

3 Tax expenditures in Latin America and the Caribbean

Principal findings

Tax expenditures are an important policy tool that can promote economic and social development. The use of preferential tax treatments to pursue economic and social objectives is well established in Latin America and the Caribbean (LAC). Countries use tax expenditures to promote investment (especially in strategic sectors), create employment and support low-income households. However, tax expenditures may not always be the most efficient policy tool for achieving policy objectives, and the foregone revenues associated with these measures can be large.

More can be done to identify and measure tax expenditures through the definition of consistent benchmarks. There is significant variation across LAC countries in terms of what constitutes tax expenditures and the methodologies employed to estimate their size. These differences make it difficult to compare the magnitude and composition of tax expenditures across and within countries over time. Caution is also warranted in the analysis of potential revenue gains from eliminating certain tax expenditures, as these estimates may not capture the dynamic interactions between different preferential treatments.

Foregone revenues from tax expenditures are significant. In 2021, foregone revenues in Latin America averaged 3.7% of GDP, equivalent to 19% of general government tax revenues. They are also large relative to public expenditures in priority sectors such as social spending and public investment. Preferential treatments for value-added tax (VAT), largely directed towards the consumption of foods and other items in the basic consumption basket, are generally the most important in terms of size. Tax expenditures related to income taxes vary in the region, with a high relative share for corporate income tax (CIT) in some countries and for personal income tax (PIT) in others.

Evaluating the effectiveness of tax expenditures is key to realising their potential contribution to development. Given the magnitude of foregone revenues due to tax expenditures in the region, it is crucial to evaluate their costs and benefits. However, the evaluation of tax expenditures is in its infancy in the LAC region, with few comprehensive studies undertaken so far.

To enhance the developmental impact of tax expenditures in the LAC region, a thorough review of preferential tax treatments should be complemented by an institutional framework that ensures good governance and creates binding legal requirements for the quantification and evaluation of tax expenditures. The use of tax expenditures should be consistent with broad tax policy priorities and aligned to the Sustainable Development Goals (SDGs).

Tax expenditures can promote economic and social development

The tax system serves as the primary tool by which governments collect funds to finance public spending and investment. It also makes an important contribution to the broad objectives of fiscal policy, such as reducing inequality through income redistribution, supporting vulnerable populations, bolstering economic growth and job creation, boosting private investment, attracting foreign capital, supporting specific economic sectors and regions, and promoting or disincentivising the production or consumption of certain goods and services. Instead of spending public funds to meet these goals, the government may forego revenues through preferential tax treatments, commonly referred to as tax expenditures.

There are a variety of conceptual definitions of tax expenditure. The OECD (2004^[1]) refers to tax expenditure as a transfer of public resources by the reduction of tax obligations with respect to a frame of reference or benchmark, rather than by direct public expenditure. The Inter-American Center of Tax Administrations defines tax expenditures as resources forgone by the State due to the existence of incentives or benefits that reduce the direct or indirect tax burden of certain taxpayers in relation to a reference tax system, to achieve certain economic and social policy objectives (CIAT, 2011^[2]).

Tax expenditures come in various forms, such as exemptions, deductions, credits, reduced rates, tax deferrals and accelerated depreciation systems. This variety provides policy makers with flexibility in designing policies involving tax expenditures (Table 3.1). The impact of these instruments differs, including in terms of the revenues foregone and changes in the behaviour of beneficiaries.

Table 3.1. Typology of tax expenditures

Type of tax expenditure	Description	Examples
Exemptions	Amounts that are excluded from the value upon which a tax is calculated (the tax base)	Exemption for educational services (VAT); exemption for income received by civil associations, cooperatives or non-profit entities (CIT)
Deduction	Amounts that can be reduced or deducted from the tax base	Deduction of certain expenses and charitable donations from the PIT or CIT base
Credit	Amounts that are deducted from the payment of taxes or make it possible to reduce them	CIT credit for investment in capital goods
Reduced rates	Lower rate applicable to certain taxable transactions or taxpayers	Zero-rating of products included in the basic shopping basket (VAT)
Deferrals	Postponement of tax payment	Accelerated depreciation for fixed capital investments (CIT)
Administrative facilities	Exceptions to the fulfilment of formal obligations that impact the calculation of the tax base	Deduction from the total income for expenses with receipts that do not meet tax requirements

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of DIPRES (2012^[3]) and SHCP (2021^[4]).

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LAC countries employ a variety of definitions and methodologies to quantify foregone revenues due to tax expenditures

There are three main approaches to measuring tax expenditures: revenue forgone, revenue gain and outlay equivalent. The revenue forgone approach calculates the revenue loss from a preferential treatment through a partial equilibrium analysis assuming no change in taxpayer behaviour. The revenue gain method estimates the increased revenue that would result from eliminating the preferential treatment and considers the impact on beneficiary behaviour. Finally, the outlay equivalent approach measures the cost of providing the same financial benefit offered by the tax treatment through direct expenditure; that is, the


direct spending needed to provide an equivalent net tax benefit to those who receive the preferential treatment being evaluated (Villela, Lemgruber and Jorrat, 2009^[5]).

Most countries in the LAC region consider tax expenditures as revenue not received or not collected (Table 3.2). However, some countries define them differently: Brazil refers to them as indirect government expenditures, Nicaragua calls them transfers from the state, and Uruguay defines them as lost revenue (Campos Vázquez, 2022^[6]).

Table 3.2. Definitions and methodologies employed in the LAC region to quantify tax expenditures

Type of information	Classification	Countries
Definition of tax expenditures	Revenue not collected	Argentina, Bolivia (Plurinational State of), Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Paraguay and Peru
	Others	Brazil (indirect government expenditures), Nicaragua (transfers from the State) and Uruguay (revenue loss)
Measurement approach of tax expenditures	Revenue forgone without changes in taxpayers' behaviour	Argentina, Brazil, Bolivia (Plurinational State of), Chile, Colombia, Costa Rica, Dominican Republic, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Paraguay, Peru and Uruguay
Frame of reference	Legal	Argentina, Bolivia (Plurinational State of), Brazil, Colombia, Costa Rica, Ecuador, El Salvador Guatemala, Honduras, Nicaragua, Peru and Uruguay
	Conceptual	Dominican Republic, Mexico and Paraguay
	Legal and conceptual	Chile

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Campos Vázquez (2022^[6]).

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Although it is more common for LAC countries to measure tax expenditures as revenue not collected, it is important to acknowledge that the estimates of tax expenditures presented by each country do not necessarily align with the revenue that would be generated if a particular preferential treatment were abolished. The ultimate impact would be contingent on how economic agents respond to the tax changes. Because these estimations are made independently, the total of their results would not necessarily match the hypothetical forgone amount, as eliminating each treatment separately is not equal to eliminating them all at once.

In general, the frame of reference used to identify and measure tax expenditures can be based on either a legal or a theoretical conceptual framework. The legal framework uses the structure established by tax law as a reference, so deviations from the general provisions of tax legislation are considered tax expenditures. The theoretical framework uses a broad tax base, calculated according to a theoretical concept of income, consumption or value-added, as a reference, and any deviation from this base results in forgone revenue. A third, less common, approach is the analogous subsidy approach, whereby tax benefits that are similar to direct subsidies are regarded as tax expenditures.

Landscape of tax expenditures in the LAC region

There is significant variation across countries in the LAC region in terms of what constitutes tax expenditures and the methodologies employed to estimate their size. These differences make it difficult to compare tax expenditures across and within countries over time. Additionally, estimates of individual tax expenditures are not additive; all countries in the LAC region employ the revenue-forgone approach, which estimates each tax expenditure in isolation and does not capture dynamic effects on the behaviour of economic actors or the interaction with other preferential treatments. As such, caution is warranted in the analysis of the potential revenue gains from eliminating certain tax expenditures. These limitations

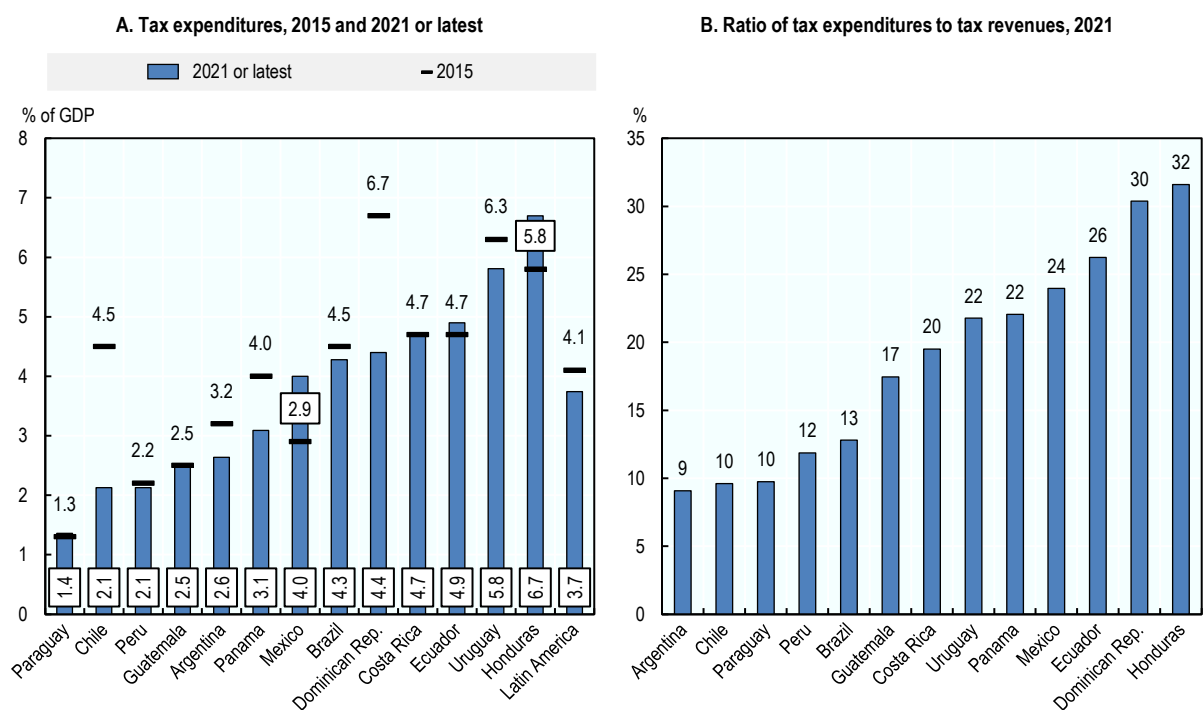
notwithstanding, this section reviews tax expenditures in the region to provide an illustrative analysis of their magnitude and composition.

Revenue losses due to tax expenditures are significant in the LAC region, although there is heterogeneity between countries. In 2021, foregone revenues in Latin America averaged 3.7% of GDP, equivalent to 19% of general government tax revenues (Figure 3.1). While this represents a modest decline with respect to 2015, most of the shift in the regional average is due to large contractions resulting from methodological changes in the estimation of tax expenditures, principally in Chile.¹ At the country level, revenues lost to tax expenditures range from 1.4% of GDP in Paraguay to 6.7% of GDP in Honduras. These results have remained relatively stable between 2015 and 2021.

Another key metric for the importance of tax expenditures is to compare them with overall tax revenues. The ratio of tax expenditures to tax revenues is particularly high in countries with a low tax take, irrespective of the level of tax expenditures. In the Dominican Republic, tax expenditures were equivalent to 30% of general government tax revenues while in Brazil they represented 13% of the total, despite having a similar level of tax expenditures as a percentage of GDP.

Figure 3.1. Latin America (selected countries): tax expenditures and ratio of tax expenditures to general government tax revenues, 2021 or latest

Percentage of GDP and percentages



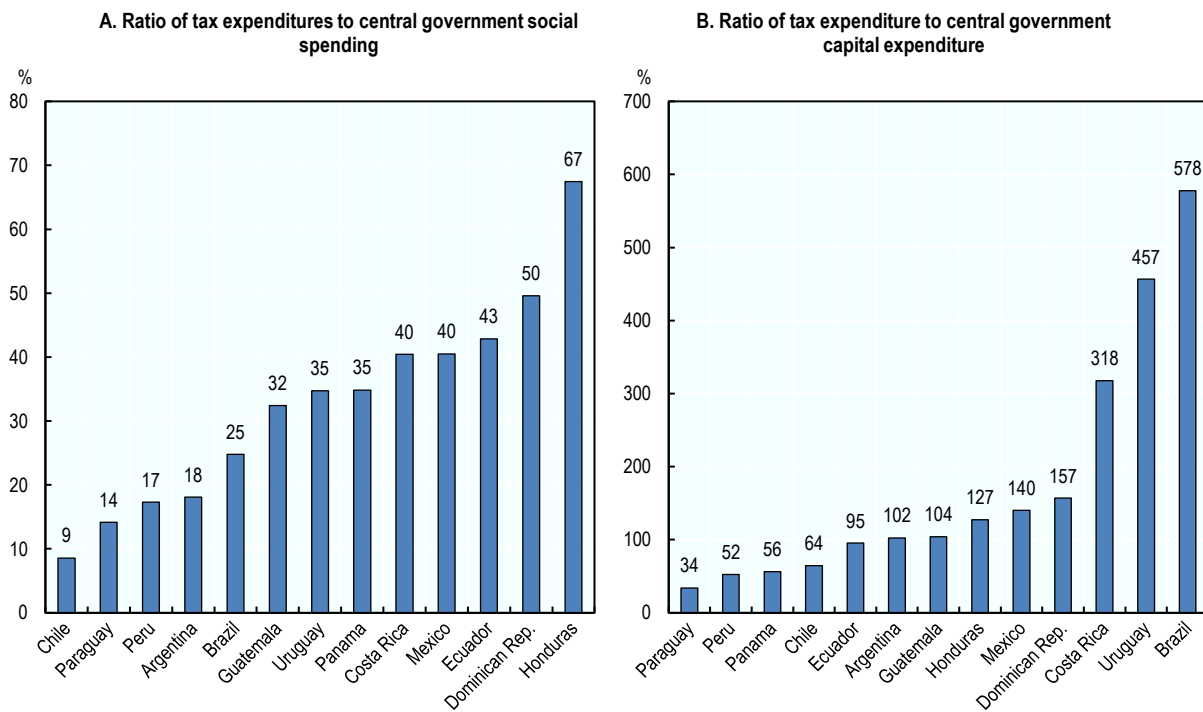
Note: Ratios of tax expenditures to tax revenues have been updated to reflect the data presented in this edition of *Revenue Statistics in Latin America and the Caribbean*. Data corresponds to reports for the specified years by country: Argentina (2021), Brazil (2021), Chile (2021), Costa Rica (2019), Dominican Rep. (2021), Ecuador (2020), Guatemala (2021), Honduras (2021), Mexico (2021), Panama (2019), Paraguay (2019), Peru (2021), Uruguay (2020).

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Campos Vázquez (2022^[6]) and OECD et al. (2023^[7]).

Given that tax expenditures can be conceived of as public spending through the tax system, it is also relevant to compare their magnitude with public outlays in priority public policy areas (Figure 3.2). Social spending in Latin America is low relative to the OECD, despite an increase during the 2008-2009 global financial crisis and more recently in 2020 as a result of the COVID-19 pandemic. The pandemic laid bare the low level of social spending, with the region's health and social protection systems unable to respond to pressing needs. Against this backdrop, tax expenditures relative to central government social spending are significant, averaging 33% in Latin America, with some countries registering much higher ratios. Likewise, capital expenditure in the region has suffered during the last decade, emerging as the principal variable of fiscal adjustment. The ratio of tax expenditures to central government capital expenditure exceeds 100% in many countries, reaching a high of 578% in Brazil.


Figure 3.2. Latin America (selected countries): ratios of tax expenditures to central government social spending and capital expenditure, 2021 or latest

Percentages



Note: Ratios were calculated using the observed spending for each component in the year that aligns with the year of the tax expenditure estimate. Data corresponds to reports for the specified years by country: Argentina (2021), Brazil (2021), Chile (2021), Costa Rica (2019), Dominican Rep. (2021), Ecuador (2020), Guatemala (2021), Honduras (2021), Mexico (2021), Panama (2019), Paraguay (2019), Peru (2021), Uruguay (2020).

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Campos Vázquez (2022^[6]) and data from CEPALstat.

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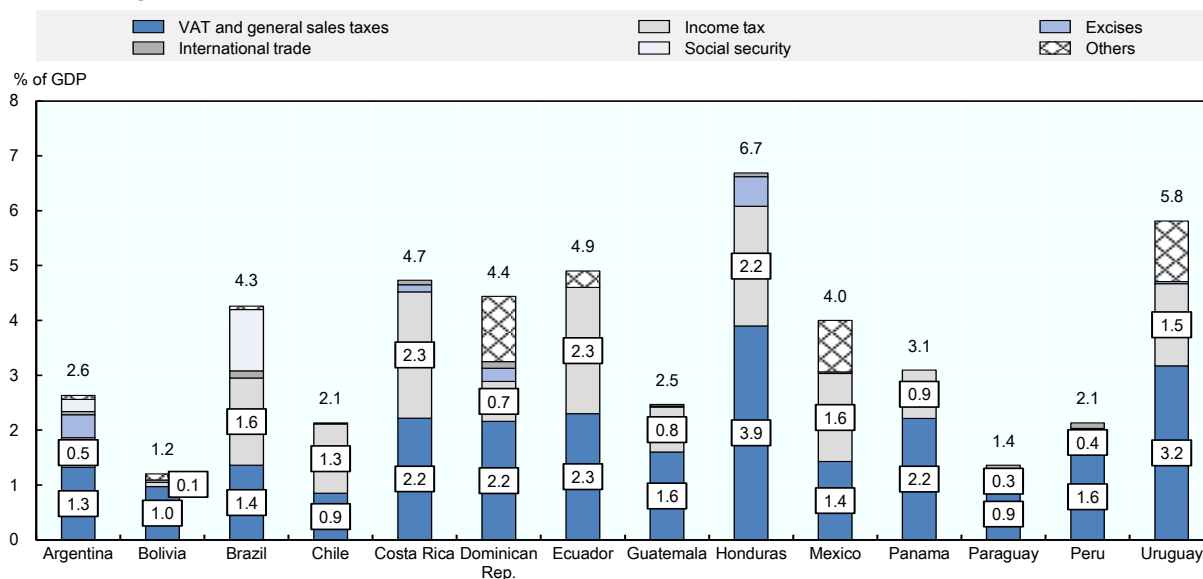
In terms of composition, tax expenditures in the region are highly concentrated in preferential treatments for VAT and income taxes (Figure 3.3). On average, VAT benefits represented 55% of total tax expenditures in 2021, with income taxes accounting for a further 31%. In the case of VAT, a key source of tax revenues in the region, forgone revenues were above 2% of GDP in five countries – Ecuador, Uruguay,

Costa Rica, Honduras and Panama – and exceeded 1% of GDP in another seven countries. In the case of income taxes, the cost of these treatments is above 2% of GDP in only three countries: Costa Rica, Ecuador and Honduras. There are also significant differences in the relative weight of tax expenditures for different tax instruments. In Bolivia, Guatemala, Nicaragua, Panama, Paraguay and Peru, VAT-related measures represent more than 60% of overall tax expenditures. In contrast, tax expenditures related to income tax are the most prominent in Brazil, Chile, Costa Rica, Ecuador and Mexico.

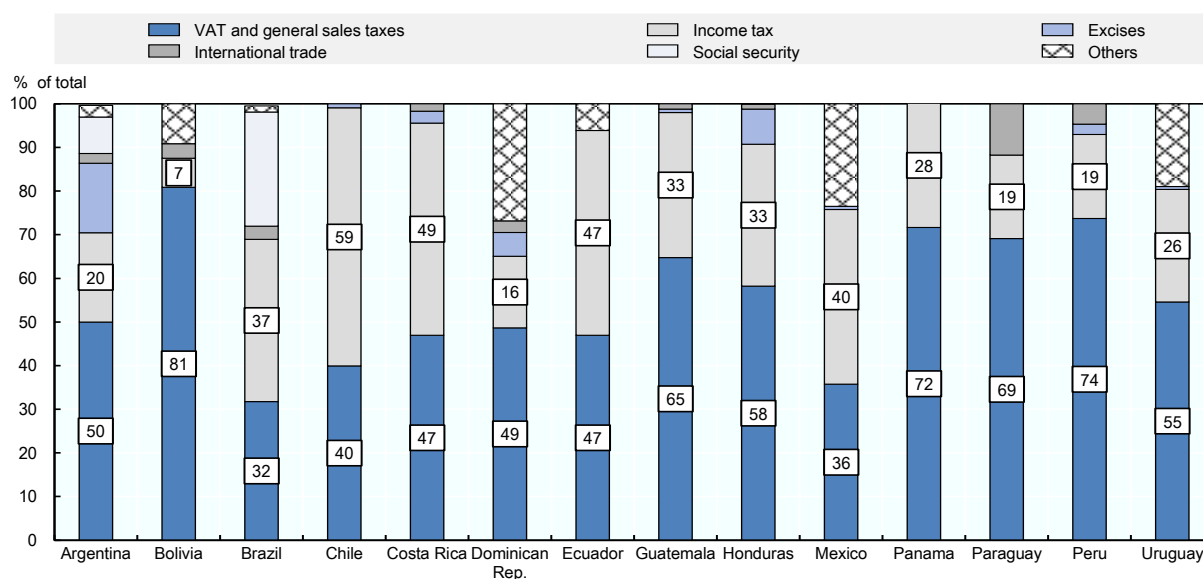
Figure 3.3. Latin America (selected countries): structure of tax expenditure, by tax instrument, 2021 or latest

Percentage of GDP and percentages of total

A. Percentage of GDP




B. Percentage of total



Note: Data corresponds to reports for the specified years by country: Argentina (2021), Bolivia (2016), Brazil (2021), Chile (2021), Costa Rica (2019), Dominican Rep. (2021), Ecuador (2020), Guatemala (2021), Honduras (2021), Mexico (2021), Panama (2019), Paraguay (2019), Peru (2021) and Uruguay (2020).

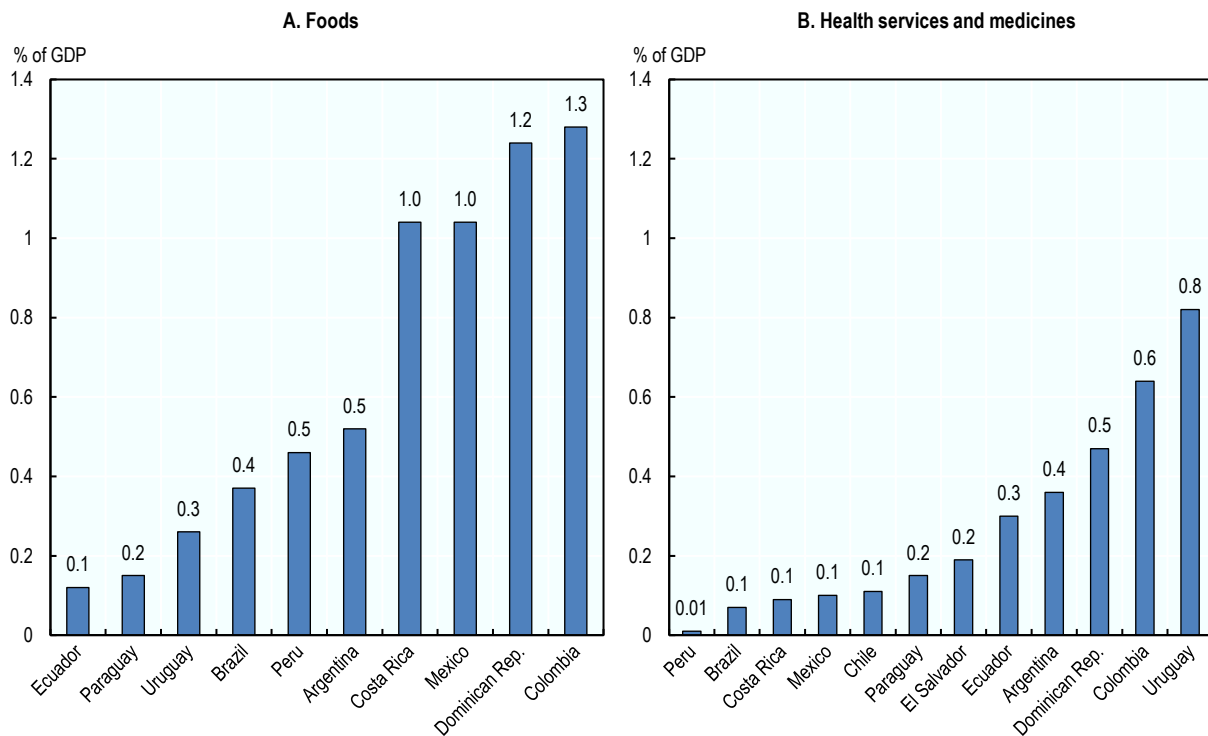
Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Campos Vázquez (2022[6]).

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VAT expenditures in the region cover a range of goods and services. One of the principal preferential tax treatments for VAT is related to purchases of food or other items in the basic consumption basket, often with the aim of supporting low-income households. These foregone revenues can be substantial, equivalent to 1% of GDP or more in some cases (Figure 3.4).

Figure 3.4. Latin America: VAT tax expenditure for foods and health services and medicines, 2021 or latest

Percentages of GDP



Note: Data corresponds to reports for the specified years by country: Argentina (2021), Brazil (2021), Chile (2021), Colombia (2018), Costa Rica (2019), Dominican Rep. (2021), Ecuador (2020), El Salvador (2016), Mexico (2021), Paraguay (2019), Peru (2021), Uruguay (2020).

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Campos Vázquez (2022^[6]).

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Beyond the magnitude of these tax expenditures, they also vary considerably in terms of design. In Costa Rica, a reduced rate is applied to the basic consumption basket, which is based on the principal goods purchased by the 30% of the population with the lowest incomes, according to data collected by the National Institute of Statistics and Census (INEC). In Mexico, purchases of foods are zero-rated. In contrast, foods are exempt from VAT in the Dominican Republic.

An important consideration for VAT expenditures for food, especially in an inflationary context, is that the benefits do not accrue equally across society. In Mexico, an estimated 27% of the total revenue foregone through the tax expenditure from the zero rate for purchases of food accrues to the top income quintile, compared with 13% for the lowest quintile (SHCP, 2022^[8]).

Preferential VAT treatments are also commonly applied to the consumption of health services and medicines. These measures can be seen as providing relief to households for the high levels of

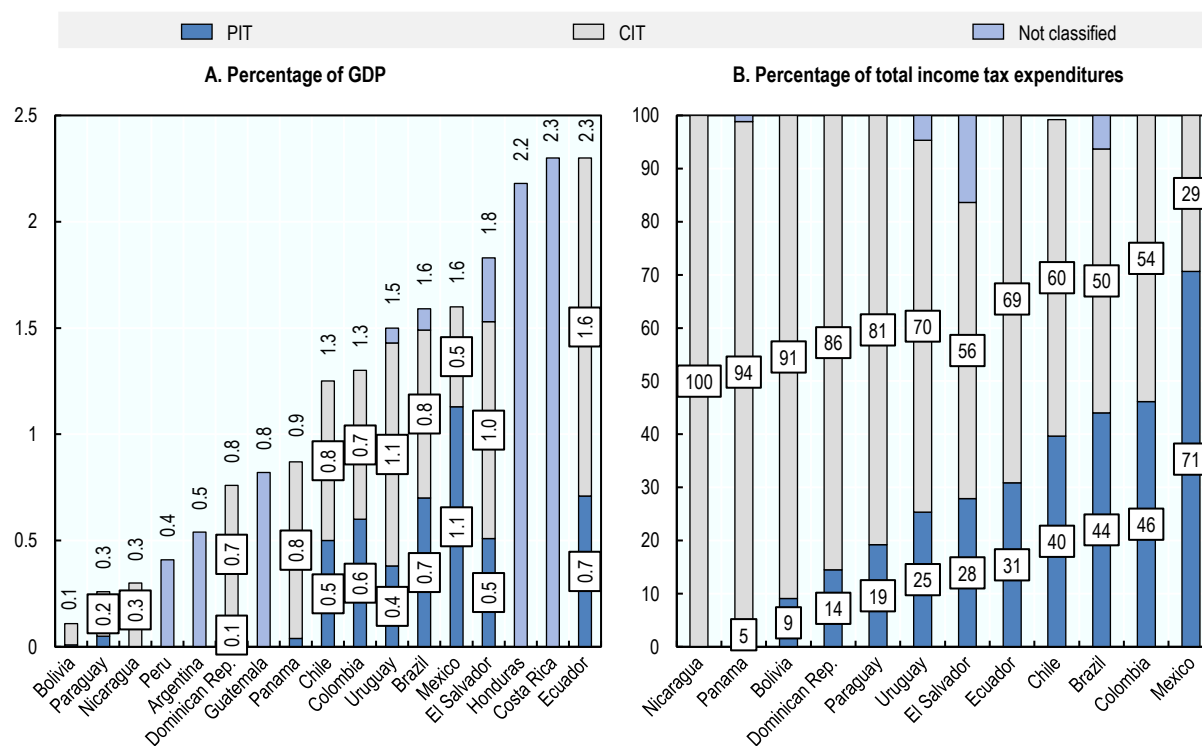
out-of-pocket health expenditure in the region. Special VAT treatments for health services and medicines are considerable in some countries, reaching upwards of 0.8% of GDP in Uruguay.

The design of these preferential tax treatments highlights a strongly country-specific set of policy objectives. Tax exemptions for health services provided by national public health institutions or social security systems are the principal form of health-related tax expenditures in Argentina and Uruguay. In Chile, Colombia and the Dominican Republic, private purchases of health services are exempt from VAT. A similar exemption exists in Ecuador, complemented by an exemption for purchases of medicines.

Tax expenditures for income taxes are common across countries, and they relate predominately to CIT (Figure 3.5). CIT exemptions for free zones are common, leading to significant foregone revenues in El Salvador (0.5% of GDP), Dominican Republic (0.4% of GDP) and Uruguay (0.2% of GDP), for example. A related objective is the promotion of investment, often in strategic sectors. Ecuador provides an eight-year CIT exemption for new productive investments in priority sectors in Quito and Guayaquil, which rises to 15 years for other areas of the country. Uruguay offers a tax credit for investments in fixed assets, among others, that are used in manufacturing or agriculture. Preferential regimes also exist for SMEs, including a reduced CIT rate for SMEs as part of the Propyme programme in Chile.

Figure 3.5. Latin America: personal income tax (PIT) and corporate income tax (CIT) expenditure, 2021 or latest

Percentage of GDP and percentage of total income tax expenditures



Note: Data corresponds to reports for the specified years by country: Argentina (2021), Bolivia (2016), Brazil (2021), Chile (2021), Colombia (2018), Costa Rica (2019), Dominican Rep. (2021), Ecuador (2020), El Salvador (2016), Guatemala (2021), Honduras (2021), Mexico (2021), Nicaragua (2013), Panama (2019), Paraguay (2019), Peru (2021), Uruguay (2020).

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Campos Vázquez (2022^[6]).

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Foregone revenues due to PIT expenditures can also be significant in some countries. In Mexico, the principal PIT expenditures are exemptions for retirement income, social welfare benefits and various types of special salary payments (such as annual bonus and overtime, among others). In Brazil, the largest foregone revenues resulting from PIT expenditures relate to exemptions for retirement income and special treatments for health expenditure. In El Salvador, deductions for education and health expenditure are among the most important preferential PIT treatments. In contrast, Ecuador provides a blanket deduction for personal expenses (resulting in foregone revenues equivalent to 0.4% of GDP). In Chile, the principal PIT expenditure is an exemption for capital gains from the sale of real estate up to a specified threshold.

Evaluating the effectiveness of tax expenditures is key to optimising their contribution to development

Given the large foregone revenues associated with tax expenditures, it is important to fully weigh their potential benefits and costs. Evaluating their effectiveness is key to making informed policy decisions, since these preferential tax treatments are used by governments in lieu of public spending to promote specific policies and objectives, ranging from economic growth and job creation to environmental protection and social welfare.

ECLAC/Oxfam International (2019^[9]) recommends evaluating three crucial points when considering the use of a differential tax treatment that leads to forgone revenue: (1) Do tax expenditures result in a more efficient allocation of resources; (2) What effect do they have on the horizontal and vertical equity of the tax system; and (3) Is there transparency and are such tax expenditures included in the budgetary process?

To assess the efficiency and effectiveness of tax expenditures, it is crucial to define the desired objective, identify the impact indicators, and determine the cost associated with each differential treatment. Attention should also be paid to the implications of additional tax system complexity, particularly in terms of higher compliance and enforcement costs. Policy makers should carefully consider the pros and cons of using tax expenditures relative to direct expenditure when making decisions about the allocation of resources. Depending on the objective, direct expenditure may be more efficient.

Tax expenditures, such as exemptions, deductions, credits, reduced rates, deferrals and accelerated depreciation systems, are sometimes used to “correct” certain distortions in the tax system that inhibit desirable economic and social outcomes. However, these treatments may not always be the most efficient method of addressing such distortions and can result in unequal treatment of taxpayers. Some taxpayers may not be able to take advantage of these benefits, leading to horizontal inequity whereby similar taxpayers have different tax burdens. For example, preferential tax treatments for firms and individuals operating in the frontier regions of Mexico can lead to situations where subsidiaries of multinational enterprises pay significantly lower taxes compared to domestic firms in similar industries located elsewhere in the country (Campos Vázquez, 2022^[6]).

Additionally, preferential treatments can negatively impact the progressivity and redistributive impact of taxes, leading to vertical inequity. For example, when the preferential treatment is applied to income received from dividends and other financial instruments that is typically concentrated among the highest income groups, it reduces the progressivity of the PIT.

Even though tax treatments may offer certain benefits when compared to other policy tools, their costs, as well as some of their advantages and disadvantages, are often “hidden” from policy makers and the general public. A lack of transparency also exists within the public sector. Since tax expenditures are typically not subject to the same level of control and evaluation as direct expenditure (they are not included in the budget and are usually automatically renewed annually), this lowers the transparency and accountability of fiscal policy, making it harder to determine who benefits from them.

Evaluation of tax expenditures in the LAC region is in its infancy

In recent years, there has been increasing interest in the LAC region in evaluating the impact of tax expenditures on various outcomes such as growth, investment and employment. To assess the overall impact of a policy, it is crucial to compare its benefits against the costs, including fiscal costs from lost revenue, as well as the impact on efficiency, equity and transparency.

Many studies in the region are limited to estimating the loss of revenue from tax incentives, with few conducting a comprehensive evaluation of the benefits and costs. In such evaluations, the benefits should include the actual impact of the tax treatment on factors such as increased revenue from new investments and the associated social benefits, while the costs should consider the loss of revenue from investments that would have occurred regardless of the incentives, increased tax administration costs, potential abuse that leads to tax evasion, economic distortions, distributive effects, and their impact on macroeconomic variables (Campos Vázquez, 2022^[6]).

Comprehensive studies of tax expenditures are limited in Latin America; Table 3.3 summarises the main findings of the few that exist, which suggest that tax expenditures, and investment incentives in particular, are not necessarily cost-effective in achieving their objectives.

Table 3.3. Selected cost-benefit evaluations of tax expenditures in LAC

Country	Year	Authors	Type of tax expenditure evaluated	Main findings
Colombia	(2012) ^[10]	World Bank (Moller, Junquera Varela, and Alvarez)	VAT exemptions and exclusions, the free trade zone regime, and the special tax regime for non-profit companies	Although the free trade zones do result in investment and employment, investment decisions depend largely on the physical infrastructure and not the tax regime, as these investments would have likely occurred regardless due to their high profitability.
Chile	(2013) ^[11]	Agostini and Jorratt	100% Exemption from tariffs on imports of capital goods.	The value of the increase in imported capital goods is higher than the loss of revenue, but there may be more efficient instruments, such as immediate depreciation.
Dominican Republic	(2017) ^[12]	World Bank	100% exemption from CIT in free zones	Despite firms in free zones creating three times more jobs than those outside the zones, each job generated costs five times more in terms of forgone revenue compared to those created by firms covered by the general CIT regime.
	(2018) ^[13]	CIAT and United Nations	Tourism Tax Incentive Program: CIT exemptions in tourism industry	The tourism industry is mainly affected by global economic conditions; tax benefits are not an important factor in the development and growth of the industry

Source: Economic Commission for Latin America and the Caribbean (ECLAC), based on ECLAC/Oxfam International (2019)^[9] and Campos Vázquez (2022^[6]).

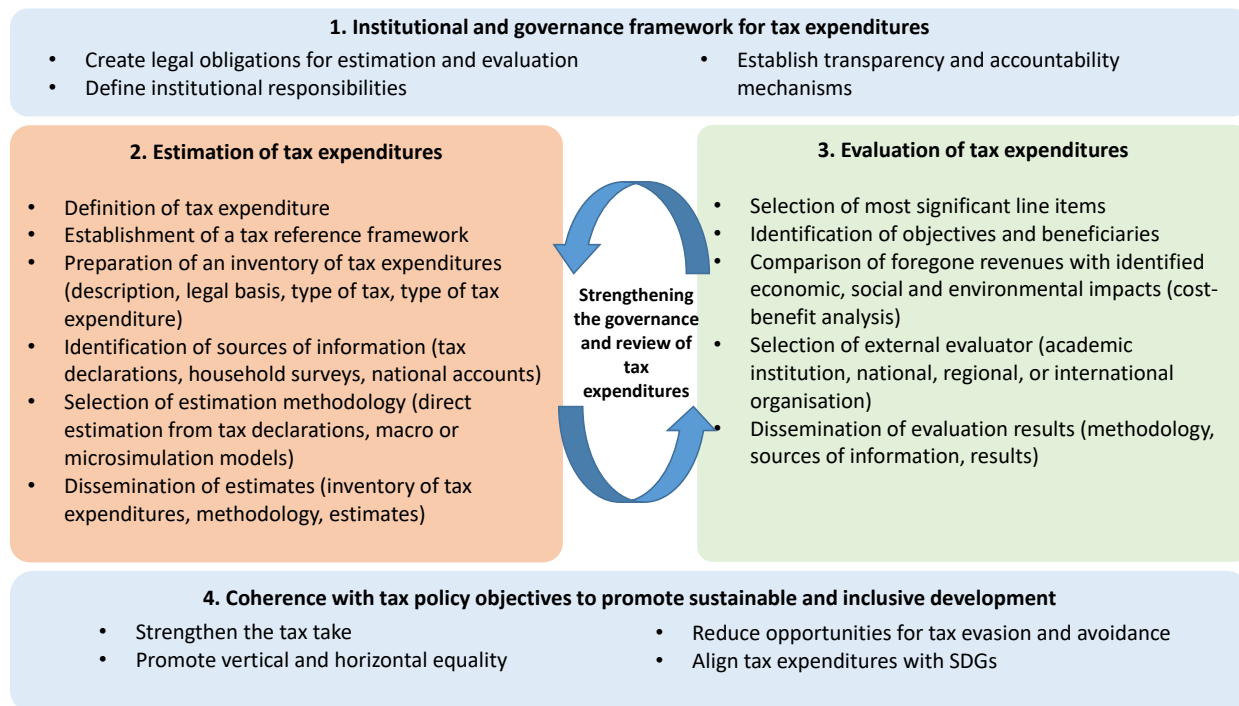
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Strengthening the role of tax expenditures as an instrument for sustainable and inclusive development


The 2030 Agenda for Sustainable Development, adopted by the United Nations General Assembly in September 2015, sets 17 goals and 169 targets aimed at promoting economic, social, and environmental sustainability for the 193 Member States that adopted it. Implementing the 2030 Agenda for Sustainable Development will be a major challenge for the LAC region; substantial investments are needed to achieve the SDGs, especially given the region's economic and social disparities. One of the key challenges is domestic resource mobilisation, as the tax take remains insufficient to meet current and future demands on public spending.

Against this backdrop, the role of tax policy in support of the SDGs has taken on renewed importance (ECLAC, 2019^[14]; 2020^[15]; 2021^[16]). Tax expenditures, particularly investment incentives, have emerged as a major policy issue. While tax expenditures can play a role in supporting the achievement of the SDGs, there is significant work to be done to ensure that they are an effective tool for development. For the region, this depends to a large extent on establishing an institutional framework capable of managing the design, implementation, and governance of tax expenditures, as well as ensuring transparency and accountability (Figure 3.6).

Figure 3.6. Strengthening the governance and review of tax expenditures to promote sustainable and inclusive development



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Campos Vázquez (2022^[6]).

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This framework depends on the credible measurement and evaluation of tax expenditures, backed by binding legal requirements to ensure their implementation. There are still opportunities in the region to incorporate best practices in the measurement of tax expenditures. The evaluation of tax expenditures significantly lags efforts to quantify tax expenditures and will require a concerted effort to build new capabilities. Regional and international cooperation can play an important role in supporting these efforts. To this end, the OECD has developed the OECD Investment Tax Incentives Database, which allows comparison of tax expenditure policies across developing regions (Box 3.1).

Box 3.1. The OECD investment tax incentives database

Tax incentives for investment are frequently used across the world, including in LAC countries. Given the wide use of tax incentives globally, their net impact is an important policy concern for national governments and the international policy community. Recent OECD work provides insights into tax incentive policies and increases the policy relevance of tax incentive analysis, with the objective to help policy makers make smarter use of tax incentives and reform inefficient ones.

The OECD Investment Tax Incentives Database (ITID) compiles quantitative and qualitative information on the design and targeting of investment tax incentives available across economies, using a consistent data collection methodology. It focuses on incentives provided through the CIT system and which are only available to a specific group of corporate taxpayers, based on the taxpayers' sector, activity, location or other investor- or project-related characteristics (i.e. targeted provisions). Celani, Dressler and Wermelinger (2022^[17]) present the methodology and key classifications underlying the OECD ITID as well as its scope.

For each CIT incentive, the database covers about 45 parameters on average that are classified into three dimensions:

A. Design features	B. Eligibility conditions	C. Governance
<p>How is the tax benefit determined and for how long does it apply?</p> <p>Design features describe how an incentive provides tax relief. This is done by first classifying the incentive into one of the four instrument types: reduced rates, tax exemptions, tax allowances and tax credits. In addition, it includes granular instrument-specific details on other design features, such as rates, qualifying income and qualifying expenditure.</p>	<p>Which investors and investment projects qualify for receiving the tax incentive?</p> <p>Eligibility conditions are criteria that investors or investment projects must meet to benefit from a tax incentive. They touch upon a wide variety of areas, such as the sector, location and size of investments. Eligibility conditions can help describe an economy's strategy for targeting incentives.</p>	<p>Which law(s) describe(s) tax incentives? Which authority(ies) are involved in granting them?</p> <p>Governance includes information on the legal provision(s) that introduce and govern the tax incentive, as well as the information on the authorities involved in granting the incentive. In some cases, several provisions govern one tax incentive.</p>

The October 2022 edition of the database provides new insights into the use of tax incentives across 52 emerging and developing economies in Eurasia, Latin America and the Caribbean, the Middle East and North Africa, South and East Asia and Sub-Saharan Africa (OECD, 2022^[18]).

Tax incentive designs are multi-dimensional, complex and often target a specific sector, region or investor within an economy (OECD, 2022^[18]). An economy's income level seems to influence the choice of tax incentive type. For example, reduced CIT rates are more widely used in low-income countries, whereas tax credits are more frequently observed in upper middle-income countries. Tax exemptions are widely used across income levels, particularly in Special Economic Zones.

The governance of investment tax incentives is also complex, which can reduce their transparency and affect the accountability of granting bodies. Less than half of all economies consolidate their CIT incentive provisions into one single piece of legislation, and all other economies scatter provisions across several laws and regulations. Granting arrangements and administration of tax incentives involve multiple authorities in most countries.

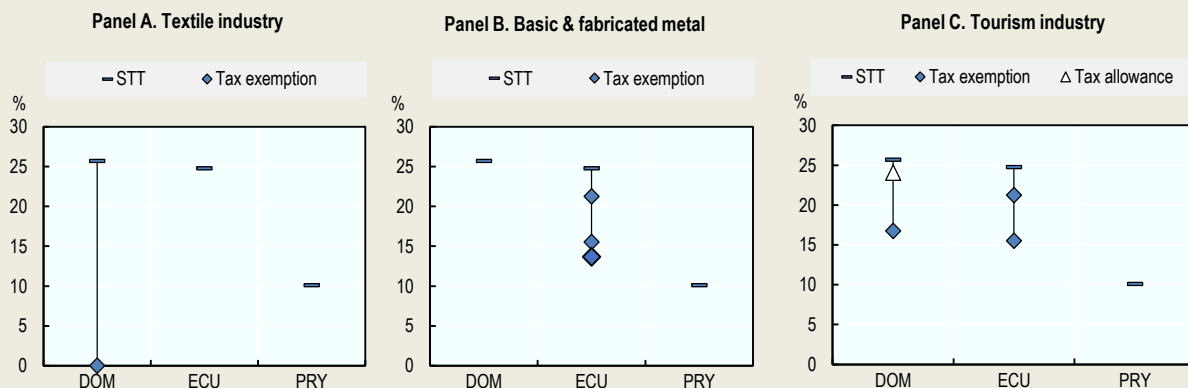
Differences in design and countries' standard tax systems often complicate the comparison of tax incentives in terms of their generosity and impact across countries. Forward-looking effective tax rate (ETR) analysis can help make complex features of tax incentives comparable and is an additional step towards developing policy guidance based on detailed information from the ITID. Recent OECD work has extended the ETR methodology to estimate ETRs under tax incentives to evaluate the incentive's effect on providing tax relief in seven Sub-Saharan African countries (Celani, Dressler and Hanappi, 2022^[19]).

There are ongoing efforts to expand ITID coverage and ETRs measures to the LAC region. To illustrate how the tax incentive analysis can be used, ETRs were calculated for selected tax incentives in three economies in the region. Figure 3.7 presents ETRs for a standardised investment project in three industries (textile, metals and tourism) in the Dominican Republic, Ecuador and Paraguay under standard tax treatment, i.e. excluding tax incentives, (horizontal black marker) and accounting for industry-specific tax incentives if available. Blue diamonds represent tax exemptions and white triangles represent tax allowances. Multiple markers in a specific country and industry indicate that various incentives apply, depending on additional eligibility conditions. For example, investment in tourism in Ecuador (Panel C) benefits from a 10-year tax exemption when located in an Economic Special Development Zone and a 5-year exemption otherwise.

Investment tax incentives lower the tax costs of investment to various degrees across the three industries and countries. While the Dominican Republic and Ecuador start from a 25% standard ETR, they offer tax incentives that substantially lower effective taxation in some of the industries. For example, ETRs can be as low as 0% in textiles in the Dominican Republic and are up to 45% lower than standard taxation in the Ecuadorian metal industry (13.7% compared to 24.8%). While Paraguay does not use CIT incentives, the country applies a relatively low standard CIT rate, resulting in the lowest ETR in the metal and tourism industries across the three countries.

Figure 3.7. Investment tax incentives lower the ETRs across industries

EATR under standard tax treatment (STT) and investment tax incentives in the corresponding industry



Note: EATR = Effective Average Tax Rate. Figure considers investment tax incentives and standard tax treatment on 1 January 2020. EATRs are calculated for a standardised investment in a single non-residential building asset. Standard tax treatment considers country-specific standard corporate income tax rates, asset-specific capital allowance rates and cost recovery method. Temporarily or permanently tax-exempt income does not give rise to standard capital allowances.

Source: OECD Secretariat based on Celani, Dressler and Wermelinger (2022^[17]) and OECD (2022^[18]).

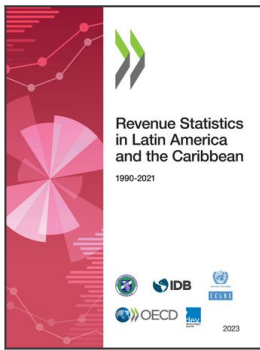
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Note

¹ In Chile, the 2020 edition of the tax expenditure report (covering the years 2019-2021) incorporated a revised benchmark tax system, greater coverage of preferential treatments, and methodological improvements to better estimate some tax expenditures, especially as related to the income tax, which were in line with recommendations provided by the IMF and the OECD at the behest of the Ministry of Finance of Chile (SII, 2021^[21]; IMF, 2020^[20]).



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