. The participating SAIs considered the granting of the reduced rate as a tax privilege that might have the nature of a subsidy. The individual SAIs therefore were fully free to decide what exceptional provision of tax law their audit mission was to cover.

The Working Sub-Group on Transparency and Subsidy Report dealt with tax subsidies both under the perspective of their introduction, change and administration as well as reporting. In this context the definition of the concept of tax subsidy differs in the framework of legislation and reporting.

In all countries, legislation is required to introduce, modify or abolish a tax subsidy. Such legislation must essentially meet the same national requirements as any other legislation.

The situation is different where reporting is concerned. In this field, the question as to whether a certain provision of tax law is considered as a “tax subsidy”, “tax privilege” or the like is of central importance. Where national provisions call for reporting, it is incumbent on the respective governments to define the term of tax subsidies in their respective national context. In practice, this leads to a scope for discretionary decisions by which the national governments can determine the extent and contents of reporting on tax subsidies. With transparency in mind, the audit activities of the SAIs focus on this issue.

4 Audit Missions

4.1 Background

In the course of the coordinated audit, each of the participating SAIs carried out audits of its own in its respective country. Taking into account the agreements made in the Working Sub-Groups, they decided at their own discretion about their contents, scope, methodology and implementation. Each SAI assigned its own audit team that looked into the same field from each SAI’s particular perspective, taking into account its relevant legal mandate. Lessons learnt were shared during joint meetings and served as input into each SAI’s own work. The participating SAIs will submit or already have submitted their final reports independently to their respective Parliament or responsible ministry.

4.2 Overview of audit mandates

The audit mandates of the participating SAIs are governed by the respective national legislation.

Generally, SAIs have a mandate to audit the revenues and expenditures of public budget. When looking into tax subsidies, which usually implies a waiver of public revenues, SAIs audit or collect audit evidence at those bodies that are responsible for drafting the relevant legislation, administering the tax in question and granting the tax relief. In most cases, tax subsidies must be applied for in tax return forms. To that extent, SAIs are able to audit the tax subsidies at the level of government entities.

As a rule, SAIs have no special audit mandate with respect to tax subsidies.

However, the political choice between a direct subsidy and a tax subsidy at the same time affects the audit rights of SAIs. As a rule, the national legislation stipulates that the appropriate use of direct subsidies may be audited, where necessary at the level of the recipient of the subsidy. In case of tax subsidies, the opposite applies. Hardly any SAI may audit tax subsidies at the level of recipients. As a consequence, SAIs are not able to verify the effectiveness and efficiency of a tax subsidy by also collecting audit evidence at the level of beneficiaries. The audit on tax subsidy is therefore also limited to the government level.

4.3 Working Sub-Group 1 – “Transparency and Subsidy Report”

A total of eleven SAIs of the countries Denmark, Finland, France, Germany, Iceland, Lithuania, Poland, Romania, the Russian Federation, Slovak Republic, and Sweden had agreed to deal with the transparency and report on tax subsidies under the coordinated audit.

The questionnaire adopted by the Working Group was based essentially on the Polish SAI's draft. The questionnaires and proposals for modification submitted to the Working Group by Denmark, Germany, Finland, Romania, Sweden and the Slovak Republic also included essential suggestions that were taken up.

4.3.1 Type of Survey

In the course of their audit, the participating SAIs focused on the areas of legislation, law enforcement and reporting.

In all countries, tax subsidies, amounting to exceptional provisions in tax law, must be introduced by legislation. Hence, these provisions must meet the national requirements for legislation.

As a rule, the implementation of tax subsidies is incumbent on the national tax administration, which in some cases is also responsible for monitoring the impact of tax subsidies.

Not all participating countries have provisions about reporting in place. Furthermore, a distinction is drawn between reporting within the framework of the respective national budget and separate information in the form of a subsidy report.

The contents and scopes of the audit carried out by the participating SAIs were determined largely by the prevailing national situation. One common objective of the audits was to answer the question about what responsibilities the national governments have with respect to tax subsidies and how they meet these responsibilities.

Since, as a rule, national finance ministries have to prepare and lead the legislation on tax subsidies, they were in most cases the appropriate contact for the participating SAIs.

4.3.2 Findings

Adequate transparency is not guaranteed in the field of tax subsidies.

The national draft bills for tax subsidies sometimes have considerable weaknesses in comparison with the existing standards of national legislation. Thus, the qualitative and the quantitative objectives of tax subsidies are in many cases documented inadequately. The description of objectives is often worded in such general terms that it is impossible to measure target achievement by means of these descriptions. The information furnished about the costs and benefits of tax subsidies often differs largely in quality. Statements about the possibilities of evaluations, especially on the timing, contents and scope, are presented only inadequately.

This is tantamount to a lack of bases for monitoring, analysing and evaluating tax subsidies. In many cases, options for setting a time limit and/or reducing the amount of a subsidy over time are often not reported.

At the stage of granting the tax subsidies, no systematic monitoring, analysing and evaluation takes place. There is a lack of appropriate strategic concepts. In most cases no current data on costs and benefits is available. No systematic evaluation takes place, which is attributable in part to the lack of such data.

The arrangements for reporting on tax subsidies either in the budget or a separate report are inadequate. An overview about all tax subsidies is often not available. Losses of tax revenues are calculated and/or estimated incompletely. No information is given about the basis of such estimates and assumptions. The presentation submitted by the national government is in most cases too concise with respect to the objectives, the target achievement, the actual outcomes and the evaluation of tax subsidies.

4.3.3 Recommendations

On the whole, the participating SAIs considered improvements in the range from legislation to reporting on tax subsidies necessary in order to create the transparency needed both for the legislator and the general public.

Based on their audits, the participating SAIs developed the following recommendations to the national governments and/or Parliaments.

Legislation

In future, legislation must define unambiguous, clearly stated and verifiable objectives of tax

subsidies. The analyses produced by government during the legislative process should be comprehensively documented. It is suggested that time limits be imposed for the validity of tax subsidies, if applicable.

Regular evaluation

At the national level, strategies must be developed and implemented that permit systematic monitoring, analysis and evaluation of the tax subsidies. Evaluations need to be carried out regularly in order to be able to provide assurance on the effectiveness and efficiency of the tax subsidies.

Reporting

All tax subsidies are to be included in reporting. Therefore the government has to make clear what it considers to be a tax subsidy and what is excluded from its reports. Comprehensive and complete information is to be provided about the losses of tax revenue caused by the tax subsidy. On the whole, regular, up-to-date and full reporting on tax subsidies is necessary.

Since few recipients benefit from tax subsidies while these subsidies are funded from the taxes paid by all taxpayers, this burden on all taxpayers can be justified only by increased transparency that discloses the effectiveness and efficiency of the exceptional provisions of tax law.

4.4 Working Sub-Group 2 – “Corporate Income Tax”

The Working Sub-Group on corporate income tax subsidies consisted of SAIs of Germany, the Republic of Latvia, the Slovak Republic, the Russian Federation and Hungary (chair). The participants of the Working Sub-Group audited corporate income tax subsidies focusing on the efficiency and effectiveness of subsidies granted for small and medium-sized enterprises or, if subsidies like these did not exist in the respective country, for regional development. The SAI of Latvia audited the whole system of corporate income tax subsidies.

4.4.1. Findings

In all participant countries, the taxation must be based on legislation. In 4 countries, corporate income tax rules are regulated in separate laws, while in the Russian Federation the Tax Code contains these rules in the chapter ‘Corporate Income Tax’. In 3 countries (Hungary, the Republic of Latvia and the Slovak Republic), the total amounts of corporate income tax are paid to the central budget, while in Germany and the Russian Federation the amounts are divided between the central budget and the budget of German states and the constituent entities of the Russian Federation.

In 3 countries (Germany, Hungary and the Slovak Republic), all corporate income tax subsidies are regulated by the Law on Corporate Income Tax, in the Republic of Latvia and the Russian Federation some of them are regulated by other laws.

The regulation on tax subsidies granted for SMEs shows a great variation in the participating countries:

- in four countries (Germany, the Republic of Latvia, the Russian Federation, the Slovak Republic), there are no special corporate tax allowances for SMEs (in the Slovak Republic corporate income tax subsidies are granted only for the purpose of regional development)
- in Hungary a special allowance is granted for SMEs in the Corporate Tax Act.

This means that in the majority of participating countries there is no corporate income tax subsidy which can be utilized solely by SMEs. However SMEs – according to general conditions – have the right to take advantage of corporate tax subsidies.

The definition of SMEs is different in the participating countries. In member states of the European Union it is based on the recommendation of the Commission. As a result of a recommendation in 1996, the Commission established for the first time a common definition for SMEs. On 6 May 2003, the European Commission adopted a new definition for SMEs to be effective from 1st of January 2005. The Russian Federation applies different rules, where the category of medium sized enterprises exists only from the 1st of January 2008.

In all participating countries, preliminary evaluations are required in the course of the legislative procedure. This includes feasibility studies, the assessment of the expected financial, economic and social impacts of the proposed law or other type of regulation. However, in general, these requirements were not or were just partially fulfilled by the Ministries of Finance. The consequence of the lack of thorough preliminary assessment of tax subsidies is that the target achievement and therefore the effectiveness of these subsidies are not evaluated later.

The regulations concerning corporate tax subsidies have been modified during the audited period several times in all countries, but these changes had only limited effect on the entire regulations. The reason of modifications was the EU harmonisation in Hungary and the Slovak Republic.

Generally, no entire legal regulation was abolished, however, in the Republic of Latvia and the Russian Federation some clauses of laws were repealed.

The practice of defining the objectives of the corporate income tax subsidies is different in the participating countries, so it is not possible to evaluate it generally. In Germany and in the Slovak Republic, the audits found that the objectives were defined and well documented, in the Republic of Latvia and the Russian Federation the objectives of corporate income tax subsidies were not defined in the legal regulations. In Hungary the objectives were defined indirectly through the requirements (conditions) for utilizing the subsidies.

The possibility of replacing corporate tax subsidies by direct financial aids was not evaluated in any country by their financial governments. The Ministries of Finance have not prepared any comprehensive evaluation on the target achievement of the legal provisions. Therefore, it is impossible to assess if alternatives exist for better legislation to achieve the same objectives. However, it can be stated that direct financial aids have different impacts on taxpayers than tax subsidies. Replacing tax subsidies by direct financial assistance would

have additional administrative costs as accompanying effects.

In all participating countries, the utilization of tax subsidies is restricted by legal regulations in the form of different types of limitations (time, amount and others). Generally, the corporate tax subsidies can be claimed without certifying the conditions. The control of the compliance with these requirements is assured by the posterior controls of the tax authorities.

The Ministries of Finance of all the participating countries estimate the amount of the tax subsidies within the central budget, the methodology of which is at the same time different. The Ministry of Finance in the Republic of Latvia and the Slovak Republic estimates the number of taxpayers utilising tax subsidies additionally to the amount. The German Ministry of Finance prepares estimation on the amount of subsidies and the taxpayers utilising them; however it is not always based on up-to-date data, because the data from official statistics may in individual cases be founded on evidence collected five or more years ago. The Ministry of Finance in Hungary and in the Russian Federation estimates the amount of tax subsidies for the proposal of the central budget.

Generally, the data supply on corporate income tax subsidies is insufficient to compare and assess the impacts of subsidies, including subsidies for SMEs. The ratio between the total number of taxpayers and the taxpayers utilised corporate tax subsidies can not be compared according to the data of the participating countries. This ratio can neither be analysed for SMEs, too. The reason is that the data of SMEs and the total number of taxpayers utilising subsidies are available only in Hungary. There are no corporate income tax subsidies separated for SMEs in Germany, the Republic of Latvia, the Russian Federation and the Slovak Republic.

The average amount of the tax subsidies for taxpayers can not be compared according to the data from the participating countries. This ratio can neither be analysed for SMEs.

The rate of the corporate tax revenues within the total tax revenues of the central budgets in the participating countries varies between 3.1% and 26.3%. The rate of the corporate tax subsidies compared to the total tax revenues of the central budget is between 0.7% and 3.3%. The rate of the corporate tax subsidies compared to the corporate tax revenues is the lowest in the Russian Federation (2.75-3.79%), meanwhile it was the highest in 2004 in the Slovak Republic (20.23%) and in 2005 and 2006 in Hungary (28.26% and 24.09%). These rates can not be calculated for SMEs.

The Ministries of Finance of the participating countries follow up the tendency of the corporate tax subsidies in order to base the central budget proposal. The tendency of corporate tax subsidies – except the Slovak Republic – is not evaluated by the Ministries of Finance of the participating countries, this is particularly true for the evaluation of the taxpayers utilising tax subsidies.

In all the participating countries, the tax authorities developed and apply IT systems to process corporate tax returns' data and to assist tax controls by the common procedure in all local tax authorities. The systems cover all the phases of the control procedure and the stored data are reliable. The access rights and the storing of records about changes made in systems are also regulated. Some kinds of deficiencies had been revealed in three countries in connection with the application of IT systems, however these problems were solved.

In all the participating countries the IT systems of the tax authorities include risk management modules to assist controls. The number and scope of the risk factors built into these modules, as well as the quality of their applications are different because of the specialities of the countries. However, each tax authority qualifies the taxpayers based on the data of the tax returns and other fiscal information, as willingness to fulfil payments. In Germany, Hungary and in the Russian Federation the inherency of data in tax returns is taken into consideration, as well.

In the participating countries – except for the Republic of Latvia – the objectives of the corporate income tax subsidies were defined clearly and measurably.

There are regulations in all the participating countries to determine that the impacts of tax subsidies and the achievement of the objectives have to be evaluated. However, in generally, there is no sufficient monitoring of the achievement of these objectives. The Ministries of Finance of the participating countries with the exception of Germany have not built up any follow-up and assessment system. Neither have they developed any methodology for evaluating target achievements. Although in Germany such methods have been developed, most of the government departments do not use a well structured approach or generally acknowledged methodology.

The administrative costs of collecting the different types of taxes – including tax subsidies – are separated neither in the Ministry of Finance nor in tax authorities of each participating countries. Therefore, the efficiency of tax subsidies can not be estimated.

Generally, the regulations do not prescribe compulsory controls. The tax authorities' controls on corporate tax include the audit of corporate tax subsidies, as well. However the types and methods of the control mechanisms are different.

The data on the controls and their results are registered differently by the tax authorities. Therefore, there is no possibility to compare them. Information on the irregularities as results of the controls – especially on tax-related criminal offences and/or administrative offences – is provided only by the Tax Authorities of Germany, Hungary and the Slovak Republic, in latter one no irregularities were identified. In Germany, such information is not centrally registered.

4.4.2. Recommendations

The Working Sub-Group, on the basis of the findings generated by the coordinated audit developed the following recommendations.

<p>1 Proposals on legislative procedure</p>	<p>documentation of the objectives of subsidies, following a systematic approach conducting both a preliminary and a concurrent regulatory impact assessment and considering alternative options, e.g. direct financial assistance</p>
<p>2 Design of eligibility rules for subsidies</p>	<p>assessment of the possibility to apply the legislation limited in time ('sunset legislation') preference for an eligibility time limit in respect of individual beneficiaries</p>

3 Obligation to publish relevant information	losses of tax revenue caused by subsidies to be stated annually, comparing the actual to targeted amount, also in respect of other tax types and financial years administrative costs where possible beneficiaries' bureaucracy costs where possible number and structure of beneficiaries
4 Periodical results evaluations	evaluation of target achievement evaluation of effectiveness evaluation of efficiency
5 Use of IT systems	fully computerised systems with compatible data base use of risk management systems based on relevant data linking-up of available data bases setting up a register of subsidies

4.5 Working Sub-Group 3 – “Value Added Tax”

The Working Sub-Group on VAT consisted of the SAIs of Latvia, Lithuania, Switzerland and Germany (chair). The participants of the Sub-Group were tasked to look into subsidies connected with the reduced VAT rate. They met at three meetings between February 2006 and January 2008.

4.5.1 Scope of Audit

As agreed the Working Sub-Group members collected audit evidence on the reduced VAT rate in their respective countries. They deliberated on audit scope and the audit methods to be used. As a result each SAI was free to choose the tax subsidies and audit objectives it wished to cover in its national audit work.

The purpose of the audit was to find out, for example, whether individual VAT rate reductions in the member states covered were still justified or generate unintended side-effects. The audit was also designed to address the question as to who or what target group benefited from the tax rate reduction in question and whether this tax privilege was a suitable tool for supporting specified activities. Furthermore, the Working Sub-Group members were requested to compile information about the problems existing in connection with the application of reduced VAT rates, the aggregate loss of VAT revenue caused by a reduced VAT rate, the effectiveness of the subsidy and the procedures to assess the effectiveness of reduced VAT rates.

After concluding audit work, the audit findings generated were presented in national audit reports by the Working Group members.

4.5.2 Findings

One SAI carried out a detailed study on the application and implementation of the reduced VAT rate in the sectors of ‘fast food restaurants’, ‘works of art and collectors’ items’ and

'combined articles'. The audit has confirmed in particular, that the application of the reduced VAT rates partly involves windfall profits and abusive arrangements and can be enforced only with a vast input of staff resources because of considerable difficulties of definition. Therefore it was recommended that the reduced VAT rate be abolished in these sectors.

Another SAI conducted audit to verify if control over justified application of reduced VAT rates is provided and organized and if revenue from reduced VAT rates is accounted. It also examined if forgone tax revenue, resulting from application of reduced rate, which could possibly be received if full VAT rate had been applied, was calculated and if reduced tax rate's efficiency and benefit to the public was assessed. This SAI found that the benefit of the public from implementation of reduced VAT rates policy is not assessed.

In one country an economic study was commissioned by the SAI. Its purpose was to examine the effect of the reduced VAT rate upon prices, supply, demand etc. The results of the study illustrated the reduced VAT rate did not produce any direct effect upon product and service prices and consumers did not derive any direct benefit.

Furthermore, one SAI chose the reduced VAT rates as the subject of an evaluation, since they represented a largely untransparent form of subsidisation, and since a reform of the VAT Act was underway that aimed at simplifying the rate structure all the way towards a uniform tax rate.

4.5.3 Conclusions

As a result of national auditing and reporting, the members of the VAT sub-Working Group arrived at the following common conclusions about the effect and the effectiveness of lower VAT rates:

- The imposition of a lower VAT rate should be of direct benefit to consumers by lowering the prices for goods and services.
- The Working Sub-Group confirms that lower VAT rates are inappropriate to reduce prices for goods and services, to stimulate supply and demand or to increase the workforce in sectors with lower rates. Where some effect of lower rates can be measured, that effect could have been achieved more economically by other means.
- In some cases, it is only the trader and not the customer who benefits from lower tax rates. This enables traders to maximise profits. The tax subsidy thus has an unintended impact on business operations.
- In connection with the application of lower VAT rates, unintended misclassification and abuse exist that lead to considerable VAT revenue losses.
- Furthermore, misallocation of a tax subsidy does not only infringe the national policy on subsidies but is also likely to be a problem for Community law.
- There is a disproportionate relation between detailed regulations for rate differentiation and available resources of tax authorities to enforce them. The Working Sub-Group is concerned that the lower VAT rates are often unduly granted.

- The members of the Working Sub-Group found that VAT rate reductions for particular goods and services were often outdated and therefore not in line with the original legislative intent. Legal provisions for a regular evaluation of such subsidies are lacking.
- Monitoring of effects of subsidies such as lower VAT rates does not receive sufficient attention. Efficiency of tax concessions, their effects on consumer prices, changing consumption patterns and additional administrative costs are not regularly assessed.
- It is worthwhile for a country to examine whether the goals envisaged by its lower VAT rate(s) might be achieved better by modifying existing instruments of social, fiscal or economic policy.

4.5.4 Recommendations

The members of VAT Working Sub-Group recommend that the following options be explored:

- Monitoring and evaluation of the application and effects of lower VAT rates on a systematic basis.
- Annual publication of the actual amount of state budget revenue lost as a result of VAT concessions.
- Assessment as to whether the number of VAT concessions by reduced tax rates on specific goods and services could be decreased and alternative instruments could be chosen.

4.6 Overall Recommendations

Although the three Working Sub-Groups looked at tax subsidies from differing perspectives, they still produced similar audit findings. The Working Group has derived the following recommendations from them.

Legislation

The objectives sought by introducing tax subsidies need to be documented in a clear and well structured way. After due examination, legislation to be adopted should limit tax subsidies to a specific period of time in all adequate cases. Alternative options such as financial grants in aid should also be considered and the regulatory impact should be assessed.

Reporting

Tax subsidy reporting should include data on the tax losses incurred as a result of tax subsidies. Such reports should be issued at regular intervals, preferably on an annual basis. Further information such as data on administrative cost and actual/targeted cost is desirable. The SAIs recommend preparing a full inventory of all tax subsidies accessible to everybody and based on clear national implementation of international definitions.

Evaluation

Evaluations should be carried out at regular intervals to provide assurance on the efficiency, effectiveness and target achievement of tax subsidies.

Information Technology

In addition, it is desirable to enhance relevant IT procedures for tax subsidies and to build networks with other relevant data processing systems to ensure data matching.

5 Activities by National Governments and Parliaments

5.1 Background

There is no EUROSAI regulation specifically governing a coordinated audit. The individual national audits and the handling of the audit findings were governed by the respective national provisions of each participating SAI.

5.2 National Activities

Within the framework of their procedures the participating SAIs had discussed the audit findings and recommendations with the competent national bodies – as a rule with the governments or ministries. Subsequently, most of the audit reports were made accessible to the general public. Where the reports were discussed at the level of Parliament, this took the form e.g. of hearings or discussions in the appropriate committees. During these hearings or discussions, the national SAIs had the opportunity of presenting their points of view and explaining them in detail. In isolated cases, statements were made to the effect that the SAIs' recommendations would in future be implemented. However, the audits have not yet resulted in tangible changes in legislation, tax administration and reporting.

6 Conclusions

In light of the diverging tax systems examined, the SAIs involved in the coordinated audit have still found comparable problems and shortcomings in tax subsidy schemes. A joint effort by the SAIs may open up new perspectives on a wider environment and stimulate fresh insights on the national audit findings notably if the applicable legal provisions are based on a common footing.

In addition, the SAIs also pursued soft goals such as sharing experience, expanding informal networks and enhancing communication with other external institutions. The SAIs involved in the coordinated audit have also reached those targets set. The Working Group hopes that the EUROSAI member SAIs will carry this effort forward and build on the success achieved so far in further joint activities.

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Seminar on “Tax Subsidies”
hosted by the Chairman of EUROSAI

Bonn, 21-22 February 2006

- Workshop Results -

“Overview and Insight – On Subsidy Control for Tax Expenditures”

Dr. Michael Thöne, Public Finance Research Institute of the University of Cologne

At first, Michael Thöne stated that, by virtue of their audit findings, SAIs may be able to convince the Legislature to modify tax laws with respect to tax subsidies. However, he added that it was unrealistic to expect legislators to take the first step.

For benchmarking purposes (comparison with a tax system without any subsidies), a distinction would have to be drawn between tax privileges and subsidies. Based on a wide definition, Michael Thöne defined tax privileges as any deviation from such a tax system which leads to losses of tax revenue and aims at inciting change in the behaviour of the tax payer.

Michael Thöne went on to say that the effect of ‘sunset legislation’ was overestimated. He recommended a Subsidy Act along the lines of the Swiss model, provided that it would be generally known and therefore could not be amended without such modification being noted.

Subsequently, the participants discussed benchmarking. Especially, it was found necessary what objectives, e.g. efficiency, equity, ‘administrative convenience’, estimated tax revenue, the participants had in mind. Also, each country would have to set its own benchmark data (applicable tax system, structure of government etc.), since a multinational comparison of the benchmarks would not be possible otherwise.

An abolition of all exceptional provisions of tax law could, on the whole, lead to a significantly higher degree of equity in taxation. This was demonstrated by the example of New Zealand which abolished almost all tax privileges in the course of its tax and economic reform of the mid-1980s. The participants expressed the hope that the audit would at least lead to abolition of the oldest tax privileges.

“Subsidy report and effectiveness of tax subsidies”

Christian Valenduc, OECD

On the whole, Mr. Christain Valenduc expressed the opinion that reporting on tax subsidies was an important step towards transparency. Such reporting needed to be proactive and would have to be better integrated into the budget process. Economic experts could be called in to analyse effectiveness; however, the final decision about the advantages and disadvantages of any tax privilege had to be taken at the political level.

Subsequently, the participants raised the question, in connection with the analysis of effectiveness, as to what extent the analyses carried out could be verified by SAIs.

Another question was as to whether there already existed a common understanding about what constituted tax privileges in a given tax system. It was considered unlikely that a uniform concept of ‘subsidy’ could be developed by means of the coordinated audit. In fact, that was one of the most difficult definitions, the principle being: the broader the definition the better. Furthermore, the concept of ‘subsidy’ would have to be revised on a regular basis.

In this context, the discussion about benchmark was considered as being rather complex. The tax system on which the comparison was to be based should be designed in a way ensuring that the developing countries remained outside the benchmark. The participants considered questions of international competition as too far-reaching in this context. The reduced VAT rate was also to be left outside the scope of benchmarking, although it could be justified for basic goods. However, the participants concurred that the application of the reduced VAT rate to some products was no longer justifiable.

Nevertheless, the (subsidy) effects of international tax competition and the target achievement degree as to the redistribution of income aimed at by the reduced VAT rate would have to be evaluated independently of whether or not they were part of the benchmark.

A long-term objective could be to include tax subsidies identified in the annual budget process and to make them quantifiable. For this purpose, priorities could be set, i.e. particular tax privileges could be highlighted, e.g. those that had never been evaluated during the last ten years.

“Taxes as a policy instrument”

Jan H. Velthoven, Algemene Rekenkamer, Netherlands

In the 1990s, the Netherlands SAI conducted a nationwide audit on the theme of ‘Taxes as a policy-making tool’. The second follow-up audit was scheduled for 2007, while the first had already taken place in 2003.

‘For the audit, 28 ‘safe’ positive incentives with an aggregate volume of NLG 6.6 billion had been selected in 1998 and had been looked into under the aspects of preparation, implementation and outcome. Furthermore, the audit had ascertained the extent to which the successes of these measures were known at the ministerial level.

The Netherlands SAI had found a series of deficiencies in the extremely important preparatory stage. E.g., the reason for selecting the tool had often not been laid down in writing and had therefore not been transparent. Also, the impact to be achieved by the measure had often been described inadequately or in terms that were not measurable. Other aspects to be taken into account in the preparatory stage were:

- a concrete formulation of the objectives of the measure;
- estimating the cost of the measure including the cost of implementation and administration;
- a decision about whether the measure was to be time-limited or not and
- the verification of feasibility and compatibility with EU law.

Concerning the implementation of the individual measures, the Netherlands SAI had found that the impact on tax revenue, the costs of implementation and administration and the degree of compliance had been known by the Government to a limited extent only. Furthermore, often the ministries had only inadequate information about the results achieved by the measures, with the follow-up checks of negative tax measures being higher than those of positive tax measures.

The Netherlands SAI's recommendations had included the following demands:

- seeking a greater consensus in the definition of the terms 'positive/negative tax incentives';
- clearly describing the *ex ante* situation;
- formulating the objectives in a more measurable way;
- paying more attention to costs;
- determining the criteria for and timing of an evaluation at an early stage and
- enhancing the possibilities of programme effectiveness in order to decide about programme continuation.

On the whole, the audit of the SAI had been favourably received. Most ministries made efforts to implement the recommendations. In contrast, the Finance Ministry only intended to ensure better documentation in the preparatory phase, and, in all other respects, had responded rather critically to the SAI's report.

During the follow-up audit in 2003, the SAI found that the Finance Ministry had started to develop a checklist for tax-based tools in the fields of income tax, wage tax, VAT and excise taxes. Since 1999, it has been obligatory to state tax subsidies in an annex to the annual budget. Since 2001, the regulations on budget preparation have also applied to tax subsidies. Furthermore, greater attention has been paid to determine the losses of tax revenues as well as the effectiveness and results of the measures.

In the participants' opinion, the audit was especially successful in enhancing the transparency of tax subsidies in the Netherlands, in having induced the Ministry to start work on a checklist and thus helped to improve the Ministry's information base. Subsequently, they discussed questions surrounding the responsibility of the line ministries in the field of subsidies, set apart from the responsibilities of the Finance Ministry, and the standards of evaluations. They concurred that the only chance to exclude the imponderables were audits carried out by the SAI.

The question of including compliance costs was also discussed. Looking into compliance costs was considered as particularly difficult in the case of small and medium-sized enterprises, depending, however, on the specific regulation. Such costs were to be taken into account, although not as a central issue. Nevertheless, it was emphasised that this was not limited to costs of tax collection.

“Tax incentives in developing and emerging countries“

Dr. David Nguyen-Thanh, Deutsche Gesellschaft für Technische Zusammenarbeit (GTZ)

In Dr. Nguyen-Thanh’s opinion, a definition of the term ‘tax subsidy’ was also necessary in connection with developing and emerging countries. Above all, tax privileges were designed to make these countries attractive for foreign investors. The tax privileges were to promote development in particular regions and above all in the formal sector and to reduce unemployment.

Nevertheless, tax privileges were a controversial issue in developing and emerging countries. If tax privileges were adequately designed, they could be effective and create momentum for tax competition. On the other hand, there were negative consequences, e.g. losses in revenue (caused partly by ‘windfall profits’), unequal treatment and corruption. The decisions about granting tax privileges often lacked transparency. The resulting administrative costs should not be ignored, bearing in mind the usually scarce administrative capacity in these countries.

Meanwhile, it had turned out that good governance and a sound tax system were important factors for a successful reform process. Tax privileges alone that had often been granted by decree of the Ministry of Finance, were not the decisive factor for foreign investors. Most enterprises attached greater importance to non-tax factors e.g. the political environment, infrastructure, availability of skilled workers and the degree to which rule of law and the availability of legal remedies prevailed.

Other factors important for the future were compliance and the development of an external audit function. Greater transparency would open up vast possibilities for the SAIs. Guidance and recommendations of other SAIs and a benchmarking exercise with respect to the tax administration would be helpful.

Subsequently, the participants discussed the difficulties connected with granting of tax subsidies also in industrial countries. They stated that the Ministry of Finance was often organised better than units in other ministries that had to deal with subsidies. It was considered desirable that a single unit within the remit of the Finance Ministry should be set up to deal with subsidies.

Further Readings

REFERENCES FOR THE EUROSAI – PROJECT

This reference list does not cover the entire field of tax expenditures, but focuses on recent publications that are in close relationship with the EUROSAI-project. The list can therefore serve as a starting-point for the members of the Working Group. The comments of the Swiss Federal Audit Office are mainly based on abstracts, back covers or introductions of the related books or articles.

IMPROVING TRANSPARENCY ABOUT TAX SUBSIDIES

Bojje Robert: Should Tax Expenditures be integrated into the Budget Process? In: Economic Review, 2/2002 (14 pages).

The author of this article worked as advisor on fiscal policy for the Swedish Riksbank. When tax expenditures come into widespread use, there is a risk that the purpose to the Swedish expenditure ceiling would be undermined. A complete integration of tax expenditures into the budget process would remove the incentive to circumvent the expenditure ceiling by reducing taxes instead. The article explains the functioning and purpose of the Swedish governments tax expenditure reporting and discusses various application problems that are pivotal if it should be thought desirable in the long term to integrate the tax expenditures fully in the budget process. It is important that there exists a broad political consensus in the Riksdag on the interpretation of the uniformity principle, at least if the tax expenditures are to be fully integrated into the budget process. The inventory of problems also indicates that the present tax expenditure calculations are incomplete and flawed by some technical problems. Therefore, the author concludes that at present, it is not possible to fully integrate tax expenditures into the budget process. Despite this, the current tax expenditure report is important in that it provides rough estimates of the tax benefits in the tax system and therefore identifies proposals with the object to by-passing the expenditure ceiling.

http://www.riksbank.com/upload/Dokument_riksbank/Kat_publicerat/Artiklar_PV/er02_2_artikel4.pdf

Forman Jonathan Barry: Would a Social Security Tax Expenditure Budget Make Sense?, In: Public budgeting and financial management, 1993, vol. 5, n° 2 (14 pages).

IMF: Manual on Fiscal Transparency, In: IMF – Fiscal Affairs Department, Washington DC, 2001. <http://www.imf.org/external/np/fad/trans/manual/>

OECD: Best Practice Guidelines – Off Budget and Tax Expenditures, OECD, 19 May 2004 (19 pages).

The purpose of this paper is to formulate best practice guidelines to ensure that off-budget and tax expenditures do not impair the proper functioning of the budget. This paper proposes

particularly guidelines for the identification of tax expenditures, the budgetary control of tax expenditures and the estimation of tax expenditures.

[http://appli1.oecd.org/olis/2004doc.nsf/43bb6130e5e86e5fc12569fa005d004c/e0ecb0e1073e2677c1256e99003a75f2/\\$FILE/JT00164525.PDF](http://appli1.oecd.org/olis/2004doc.nsf/43bb6130e5e86e5fc12569fa005d004c/e0ecb0e1073e2677c1256e99003a75f2/$FILE/JT00164525.PDF)

OECD: Tax Expenditures. Recent Experiences, OECD, Paris, 1996 (118 pages).

This report provides a survey of tax expenditure reporting, highlighting a number of differences in practice and investigating the reasons for those differences. It provides a review of each country in a standard format: the background to and introduction of tax expenditure reporting, the structure of the report, the definition of tax expenditures, the method of calculation and the use of tax expenditure reports.

United States General Accounting Office (GAO): Tax Policy. Tax Expenditures Deserve More Scrutiny, GAO/GGD/AIMD-94-122 Tax Expenditures, June 1994 (135 pages).

GAO develops in this report three options to increase attention paid to tax expenditures and reduce their revenue losses. First, greater scrutiny could be achieved with little or no change in congressional processes and jurisdictions by strengthening or extending techniques currently used to control tax expenditures, ceilings and floors on eligibility, better highlighting of information, or setting a schedule for periodic review of some tax expenditures. The second option is for Congress to further integrate tax expenditures into the budget process. One feasible approach would be for Congress to decide whether savings in tax expenditures are desirable and, if so, to set in annual budget resolutions specific savings targets. Savings could be enforced through existing reconciliation processes. A third option is to integrate reviews of tax expenditures with functionally related outlay programs, which could make the government's overall funding effort more efficient. Such integrated reviews could be done by executive or legislative branches, or both.

<http://www.unclefed.com/GAORports/ggd94-122.pdf>

AUDITING, EVALUATING, AND/OR COMPARING SELECTED TAX SUBSIDIES

Datta Lois-Ellin & Grasso Patrick G.: Evaluating Tax Expenditures: Tools and Techniques for Assessing Outcomes: New Direction for Evaluation, n° 79, Jossey-Mass, September 1998 (150 pages).

Social justice and good governance both demand determination of whether tax expenditures are yielding the benefits anticipated in the original legislation, and if there are as good or better than policy alternatives in direct expenditures programs. The six case studies in this issue examine a variety of tax expenditures. Applying a range of evaluative, research and analytic techniques, the authors demonstrate how publicly available data and the familiar tools of evaluation can be successfully used to examine the effectiveness, results and impacts of tax expenditures.

Eade Deborah: Bad Breaks all Around: the Report of the Century Foundation Working Group on Tax Expenditures, Century Foundation Press, New York, 2002 (200 pages).

This volume offers the report of the Working Group and three background papers that informed the group's deliberation. Those papers offer analytical and factual insights about tax expenditures. Eric Toder's paper provides evidence on the growing importance of tax breaks as a policy tool in the US and discusses the problems this raises as well as circumstances under which the tax code may be a useful vehicle for providing benefits. Bernard Wasow's paper suggests that it is very hard to demonstrate, with evidence or with theory, that tax breaks have the desirable effects on behaviour that advocates take for granted. The third is the thorough review of tax breaks by Michael Ettlinger. He provides detailed information on the myriad tax breaks in the US to businesses and households as well as careful assessments of the beneficiaries of tax breaks.

Howard Christopher: The Hidden Welfare State. Tax Expenditures and Social Policy in the United States, Princeton University Press, Princeton, 1997 (272 pages).

This book focuses four selected tax expenditures with social welfare objectives in the US: deductions for home mortgage interest rate, employer-provided retirement pensions, the Earned Income Tax Credit, and the Targeted Jobs Tax Credit. In particular, the study analyzes the longterm development of these social programs that are administered through the tax code. The approach of the book is decidedly historical, as the author considers history as helpful in analyzing tax expenditures because evidence for any single year or interesting episode is often only spotty. Tax expenditures turn out to be easily enacted and to grow in times of escalating budget deficits and heightened criticism of traditional welfare programs. They are difficult to be politically influenced in relation to size and benefit distribution.

Netherlands Court of Audit: Taxes as a policy instrument (summary published March 18th, 1999, 5 pages).

The Netherlands Court of Audit drew up an inventory of fiscal incentives or disincentives that were introduced or amended between 1988 and 1998. It selected 28 fiscal incentives and looked at the preparation, implementation and results of policy. In the 1999 Budget Memorandum it was estimated that these 28 schemes represented a loss of tax and contributions of approximately NLG 6.6 billion in 1998. In the case of 6 clusters of fiscal disincentives the Netherlands Court of Audit performed an audit on ministerial awareness of policy results.

http://www.rekenkamer.nl/9282000/d/q179_summary.pdf

Polackova Brix Hana, Valenduc Christian M.A. & Li Swift Zhicheng: Tax Expenditures – Shedding Light on Government Spending through the Tax System. Lessons from Developed and Transition Economies, The International Bank for Reconstruction and Development, Washington, 2004 (233 pages).

This book discusses conceptual and methodological issues relating to tax expenditures, provides a framework for evaluating them, offers case studies on government treatment of tax expenditures from developed and transition economies, and outlines generally applicable policy frameworks. It also provides individual chapters with case studies of the treatment of tax expenditures in Australia, Belgium, Canada, China, the Netherlands, Poland, and the United States. Each chapter presents how the nation defines tax expenditures and the corresponding benchmark tax system. Some chapters also examine specific topics, such as methods for estimating and evaluating tax expenditures for policy analysis, how this analysis can contribute to policy debate, and how to budget for the cost of tax expenditures. The experience of two transition economies, Poland and China, illustrate the consequences of implementing tax expenditure policies without an adequate institutional and analytical framework.

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This paper provides a theory for deciding when a spending program should be implemented through the tax system. The decision is traditionally thought to be based on considerations of tax policy. The most common theories are the comprehensive tax base theory and the tax expenditures theory, both of which rely on tax policy to make the determination. The authors argue instead that the decision between tax and spending programs should be based solely on consideration of organizational design. After developing this theory, the paper analyses whether food stamps and the Earned Income Tax Credit should be implemented through the tax system or not, an important paper for everyone who wants to compare tax expenditures with other instruments of public policy.

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- **International Tax Dialogue**

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- **Tax Expenditure**

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