APPENDIX G

ESTIMATES OF TAX EXPENDITURE

Tax expenditure is normally defined as that part of the tax revenue forgone by government due to provisions in tax legislations which allow for, *inter-alia*, special exclusion, exemption or deduction or which provide for a special credit, a preferential rate or a deferral of liability.

As its name suggests, tax expenditure can be construed as a type of government financial assistance to certain groups or businesses which does not go through the normal appropriation process, but which is provided through the tax system. The impact on public finance is similar to a subsidy, but it is less transparent and not subject to the same level of public scrutiny as public spending. That is why an increasing number of countries have introduced tax expenditure accounting and reporting and subject tax expenditures to normal budgetary controls.

In this Appendix, a first attempt has been made to estimate the tax expenditures in respect of five major taxes from which government derives bulk of its revenues. These are personal income tax, corporate income tax, value added tax, customs duty and excise duty.

Methodology of Estimation

Tax expenditures are deviations or exceptions from what is accepted as normal tax provisions. The first step in their quantification is to define and establish benchmarks, against which those provisions can be compared and the cost implications measured.

A normal tax mainly includes the following features:

- <u>a base</u> on which that tax is levied such as income or consumption;
- <u>an entity</u> which, by definition, include any person, company, trust or société;
- a <u>normal tax rate</u>, that is applied to the tax base; and
- the <u>procedures</u> for the <u>administration</u> of the tax

The methodology used for estimating tax expenditures for each tax type has been summarized below. In each case, an attempt has been made to adapt the methodology to the type of information available. Static method, which allows only for changes in the tax provisions, has been used. Therefore, revenue loss arising from any specific tax expenditure is not likely to equal the gain in revenue from removal of the tax expenditure, as behavioral changes have not been taken into account.

Tax Expenditure under Personal Income Tax (PIT)

In the case of PIT the normal tax base includes basic personal deduction, deductions in respect of dependents i.e., spouse, children and handicapped persons as well as deductions for alimony and maintenance. On the other hand, transport allowances i.e., refund of bus fare or mileage received by virtue of terms and conditions of service, have been excluded due to unavailability of information in respect of private sector employees. According to the IMF, these are considered as deviations from the normal benchmark and are part of tax expenditure.

The estimates for 2005/06 and 2006/07 are based on information obtained from tax returns filled by liable taxpayers only. Tax expenditures for non-liable cases cannot be estimated, as those who do not have any tax liability are not required to file tax returns. Likewise, certain tax expenditures arising, for instance, from exempt income have not been included in the estimates. This is due to either unavailability of data or their marginal impact on cost of tax expenditure.

While estimating the tax expenditure under PIT, the period taken is the year of assessment i.e., the year in which returns are made. For instance, tax expenditures for 2005/2006 are in respect of income derived during 2004/2005. A 20 per cent rate has been used for calculating the tax expenditure. This is the average of the two rates that were applicable during the period.

As a percentage of GDP, tax expenditure under PIT is expected to reach nearly zero per cent of GDP in assessment year 2007-2008 from around 0.7 per cent of GDP in 2006-2007, for items in respect of which information is available. This sharp decline is attributable to the reform of the PIT system implemented as from 2006-2007. However, certain items of tax expenditure still exist under PIT i.e., those allowed under items 16 to 21 in Table 1A. Quantification of their cost is not possible due to unavailability of data.

Tax Expenditure under Corporate Income Tax (CIT)

The tax base under CIT normally relates to profits derived by a company or a body corporate after allowing for expenses incurred in the production of income. The Income Tax Act, *inter-alia*, provides for various exemptions, allowances, deductions and tax credits. These exceptions erode the tax base and constitute the main element of tax expenditure under CIT.

The estimates provided in Table 1B have been worked out from returns of liable taxpayers only. They, however, exclude liable taxpayers who after allowing for exceptions become non liable. In addition, differential in the tax rates under CIT has been excluded as a uniform flat rate of 15 per cent will be applicable as from next year.

The decline in the cost of tax expenditure under CIT in 2007-2008 is mainly attributable to the reform of the income tax regime implemented as from 2006-2007.

Tax Expenditure under Value Added Tax (VAT)

VAT is chargeable on all taxable supplies of goods and services made by a taxable person. Under VAT, tax expenditure is the revenue foregone due to exemption and zero-rating of certain goods and services as well as exemption from payment of the tax by certain bodies or persons. The tax base for VAT also includes customs duty and excise duty payable. The VAT component foregone from any exemption given under the Customs Tariff Act or Excise Act therefore constitutes tax expenditure.

Zero-rating of exports is not considered as tax expenditure since VAT applicable in Mauritius is on a destination based principle. Exemption of businesses with turnover below the exemption threshold is a component of the baseline tax and, therefore not considered as tax expenditure.

Normally input-output table is used to estimate tax expenditure under VAT. However, due to unavailability of data, VAT expenditure has been estimated on an aggregate basis using information obtained from returns submitted by VAT registered persons, including those selling both zero-rated goods and exempt goods as well as taxable goods. Traders who sell exempt goods only are not registered with MRA and therefore do not submit returns. To that extent the estimates provided in Table 1C are lower bound estimates.

Tax Expenditure under Customs Duty (CD)

In case of customs duty, different rates form part of the normal tax structure depending on the type of product category and these are provided in the schedule to the Customs Tariff Act. Tax expenditure in respect of CD is revenue foregone from exemptions or remissions provided to importers. This can be taken as the difference between the customs duty payable and the amount actually paid in case of past period. It is calculated as follows:

In case of ad valorem rates

Revenue forgone = (c.i.f value of imports x the tariff rate applicable) – customs duty paid

In case of specific rates

Revenue forgone = (volume of imports x the tariff rate applicable) – customs duty paid

The data used for the computation of tax expenditure under CD has been obtained from bills of entry processed by the MRA (Customs). From the data available a fair estimate of tax expenditure arising from CD in respect of such imports could be calculated. However, tax expenditures arising from i.e., duty free allowance given to incoming passengers and goods imported by post or courier services up to Rs 1,000 cif value of imports have not been included as data is not captured under the present system. Furthermore, no adjustment also has been made in 2005-2006 and 2006-2007 estimates for reimbursement of the part of the duty exemptions allowed to importers. Exemptions arising from imports originating from regional trade agreements i.e., SADC, COMESA and COI, are not considered as tax expenditures and have thus been excluded from the estimates.

As indicated in Table 1D, tax expenditure under CD, which was around 0.7 per cent of GDP in 2005-2006, is expected to decline to 0.2 per cent of GDP in 2006-2007. This is mainly attributable to the lowering of the top rate from 65 per cent to 30 per cent and to the reduction in the number of non-zero tariff bands from seven to three. In 2007-2008, the ratio is expected to remain around the same level.

Tax Expenditure under Excise Duty (ED)

As in the case of customs duty, under excise duty also different rates form part of the normal tax structure depending on the type of product. These are provided in the schedule to the Excise Act. Excise duty is applicable to both imported and locally manufactured goods, which include motor vehicles, petroleum products, cigarettes, alcoholic beverages and plastic products. Tax expenditure under ED is normally calculated as follows:

In case of ad valorem rates

Revenue forgone = (c.i.f value of imports/value of locally manufactured goods x the tariff rate applicable) – excise duty paid

In case of specific rates

Revenue forgone = (volume x the tariff rate applicable) – excise duty paid

The estimates of tax expenditure under ED have been worked out using data obtained from bills of entry/returns processed by the MRA (Customs). The tax expenditure under excise duty is mainly in respect of various concessions and exemption granted on motor vehicles to taxi-drivers, civil servants/advisors, benevolent/religious associations, embassy etc. The fall in tax expenditure on motor vehicles in 2006-2007 compared to 2005-2006 is attributable the lowering of the excise rate on motorcars in June 2006.

Tax expenditure on petroleum products in 2006-2007 is due to exemption granted on gas oil to manufacturing enterprises. The high level of tax expenditure in 2005-2006 is mainly explained by exemption granted on both fuel oil and gas oil. However, in September 2005, excise duty on fuel oil was abolished.

On the other hand, tax expenditure on alcoholic beverages and tobacco products is basically the result of exemptions granted to foreign embassies. However, tax expenditures arising from duty concession to incoming passengers (i.e., 1 litre of spirit, 2 litres of wine and 250 grams of tobacco products) not been included due to unavailability of data.

APPENDIX G - *continued*

Table 1

SUMMARY OF ESTIMATES OF TAX EXPENDITURE BY TAX TYPE
(AS A PERCENTAGE OF GDP)

		2005-06	2006-07	2007-08
A	Personal Income Tax	0.71%	0.65%	--
B	Corporate Income Tax	0.91%	1.42%	0.61%
C	Value Added Tax	0.66%	0.67%	0.67%
D	Customs Duty	0.75%	0.20%	0.19%
E	Excise Duty	0.44%	0.17%	0.16%
	TOTAL	**3.46%**	**3.10%**	**1.64%**

Table 1A

A. PERSONAL INCOME TAX

	Assessment Year	2005-06	2006-07	2007-08
1	Emoluments Relief	0.31%	0.28%	--
2	Retirement Pension Relief	0.02%	0.01%	--
3	Relief for Pension Contribution	0.03%	0.02%	--
4	Deduction for Contribution to NSF	0.00%	0.00%	--
5	Relief for Life Insurance Premium	0.11%	0.10%	--
6	Relief for Premium on Personal Pension Scheme	0.02%	0.02%	--
7	Relief for Premium on Retirement Annuity	0.00%	0.00%	--
8	Relief for Contribution to Medical Scheme	0.01%	0.01%	--
9	Savings Relief	0.04%	0.04%	--
10	Deductions for Medical Expenses	0.01%	0.01%	--
11	Deduction for Expenditure on Education & Training for Self	0.01%	0.01%	--
12	Donations to charitable institutions	0.01%	0.01%	--
13	Interest Relief	0.13%	0.12%	--
14	Investment Relief	0.01%	0.01%	--
15	Agricultural Income Relief	0.00%	0.00%	--
16	Emoluments Derived by President and Vice President	n.a	n.a	n.a
17	Rent Allowance Payable to Public Officers under Income Tax Act	n.a	n.a	n.a
18	Housing Allowance Not Exceeding Rs 100 per Month	n.a	n.a	n.a
19	Passage Benefits Not Exceeding 6 per cent of Basic Salary	n.a	n.a	n.a
20	First Rs 1 Million of Lump Sum	n.a	n.a	n.a
21	Advantage in Money or Money Worth Received as Lump Sum Under Voluntary Retirement Schemes	n.a	n.a	n.a
	TOTAL	**0.71%**	**0.65%**	**--**

Table 1B

B. CORPORATE INCOME TAX

	Assessment Year	2005-06	2006-07	2007-08
1	Exempt Income	0.18%	0.54%	0.35%
2	Annual Allowance	n.a	0.12%	0.12%
3	Investment Allowance	0.12%	0.10%	0.04%
4	Overseas, Marketing and Promotional Expenses	0.03%	0.06%	0.06%
5	Authorised Deductions	0.45%	0.56%	--
6	Investment Tax Credit	0.00%	0.00%	--
7	Tax Credit for Modernisation and Expansion Enterprises	0.01%	0.00%	0.00%
8	Tax Credit for Export	0.00%	0.00%	0.00%
9	Special Tax Credit	0.11%	0.03%	0.04%
	TOTAL	**0.91%**	**1.42%**	**0.61%**

Note: Figures for global businesses are not available.

APPENDIX G - *continued*

Table 1C

C. VALUE ADDED TAX

	Financial Year	2005-06	2006-07	2007-08
	INCREASE IN THE VAT BASE	4.84%	5.66%	5.69%
1	Goods and Services Supplied on the Local Market	4.60%	5.53%	5.57%
	Zero-Rated	3.07%	3.82%	3.85%
	Exempt	1.53%	1.71%	1.72%
2	Taxable Supplies Sold to Exempt Bodies	0.05%	0.07%	0.07%
3	Exemption under the Customs Tariff Act and Excise Act	0.18%	0.05%	0.05%
	Less REDUCTION IN THE VAT BASE	4.18%	4.99%	5.02%
4	Zero-Rated Inputs (both local and imported)	2.07%	2.81%	2.82%
5	Exempt Inputs (both local and imported)	1.49%	1.54%	1.55%
6	Taxable Input on which No Input Tax is Allowed as Credit	0.61%	0.65%	0.65%
	TOTAL	**0.66%**	**0.67%**	**0.67%**

Table 1D

D. CUSTOMS DUTY

	Financial Year	2005-06	2006-07	2007-08
1	Foodstuffs and Agricultural Produce	0.22%	0.12%	0.12%
	Sugar	0.18%	0.09%	0.08%
	Preparations of Vegetable, Fruits and other Edible Preparations	0.03%	0.03%	0.03%
	Others	0.01%	0.00%	0.00%
2	Plastics	0.09%	0.00%	0.00%
3	Paper and Paperboards	0.02%	0.01%	0.01%
4	Articles of Apparel and Clothing	0.03%	0.01%	0.01%
5	Base Metal and Article thereof	0.15%	0.01%	0.01%
6	Mechanical, Electrical Appliances and Other Appliances	0.15%	0.02%	0.02%
7	Motor Vehicles	0.01%	0.00%	0.01%
8	Furniture and Part thereof	0.02%	0.01%	0.01%
9	Others	0.06%	0.01%	0.01%
	TOTAL	**0.75%**	**0.20%**	**0.19%**

Note: Excludes exemptions granted under SADC,COMESA and COI

Table 1E

E. EXCISE DUTY

	Financial Year	2005-06	2006-07	2007-08
1	Alcoholic Beverages	0.00%	0.00%	0.00%
2	Tobacco	0.00%	0.00%	0.00%
3	Petroleum Products	0.04%	0.00%	0.00%
4	Motor Vehicles	0.39%	0.16%	0.16%
	TOTAL	**0.44%**	**0.17%**	**0.16%**

Note: Tax expenditure in respect of tobacco is less than Rs 1 million.
n.a - not available