This note is submitted to the Steering Group on Revenue Statistics of Working Party No.2 FOR DISCUSSION AND DECISION under item IV of the agenda of their meeting to be held on 14 November 2000.

For further information please contact: Mr. Steven Clark, Tel: (33 1) 45 24 96 66; Fax: (33 1) 44 30 63 51; Email: steven.clark@oecd.org
THE TREATMENT OF NON-WASTABLE TAX CREDITS

I. Introduction

1. At the 6th Meeting of the Steering Group on Revenue Statistics, Delegates considered the issue of the reporting of ‘non-wastable’ tax credits in the Revenue Statistics. The term refers to tax credits that provide a taxpayer with a cash transfer in respect of the portion of tax credits earned that cannot be claimed to offset the taxpayer’s tax liability.1 The treatment is considered important given the amounts involved. For example, roughly $5 billion of the total $30 billion in assistance under the U.S. Earned Income Tax Credit is claimed through personal income tax credits, with the bulk (over $25 billion) delivered by way of cash transfers. In accordance with the current reporting guidelines, the U.S. does not net the transfer amounts against reported tax revenues. As another example, the U.K. introduced the Working Families Tax Credit in October 1999. The program is expected to provide roughly £4.7 billion in assistance in 2000-2001, with an unknown fraction of the total delivered as a cash transfer.

2. Current guidance under §20-21 of the Interpretative Guide requires that only that portion of a non-wastable tax credit that is claimed directly by a taxpayer and used to reduce or eliminate that person’s tax liability should be taken into account in the reporting of tax revenues. The excess of tax credits earned that cannot be claimed by the taxpayer should be treated as a transfer (expenditure) item, falling outside the reporting of revenue data in the Revenue Statistics. Annex I of this note reproduces the current wording in §20-21 making the distinction between tax and expenditure provisions.

3. In debating this issue at the 6th Meeting, Delegates were concerned about the comparability of revenue figures across countries on account of possible inconsistent treatment of non-wastable tax credits. To permit an assessment of this issue, the Secretariat was instructed to prepare a questionnaire soliciting information from countries on their current reporting practice in the tax credit area, with a special focus on non-wastable tax credits.

4. The questionnaire sent to Delegates on 09 December, 1999 (see Annex II) asks countries to specify all wastable tax credits and all non-wastable tax credits in their personal income tax system and the estimated revenue impact (cost) of each tax credit in year 1999. For non-wastable tax credits, countries were asked to separately identify, if possible, the revenue cost associated with the tax expenditure portion of the credit that is claimed against individual personal income tax liabilities, and the portion that is a transfer item (the ‘unused’ portion that gives rise to a transfer of funds to the taxpayer). Unless otherwise indicated, the reporting shown in Table 1 for the responding countries with non-wastable tax credits corresponds to the reporting practice followed for the Revenue Statistics.

---

1 The term ‘transfer’ includes the payment of cash or cash-equivalent to taxpayers, paid by the government directly or indirectly through an intermediary (e.g., an employer or other company). In the case of a direct payment, the term includes amounts transferred by crediting provisions that allow the taxpayer earning the credit to net the excess tax credit amount against other tax liabilities of that taxpayer to the government. In the case of an indirect payment, the intermediary is reimbursed for its transfer of the excess tax credit amount to the taxpayer earning the credit (e.g., by allowing the intermediary to net the amount against its tax liabilities to the government).
5. Section II summarises findings from the responses to the tax credit questionnaire from 17 countries, revealing discrepancies in reporting practices in this area. Section III reviews the implications of the cash basis-reporting standard in the Revenue Statistics, and stresses the need for comparability of revenue and expenditure data across countries and time. It also provides a summary of alternative mechanisms used to provide taxpayers with refunds, as identified in the questionnaire responses. Section IV suggests possible options for deciding how best to resolve the non-wastable tax credit reporting issue.

II. Summary of Country Responses to Questionnaire

6. Responses to the tax credit questionnaire have been received from Austria, Canada, the Czech Republic, Denmark, Finland, Germany, Hungary, Ireland, Mexico, Norway, the Netherlands, Portugal, Spain, Sweden, Switzerland, the United Kingdom, and the United States.

7. Out of the seventeen responses, 9 countries (Czech Republic, Denmark, Finland, Hungary, Ireland, the Netherlands, Portugal, Spain and Switzerland) report that their personal tax system did not contain tax credit provisions in 1999. Sweden reports two wastable tax credits for 1999, with a third introduced in 2000. Ireland indicates that it will be introducing a wastable tax credit system for the tax year beginning 6 April, 2001. As part of a far-reaching tax reform, the Netherlands will replace a number of personal allowances in the personal income tax by non-wastable tax credits as from 1 January 2001. Seven countries – Austria, Canada, Germany, Mexico, Norway, the United Kingdom and the United States – report non-wastable tax credit, with credit amounts shown Table 1.

8. Austria reports three non-wastable tax credits in its response to the questionnaire. The Children Tax Credit provides for a pure transfer of funds, along with the family allowance, to families with children. The transfer amount in year 2000 is 8400 Austrian schillings (ATS) per child, per annum. The total cost of the program, with credits earned in respect of 1.9 million children, was 16 billion ATS in 2000 (up from 12.9 billion ATS in 1999, as shown in Table 1). While the Children Tax Credit is defined as a tax credit in the income tax law, in fact it is not a tax credit (as the term is normally understood) given that no part of the credit is applied against personal tax liabilities. For budget accounting purposes, the program cost deducted from income and wage tax revenues. Therefore, the program cost (full cash transfer amount) is added back to income and wage tax revenues for Revenue Statistics reporting purposes.

9. In contrast, the Wage Earner Tax Credit, and Sole Earner & Single Parent Tax Credit in the Austrian tax system are non-wastable tax credits applied in part against personal tax liabilities. In particular, both are deducted at source by employers from gross income (wage) tax of individuals, up to the amount of gross income tax. Cash transfers are provided by the government to individuals following

---

2 In his response, the Delegate from Denmark notes that a “general” wastable tax credit is part of the Danish tax system (as described in Taxing Wages, Part IV, section 1.123), and that in almost all cases the tax credit can be interpreted as a general allowance or a zero-rate first tax band.

3 In order to accommodate a smooth transition to this system, a number of existing and new personal income tax allowances and reliefs have been restricted to the standard tax rate. To the extent that all (standard rated) allowances have a fixed value to all taxpayers, they can be equated with wastable tax credits.

4 The Wage Earner Tax Credit is 1500 ATS per annum. Where gross income (wage) tax before subtracting the credit is less than 1500 ATS, the employee is entitled to a transfer (negative tax) for the excess of the credit over gross tax, which is paid out after tax assessment (with the transfer capped to not exceed 10 per cent of the employee’s social security contribution). Austria also provides a Single Parent Tax Credit of 5000 ATS, and a Sole Earner Tax Credit of 5000 ATS where a taxpayer’s partner earns less than 30000 ATS in income (60000 ATS if with children). For single parents or qualifying sole earners with children, a cash transfer (negative tax) may be granted if tax before deduction of the tax credit is less than 5000 ATS. The transfer amount is the full 5000 ATS, less the amount used first to eliminate individual tax liability.
application and tax assessment at the end of the year for the amount, if any, by which tax credits earned exceed gross income tax.\(^5\) While Austria is able to estimate the transfer amount of the wage earner tax credit (at 310 million ATS, out of a total cost of 4.8 billion ATS), tax revenues as reported in the Revenue Statistics are shown net of the full program cost. Reported tax statistics are measured net of the transfer component, as separate accounts are not held measuring the aggregate transfer amount (only estimates available, as noted). Similarly, separate accounts are not held for the transfer component of the Sole Earner Tax Credit and the Single Parent Tax Credit. Thus reported revenue statistics are measured net of the full program cost of each, calculated at 5 billion ATS and 0.5 billion ATS respectively.

10. The Canada Child Tax Benefit, introduced in 1993, provided over $5.2 billion (CDN) in relief in 1996. This non-wastable tax credit is treated in Canada’s public accounts as a pure tax expenditure item. Consistent with this approach, the full program cost, including both the true tax expenditure component and the cash transfer component, are netted against reported tax revenues in the Revenue Statistics. Similarly, reported revenues for Canada are measured net of the tax expenditure and transfer components of the Goods and Services Tax (GST) Credit – which offers taxpayers relief in respect of notional amounts of GST paid – with a total program cost of over $2.7 billion (CDN) in 1996.

11. Mexico operates a Basic Tax Credit (BTC) program introduced in 1994 that targets a non-wastable tax credit at wage earners. The credit, which is adjusted on a yearly basis, decreases as income increases and is applied against personal income tax liabilities.\(^6\) Where a BTC exceeds an employee’s tax liability, the excess is paid to the employee by his/her employer and the employer is reimbursed this amount by the government. To streamline administration, the employer is allowed to deduct the reimbursement amount against its own federal tax liability, and a cash transfer is paid to the employer for the amount, if any, by which the reimbursement amount exceeds the employer’s tax liability.

12. Mexico is currently unable to identify the aggregate cost to the government of its BTC program and the split of the aggregate cost between the amount linked to the claiming of credits to reduce personal income tax liabilities and the excess (transfer) amount. Mexico’s tax revenues reported in the Revenue Statistics are measured net of the aggregate (unmeasured) cost of the BTC – that is, net of both the credit claimed and the transfer amount.

13. Norway reports that the aggregate cost to the government in 1999 of its Child Tax Credit (CTC) program, operating since 1975, was NOK 1,990 million. Expenditures by the government under the CTC program form an integrated part of Norway’s tax accounts, and separate accounts are not maintained measuring the part of the aggregate program cost that is linked to CTC claims against personal income tax liabilities, and separately the part paid as a cash transfer to taxpayers. Personal income tax revenues reported in the Revenue Statistics are measured net of the aggregate program cost. Norway estimates that the expenditure (cash transfer) component is relatively small – roughly NOK 120 million, or 6 per cent of the total program cost in 1999.

14. In Germany, non-wastable tax credits were introduced as early as 1956 in the form of a credit against tax on wage income for miners. The total expenditure cost of this program was DM 100 million in 1999. This figure is relatively small compared to the total expenditure cost of the child tax credit (CTC) program introduced in 1996, estimated at DM 57.6 billion in 1999. Another non-wastable tax credit in

\(^5\) This calculation measures the amount of unused tax credit. To illustrate, assume a taxpayer with a gross income tax liability of 100 earns 125 in non-wastable tax credits. The first 100 in tax credits earned eliminates the income tax liability, leaving 25 as a refund. The refund equals the difference between non-wastable tax credits earned (125) and the gross income tax liability (100).

\(^6\) In 1999, the credit was 3,584.34 pesos for the lowest income tax bracket, and 1,565.79 pesos for the highest.
Germany, the tax credit for owner-occupied housing, also introduced in 1996, cost the government DM 10.4 billion in 1999. This amount includes the aggregate tax credits claimed plus the cash transfers paid in respect of the earned credit amounts that could not be used to reduce personal income tax liabilities. A non-wastable investment tax credit found in the personal income tax system (which has a counter-part in the corporate tax system) cost the government DM 320 million in 1999. For each of these non-wastable tax credit programs in Germany, data are available only on the total program cost – figures showing the split between the tax expenditure and cash transfer components are not captured. And, as in the case of other countries noted above, Germany reports tax revenues in the Revenue Statistics net of the full program cost of its non-wastable tax credits.

15. The Earned-Income Tax Credit (EITC) program has existed in the United States since 1975, with expenditures under this scheme growing significantly over the 1990s. The bulk of the credit is received at the end of the year as a lump sum (cash transfer), although the option exists of receiving assistance on a monthly basis with an annual reconciliation of any over- or under-payment. The total cost of the program in 1999 was roughly $30.5 billion – about a third of a percentage point of GDP – with $25.6 billion delivered as a cash transfer. Another non-wastable tax credit in the U.S., the child tax credit, provided more than $19.4 billion in tax expenditure relief (offsetting personal tax liabilities), with roughly $0.5 billion provided as a cash transfer.

16. The United States stands out as one of the few countries that is able to separately measure the split between the amount of the aggregate cost of non-wastable tax credit programs attributable to transfers, and the tax expenditure amount (reducing personal income tax liabilities.) The allocation of costs for the two programs noted above is shown in Table 1. With information on the split, the U.S. is in conformity with the current Guidelines, reporting revenues net of the tax expenditure component alone.

17. One of the main non-wastable tax credit programs reported by the United Kingdom for 1999 is the Mortgage Interest Relief at Source (MIRAS) program, which offers taxpayers relief for interest charges on house mortgages (the program has been recently phased out). Since April 1991, mortgage interest relief has been provided at source by mortgage institutions at a fixed rate, independent of a taxpayer’s tax assessment. Prior to 1991, relief was provided at the taxpayer’s marginal tax rate, as determined under personal income tax assessment (for a discussion of the pre-1991 treatment, see the discussion in DAFE/CFA/WP2(99)15).

18. Under the MIRAS structure, mortgage institutions (primarily banks) are reimbursed directly by the government (by cheque) for interest relief that they provide under the program (i.e., no netting of the transfer amount (equal to the interest relief provided) against the intermediaries own tax liability). The MIRAS program is referred to as a tax credit program on the basis that predecessor program details had some linkage to personal tax assessment, despite the fact that, under its final design structure, assistance is provided to taxpayers independent of their tax assessment. As noted above, prior to 1991, relief was available to a taxpayer at his/her marginal tax rate, with higher rate taxpayers receiving additional relief as a deduction against personal income tax liabilities.

---

7 In 1999, taxpayers with more than one child could benefit from the credit if they had earned income of less than $30,095 ($26,473 if they had one child, and $18,030 if they had no children).

8 In 1999, the maximum subsidy for a two-child couple was $3,756, received when income is between $9,930 and $12,260, with the credit phased in at a rate of 40 per cent below that level (negative marginal effective tax rates), and phased out at a rate of just over 21 per cent.
Table 1
Summary of Findings on Non-Wastable Tax Credits, 1999

<table>
<thead>
<tr>
<th>Country and program</th>
<th>Total expenditure</th>
<th>Treated (included) in Revenue Statistics as a tax expenditure</th>
<th>Not included in Revenue Statistics (treated as non-tax expenditure (transfer))</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>United States</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Earned income tax credit</td>
<td>30,457 ($ million)</td>
<td>4,825</td>
<td>25,632</td>
</tr>
<tr>
<td>Child credit</td>
<td>19,880 ($ million)</td>
<td>19,435</td>
<td>445</td>
</tr>
<tr>
<td><strong>United Kingdom</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Working families tax credit</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Disabled persons tax credit</td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Mortgage interest relief at source (MIRAS)</td>
<td>1,880 (£ million)</td>
<td>1,770</td>
<td>110</td>
</tr>
<tr>
<td>Life assurance premium relief at source (LAPRAS)</td>
<td>120 (£ million)</td>
<td>100</td>
<td>20</td>
</tr>
<tr>
<td>Vocational training relief</td>
<td>45 (£ million)</td>
<td>25</td>
<td>20</td>
</tr>
<tr>
<td><strong>Germany</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Child tax credit</td>
<td>57,600 (DM million)</td>
<td>57,600</td>
<td>0</td>
</tr>
<tr>
<td>Tax-credit for owner-occupied housing</td>
<td>10,400 (DM million)</td>
<td>10,400</td>
<td>0</td>
</tr>
<tr>
<td>Investment tax credit</td>
<td>320 (DM million)</td>
<td>320</td>
<td>0</td>
</tr>
<tr>
<td>Tax credit for miners</td>
<td>100 (DM million)</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td><strong>Norway</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Tax credit for children</td>
<td>1,990 (NOK million)</td>
<td>1,990</td>
<td>0</td>
</tr>
<tr>
<td><strong>Austria</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Child tax credit</td>
<td>12,933 (ATS million)</td>
<td></td>
<td>12,933</td>
</tr>
<tr>
<td>Wage earner tax credit</td>
<td>4,800 (ATS million)</td>
<td>4,800</td>
<td>0</td>
</tr>
<tr>
<td>Sole earner/single parent tax credit</td>
<td>5,500 (ATS million)</td>
<td>5,500</td>
<td>0</td>
</tr>
<tr>
<td><strong>Canada</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Child tax benefit</td>
<td>5,215 ($CDN million)</td>
<td></td>
<td>5,215</td>
</tr>
<tr>
<td>Goods &amp; services tax credit</td>
<td>2,785 ($CDN million)</td>
<td></td>
<td>2,785</td>
</tr>
<tr>
<td><strong>Mexico</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Basic tax credit</td>
<td>Unknown</td>
<td>Treated (in full) as tax provision</td>
<td>0</td>
</tr>
</tbody>
</table>

n.a.=not available. Figures shown for Canada are for 1996.
19. As shown in Table 1, the total 1999 cost of the MIRAS program at £1,880 is estimated to consist of £1,770 million in tax expenditures (an estimate of the amount that could have been netted against personal income tax revenues), and £110 million recorded as a pure expenditure provision. The latter is an estimate of the amount of the transfer (interest relief) provided to households not paying income tax in 1999. Personal income tax revenues reported in the Revenue Statistics are measured net of the estimated £1,770 million in interest relief provided to households paying income tax. The adjustment to personal income tax revenues is made – despite the fact that the program operated outside the personal tax system in that year – given the history of the program and the desire to maintain consistency in reporting practice.

20. A similar reporting arrangement exists for the U.K. Life Assurance Premium Relief at Source (LAPRAS) program, which cost the government £120 million in total in 1999 (less than one-tenth the cost of the MIRAS program.) Of this, £100 million is netted against reported personal income tax revenues in respect of estimated premium relief provided at source to taxable households. The remainder £20 million is the estimated amount of the cash transfer flowing to households that did not pay tax in 1999.

21. The U.K. reports that it will not be possible to separately measure the fraction of the total cost of the Working Families Tax Credit Program, at £4,700 million, that will claimed against personal income tax liabilities and the fraction that will be paid out as a transfer. Similarly, a split cannot be measured for the Disabled Persons Tax Credit Program, with an estimated total cost of £100 million in 2000-2001.

22. Lastly, in this sub-section it could be noted that while the questionnaire focuses on non-wastable tax credits found under personal income tax rules, non-wastable credits are also found in other taxes as well. For example, Canada operates an R&D tax credit program that provides small businesses with a transfer for the portion of the credit that cannot be claimed to reduce corporate income tax liability. Germany also has an investment tax credit in its corporate tax system that provides for transfers. The Czech Republic reports that employers including natural persons (unincorporated employers) are given a social insurance contribution refund provided that at least 55 per cent of its employees are disabled persons. The transfer is treated as an expenditure provision (6.9 million koruny in 1999). In other words, the aggregate social insurance transfer is not offset against social security contributions reported in the Revenue Statistics. The fact that such transfers arise in a number of countries and in a number of contexts calls for a search for a more general solution to the reporting of non-wastable tax credits in the Revenue Statistics.

III. Considerations Relevant to Classification

23. This section raises a number of issues to consider in determining how the Interpretative Guide might be revised to give direction on the reporting of non-wastable tax credits in the Revenue Statistics.

(A) A focus on government receipts, not social expenditures

24. The focus of the Revenue Statistics is on the revenue side of government, reporting revenues raised by government and the various tax bases relied upon. Government expenditures or more precisely, non-tax expenditures, are intentionally excluded, data permitting, given policy interest in determining tax revenues raised separately from the expenditure side of the budget equation. This focus is consistent with cash basis reporting that incorporates provisions affecting the flow of tax payments from the taxpayer to the government, but excludes provisions that do not affect this flow and are taken as pure expenditure items.
Revenue Statistics data, by relying on cash basis reporting, are not entirely ‘pure’ revenue figures in that, for all OECD countries, they are measured net of a variety of tax expenditures – meaning offsets to tax liabilities found in tax legislation but arguably outside a country’s basic or ‘benchmark’ tax structure. In practice, netting out tax expenditures can be problematic. This is particularly true in the case of special tax allowances and deductions taken against the tax base, given the need to define the benchmark tax system in each country (e.g., the choice of unit of assessment and rate structure, the treatment of pension contributions, imputed income, depreciation allowances and integration relief). Thus measurement as well as conceptual problems can arise in determining notional tax liabilities gross of tax offsets that qualify conceptually as tax expenditures.

26. Under current cash basis reporting guidelines, tax credits including those that might qualify as tax expenditures are to be factored into reported tax revenues only up to the point where they extinguish the taxpayer’s tax liability, and no further. The transfer portion – that is, the portion of a tax credit that is not claimed against the taxpayer’s current tax liabilities (or against prior year tax liabilities under tax credit carryback rules) – should not be taken into account. In other words, tax expenditures including social expenditures delivered through the tax system may lower aggregate reported tax revenues only up to the point where they eliminate a taxpayer’s tax liability. Beyond that point, the transfer from government to taxpayers is deemed to be a pure expenditure item, outside the determination of aggregate revenues as reported in the Revenue Statistics.

27. Allowing the transfer portion of non-wastable tax credits to offset aggregate tax revenue figures would take the reporting in the Revenue Statistics further in the direction of accounting for targeted social expenditures, at least insofar as the expenditures are delivered through the tax system. Current reporting guidelines already allow a deviation from a theoretically ‘pure’ tax revenue measure that would exclude tax expenditures, by not requiring a grossing up of tax revenues in respect of the tax expenditure amounts – given the ‘benchmarking’ and notional tax measurement problems noted above. Allowing the transfer portion of non-wastable tax credits to be netted against revenue figures would entail a further departure from a theoretically pure reporting standard, as well as a move away from cash basis reporting.

28. There are significant conceptual and practical difficulties in following the current guidelines. For example, as noted from the questionnaire replies, it is not possible in practice in a number of countries to establish what the transfer portion of non-wastable tax credits is. This information gets lost in accounting procedures that net two or more transfer obligations from taxpayers to government, and from government to taxpayers, to arrive at a single payment to ease compliance and/or administrative burdens.

9 For a discussion of these and other relevant issues, see Tax Expenditures – Recent Issues (OECD, 1996).

10 Backing tax expenditures out of reported tax revenues (i.e., grossing revenues up by tax expenditure amounts) requires specification of the benchmark tax rate, in the case of special (non-benchmark system) tax deductions and allowances. In the case of special tax credits, specifying the benchmark tax rate is generally not necessary. However, in both cases, an accurate assessment of notional tax revenues in the absence of tax expenditures requires a tax simulation model that assigns an ordering of discretionary tax deductions and tax credit claims that are deemed part of the benchmark system, and reworks tax calculations (generally under the assumption of a taxpayer strategy of tax minimization.) Alternatively, in the case of special tax credits, an alternative approach to back these out of reported revenues is to simply add to reported revenues the aggregate value of tax credits claimed.

11 The term ‘refundable’ tax credit is sometimes used to refer to a non-wastable tax credit. The refundable portion of a refundable tax credit refers to the transfer portion – that is the portion of a credit earned that cannot be used by the taxpayer to offset current (or prior) year tax, and by virtue of the ‘non-wastable’ property of the tax credit, creates a liability for a direct or indirect transfer from government to the taxpayer in the amount of the excess of the credit earned over the credit claimed. The use of the term ‘refundable’ may be considered illogical given that the transfer in this case is not a payment back to the taxpayer for an amount already paid by the taxpayer to government. Therefore, we use the term ‘transfer’ in this note.
Lastly, under this item, it might be noted that Revenue Statistics data are measured net of refunds for the over-payment of tax (tax re-assessment). While these are also payments from government to taxpayers, they differ in that they are actual tax refunds (i.e., the payment back of amounts paid by taxpayers), and thus differ in this respect from transfers on non-wastable tax credits (and thus do not create a precedent for the netting of non-wastable tax credits against Revenue Statistics data). In particular, where over-payment occurs because a taxpayer overestimates tax liability, the flow of funds from government to the taxpayer represents an offset to a corresponding initial tax payment that exceeds the refund. Similarly, in the case of a re-assessment of a prior year tax liability where a taxpayer carries tax losses or tax credits back to offset tax paid in that year, again the offset is less than the initial tax payment. Thus while these transfers of funds to taxpayers are netted against revenues in Revenue Statistics, they cannot create negative tax payments. The same cannot be said of the transfer portion of non-wastable tax credits.

(B) Consistency in the treatment of alternative transfer mechanisms

The tax credit questionnaire does not request detailed information on mechanisms used to provide taxpayers with the transfer portion of non-wastable tax credits. However, enough information is available to permit a categorisation of main delivery mechanisms. These categories are considered in the box below, to shed light on the scope for consistent treatment across categories in the Revenue Statistics.

In principle, based on the considerations set out in section (A), cash transfers in the same amount, whether delivered by means of a), b), c) or d), should not be factored into reported revenues. However, difficulties in separately identifying the transfer amount arise in cases b) and d) where the transfer amount is netted against other tax liabilities. And it may be that reporting difficulties arise for certain countries in cases a) and c) where detailed information on government expenditures is not compiled.

<table>
<thead>
<tr>
<th>Possible Tax Credit Transfer Delivery Mechanisms</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Direct transfer</strong></td>
</tr>
<tr>
<td>a) The transfer portion is paid in cash/cash-equivalent (e.g., cheque) to the taxpayer by the government.</td>
</tr>
<tr>
<td>b) The transfer portion is netted against other tax liabilities of the taxpayer (e.g., the transfer portion of a non-wastable personal income tax credit is netted against the taxpayer’s property tax liability.)</td>
</tr>
<tr>
<td><strong>Indirect transfer (through an intermediary):</strong> The transfer portion is paid in cash/cash-equivalent by an intermediary (e.g., employer, insurance/other company) to the taxpayer earning the credit, and the intermediary is reimbursed by the government for this amount – possible reimbursement mechanisms include:</td>
</tr>
<tr>
<td>c) The reimbursable amount (equal to the transfer portion) is paid in cash/cash-equivalent (e.g., cheque) to the intermediary by the government.</td>
</tr>
<tr>
<td>d) The reimbursable amount is netted against other tax liabilities of the intermediary (e.g., the reimbursable amount is netted against the intermediary’s property tax liability.)</td>
</tr>
<tr>
<td><strong>Direct and indirect transfer:</strong> In some cases, both a direct and indirect transfer may apply – with a partial transfer taking the form of a) or b), and the remainder delivered using form c) or d).</td>
</tr>
</tbody>
</table>

12 As discussed in DAFFE/CFA/WP2(99)15, under the U.K. mortgage interest relief program, up until 1990-91 when mortgage interest relief was available at a taxpayer’s marginal tax rate, transfers were delivered at source at a flat rate (with the mortgage provider reimbursed for this amount), with an additional transfer provided through the personal income tax system (determined according to the taxpayer’s marginal personal income tax rate). Tax credits provided at source differ from non-source tax credits in that the latter involve a transfer for the residual amount of a tax credit earned that cannot be used first to offset the
32. It should be noted that where a netting of tax transfers against tax liabilities occurs, the offset to reported tax revenues may be against a different tax base than the one in which the tax credit is earned. For example, a tax credit earned by an individual taxpayer through the personal income tax system may give rise to a reduction in measured property taxes, either at the individual level (as in case b) or at the corporate level (case d). This suggests that the possible footnoting of the treatment of transfer tax credits may involve cross-references to different tax bases.

33. Lastly, under this item, it should be noted that care should be observed to avoid double-netting of the transfer portion of credit. Where, for example, an intermediary nets against its corporate income or other tax liability an amount that reimburses it for the cash transfers it provides to taxpayers, none of this amount should be netted against other tax revenues (e.g., personal income tax revenues in the case of a personal income tax credit).

(C) Comparability of revenue (and expenditure) data across countries and time

34. Current reporting practice in relation to non-wastable tax credits diminishes the comparability of Revenue Statistics data across countries. With some countries (e.g., United States) currently following the Interpretative Guide, and others not, cross-country comparisons are compromised. A special case to consider is the U.K. example, where amounts are taken off reported revenues on account of the mechanism used to refund mortgage institutions (acting as intermediaries/agents for the government) for expenditure amounts paid to home owners.

35. As noted above, policy analysts have an interest in the measurement of government tax revenues and the tax bases relied upon, with aggregate tax revenues and tax revenues by main category often expressed as a percentage of GDP. Policy analysts are also interested in aggregate data on expenditures of public funds, often with a special interest in social expenditures – that is, government expenditures in the areas of health, education and income maintenance.

36. The OECD Directorate for Education, Employment, Labour and Social Affairs maintains a social expenditure (SOCX) database, and reports gross aggregate social (public and mandatory private) expenditures and social expenditures by main category as a percentage of GDP. Under the current reporting structure, gross social expenditures are measured inclusive of the transfer portion of non-wastable tax credits. That is, tax credit transfers falling inside the social program envelope are added to other social expenditures delivered outside the tax system to arrive at an overall social expenditure total.

37. As with reporting practice behind the Revenue Statistics, the reporting of social expenditures in SOCX is constrained by data availability. Aggregate social expenditures for a given country with non-wastable tax credits include the transfer portion of non-wastable tax credits only where the latter are separately measured and reported.

38. Thus, aggregate tax revenue figures reported in the Revenue Statistics and social expenditure figures included in the SOCX database are currently consistent, avoiding double-counting and non-counting. Where the transfer portion of non-wastable tax credits is known, the amount is not netted against tax revenues but is included in social expenditures (i.e., tax revenues and social expenditures are both higher by (measured gross of) the tax credit transfers). Where the transfer portion is not separately identified and is captured in tax revenue data, the under-reporting of tax revenues in the Revenue Statistics is matched by an under-reporting of social expenditure figures in the SOCX database. Note that tax-to-taxpayer’s personal tax liability. Under post 1991 rules, the MIRAS program and cash transfer provision operate entirely outside the personal income tax system.
GDP ratios and social expenditure-to-GDP ratios are systematically lower where the latter reporting practice is followed.

39. Discussions with those at the OECD responsible for the SOCX database indicate a preference for including tax transfers on non-wastable tax credits in the social policy area in reported social expenditures, to provide a more complete picture of social expenditure (i.e., inclusive of assistance delivered both outside and through the tax system). A decision taken to change reporting guidelines to measure tax revenues in the Revenue Statistics net of the transfer portion of non-wastable tax credits, without a corresponding adjustment to the reporting of social expenditures, would remove the symmetry observed in the current structure, noted above.

IV. Possible Solutions

40. Delegates are asked to consider the points raised above, a previous note on the issue considered at the last meeting of the Steering Group on Revenue Statistics (DAFFE/CFA/WP2(99)15) and other points raised at the current meeting. Delegates are then asked to suggest a way forward.

41. Delegates are first asked to explore whether additional data could be made available. In particular, it would be helpful if Delegates from countries with tax systems offering non-wastable tax credits could indicate whether current accounting structures that deny the reporting of information on the transfer portion of non-wastable tax credits could be adjusted to provide this data. Where these amounts cannot be retrieved under the existing or a revised structure, can such amounts be roughly estimated, along the lines that Norway has estimated this amount in its reply to the tax credit questionnaire?

➢ Delegates are asked to consider the following options in addressing the question of how best to report non-wastable tax credits in the Revenue Statistics:

Option 1

☐ Report tax revenues gross of the full amount (tax expenditure plus transfer component) of non-wastable tax credits – that is, treat the full cost of a non-wastable tax credit program as a social expenditure.

42. Under this option, wastable tax credits would continue to be factored into (and reduce) reported tax revenues, but non-wastable tax credits would not. This approach implicitly recognises that relief offered by wastable tax credits, like relief provided by tax exemptions and allowances, is constrained to be no greater than the amount of tax otherwise payable. In contrast, non-wastable tax credits are in effect similar to direct social expenditure programs, providing assistance that is independent of a taxpayer’s income and tax otherwise payable.

43. This option would attempt to move current practice closer to pure tax revenue reporting. As noted above, under current guidelines countries are to report tax revenues net of social expenditures delivered through the tax system only insofar as those expenditures eliminate the tax liabilities of the taxpayers targeted under the given social expenditure program. The Interpretative Guidelines recognise difficulties in deriving notional tax revenues gross of tax expenditure amounts.

44. Some of the main conceptual difficulties with measuring tax expenditures are not encountered in the case of non-wastable tax credits. Their value is independent of a benchmark tax rate structure, and the programs typically target assistance to child or family support, increased employment or other social goals arguably outside the benchmark tax system. Countries that currently make the split between the tax expenditure and transfer components would add the tax expenditure component to revenue figures already
measured gross of the transfer amount. Countries that cannot make the split and currently report tax revenues net of both the tax expenditure and transfer amounts would add an estimate of the total program cost to net revenue figures.

45. In practice, this option would raise a number of difficulties. First, it may be difficult to establish in each case that a given non-wastable tax credit program is not part of the benchmark tax system. Second, while countries can estimate the aggregate cost of their non-wastable tax credit programs, the quality of the estimates would vary across countries, and in each case the adjustments to actual reported revenues would involve the use of estimates rather than actual figures. Third, where intermediaries are used to deliver tax transfers under a given non-wastable tax credit program, it is not obvious how the revenue adjustment (gross-up) in the amount of the total program cost should be allocated across the various tax classifications appearing in the Revenue Statistics. Where an allocation across tax classifications is not possible, the only adjustment that could appear in the publication would be to aggregate revenue figures.

46. This option would also create a break in the time series for all countries with non-wastable tax credit programs, as currently all countries with such programs report tax revenues net of the tax expenditure component (with most also netting out the transfer component), whereas under option 1, tax revenues would be reported gross of the tax expenditure. An inconsistency would be introduced with the treatment of transfers in the SOCX database that currently excludes tax expenditures from social expenditure data. However, the possibility of expanding the coverage of the database could be explored.

Option 2

- Deduct the ‘transfer’ portion of non-wastable tax credits from reported tax revenues – that is, report tax revenues net of the full program cost (tax expenditure plus transfer component) of non-wastable tax credits.

47. The main rationale for adopting this option would be to move towards consistent reporting across countries in a way that is administratively feasible. As noted, a number of countries (e.g., Canada, Mexico, Norway, Germany, U.K.) already report non-wastable tax credits on this basis. For countries that currently follow the Interpretative Guideline and consistently report revenues net of the tax expenditure component but gross of the transfer component, data on the latter may be available (to be confirmed). Option 2 would be more attractive where it can be established that the transfer component can be measured using actual rather than estimated amounts.

48. Under this option, countries able to make the split between the tax expenditure and tax transfer component might consider showing the transfer component as a memorandum item. This additional information would allow the calculation of more pure revenue figures for those countries.

49. While creating greater consistency in reporting aggregate tax revenues across countries, option 2 comes at the cost of moving coverage of the Revenue Statistics further towards revenue reporting net of social expenditures (i.e., further away from ‘pure’ revenue reporting standards based on a benchmark tax

---

For example, where a tax transfer to individuals is provided through an intermediary, and the intermediary is allowed to credit the payment of the transfer against its own corporate or payroll (or other) tax liabilities, the fractions of the estimated total program cost that should be added back to i) reported aggregate personal tax revenues (corresponding to the tax expenditure component), and ii) corporate/payroll taxes (corresponding to the transfer component), would be unknown. It should be noted, however, that the current reporting practice in some countries is misleading where transfer components of non-wastable tax credit programs targeted at individuals offset reported revenues under corporate, payroll or other tax classifications.
system). It would also mean a time series break for those countries (e.g., U.S.) that follow the current reporting procedure set out in the Interpretative Guideline.

50. Also, the treatment of non-wastable tax credits, while consistent across countries on an aggregate tax revenue basis, would not be fully consistent across tax categories. This follows from the use of alternative direct and indirect transfer/refunding mechanisms and the differential impact of alternative mechanisms across tax categories.¹⁴

51. Finally, an inconsistency would be introduced with the treatment of transfer tax credits in the SOCX database. In particular, double-counting of social expenditures would result where the Revenue Statistics reports tax revenues net of tax credit transfers, while the SOCX database treats these amounts as social expenditures. While the possibility of restricting coverage of SOCX to exclude transfers could be explored, it may be that some resistance would be met, given that certain very large non-wastable tax credit programs providing social assistance consist largely of transfer (as opposed to tax expenditure) amounts.

Option 3

☐ Deduct the ‘transfer’ portion of a non-wastable tax credit from reported tax revenues only where at least 50 per cent of the total program cost is claimed as a tax credit by the targeted taxpayer group. Where this threshold test is not met, reported revenues should be measured gross of the full program cost.

52. This approach takes the view that Option 2, while offering consistent treatment across countries, does not provide a balanced distinction between programs that provide assistance for the most part by way of tax relief, and programs that provide assistance primarily by way of cash transfers. For example, under Option 2, tax revenues for the U.S. in 1999 would be reported net of both the $30.5 billion cost of its earned income tax credit program, and the $19.9 billion cost of its child credit program. Yet the programs are significantly different in terms of their linkage with the tax system and pre-credit tax liabilities. Over 97 per cent of the child credit benefit is delivered by way of a tax expenditure. The corresponding figure for the earned income tax credit program is only 16 per cent. Giving equal tax expenditure treatment to both programs might be questioned. Reporting guidelines that permit the whole of a program cost to be set off against tax revenues where the tax expenditure component is small, perhaps negligible, would seem too far removed from the ideal of reporting income tax revenues based on a benchmark measure of income.

53. The tax credit claims that would be taken into account – in determining whether, in aggregate, the tax credit claims amount to 50 per cent of the total cost of a given non-wastable tax credit program – would be limited to tax credit claims of the targeted group. Therefore, tax offsets taken by intermediaries (e.g., credits against corporate or payroll tax taken as compensation for transfers made by them to the targeted group under a given program) would be excluded from the threshold test.

54. Under this option, where a non-wastable tax credit program does not meet the threshold test, no offset against tax revenues would be allowed in respect of that program for revenue reporting purposes. For countries that cannot make the split between tax expenditure and transfer components, the full program cost amount would be added back to total tax revenues measured net of this cost. For countries that can make the split and currently report revenues net of the tax expenditure component, the required adjustment would involve grossing up reported revenues by the tax expenditure amount. In both cases, the approach would be the same – reporting revenue figures net of the full program cost of non-wastable tax credit

¹⁴ For example, a comparison of personal income tax revenues between countries is made difficult where one country allows for a netting of transfers to persons against revenues raised on another base (e.g., property tax) while another country does not.
programs that meet the threshold test, and gross of the full program cost of non-wastable tax credit programs that do not.

55. Option 3, like the previous options, would mean a time series break for countries that currently report tax revenues gross of the tax transfer component of non-wastable tax credits, the cost of which would be set off against reported tax revenues under this option. It would also mean a time series break for countries that currently net the full cost of a non-wastable tax credit program against reported tax revenues, but would no longer be allowed to do so where the threshold test is not met.

56. Again, an inconsistency would be introduced with the treatment of transfer tax credits in the SOCX database. The possibility could however be explored with DEELSA as to whether a similar treatment might be adopted for the purpose of determining social expenditures (i.e., treating the full cost of a given non-wastable tax credit as a social expenditure where more than 50 per cent of the total assistance is provided through cash transfers).

Option 4

☐ Maintain the existing reporting guideline (that the transfer portion not be deducted from reported tax revenues), but introduce new text highlighting inconsistency in the treatment of non-wastable tax credits across countries, and provide where possible figures indicating the aggregate transfer amount.

57. The main argument for following this approach would be to not disrupt the time series. However, this is arguably a weak argument given the general over-riding goal of attempting consistency in reporting across countries, while recognising that this may give rise to breaks in the time series over time as new problems are identified and corrected.
Annex I

Current Reporting Criteria
(Interpretative Guide, § 20-21)

The distinction between tax and expenditure provisions

58. 20. Because this publication is concerned only with the revenue side of government operations, no account being taken of the expenditure side, a distinction has to be made between tax and expenditure provisions. Normally, there is no difficulty in making this distinction as expenditures are made outside the tax system and the tax accounts and under legislation separate from the tax legislation. In borderline cases the principle of cash basis reporting is used to distinguish between tax provisions and expenditure provisions. Insofar as a provision affects the flow of tax payments from the taxpayer to the government, it is regarded as a tax provision and is taken into account in the date shown in this publication. A provision that does not affect this flow is seen as an expenditure provision and is disregarded in the data recorded in this publication.

59. 21. Tax allowances, exemptions and deductions against the tax base clearly affect the amount of tax paid to the government and are therefore considered as tax provisions. At the other extreme, those subsidies which cannot be offset against tax liability and which are clearly not connected with the assessment process do not reduce tax revenues as recorded in this publication. Tax credits are amounts deductible from tax payable (as distinct from deductions from the tax base.) Two types of tax credits are distinguished, those (referred to here as wastable tax credits) which are limited to the amount of the tax liability and therefore cannot give rise to a payment by the authorities to the taxpayer, and those (referred to as non-wastable tax credits) which are not so limited, so that the excess of the credit over the tax liability can be paid to the taxpayer. A wastable tax credit, like a tax allowance, clearly affects the amount of tax paid to the government, and is therefore considered as a tax provision. The same applies to a non-wastable tax credit that is equal to, or less than, tax liability. The practice followed for non-wastable tax credits that exceed that liability is to reduce tax revenues by that part of the tax credit that is offset against tax liability, but to classify as an expenditure any amount of tax credit that exceeds tax liability and is accordingly paid out by the tax authorities.

15 A more detailed explanation of this distinction can be found in Annex II of the 1980 edition of the Revenue Statistics.

16 Sometimes the terms “non-refundable” and “refundable” are used, but it may be considered illogical to talk of ‘refundable’ when nothing has been paid.

17 A different treatment, however, is accorded to non-wastable tax credits under imputation systems of corporate income tax (§32-34.)
Annex II

This Annex reproduces the questionnaire on tax credits, sent out to Delegates on 9 December 1999, with a request for a response to the Secretariat by 15 February, 2000.

QUESTIONNAIRE

In §21 of the Interpretative guide, two types of tax credit are distinguished:

a. wastable tax credits: — i.e. tax credits which are limited to the amount of the tax liability and therefore can never give rise to a payment by the authorities to the taxpayer; and

b. non-wastable tax credits, which are not so limited, so that any excess of the credit over the tax due can be paid to the taxpayer.

A wastable tax credit, like a tax allowance, clearly affects the amount of tax paid to the government and is therefore considered as a tax provision. The same applies to a non-wastable tax credit that is equal to, or less than, tax liability and to that part of a non-wastable tax credit which does not exceed tax liability. However, the Interpretative guide suggests that any amount of tax credit that exceeds tax liability and is accordingly paid out by the tax authorities should be classified as expenditure.

Table 1 seeks to clarify to what degree countries make this split in practice for reporting in Revenue Statistics, i.e. which part of the total revenue loss as a consequence of non-wastable tax credits is reported as lower cash tax receipts, and which part is not offset against aggregate tax revenues, because it is treated as an expenditure item. Where you do not make this split but treat as either all tax or all expenditure, please indicate this in Table 1 and explain under question 2 why you adopt this approach.

Please specify below all tax credits that are part of the personal income tax system of your country, with an estimate of their revenue impact in year 1999. These tax credits may also impact on revenue from the wage withholding tax and/or certain social security contributions. Please include the associated revenue loss (of wage tax and such contributions) to the amount for the personal income tax proper in the third column of Table 1.

Table 1  Tax credits and their revenue impact, 1999

<table>
<thead>
<tr>
<th>Name of programme</th>
<th>Introduced (year)</th>
<th>Revenue impact in 1999 (in millions of national currency) of which reported as:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Tax provisions a)</td>
<td>Expenditure provision b)</td>
</tr>
<tr>
<td>Wastable tax credits c)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

[please specify programme by programme]

Non-wastable tax credits c) |                   |                                                        |  |

[please specify programme by programme]
a. Associated revenue loss is subtracted from aggregate cash revenues reported in Revenue Statistics.
b. Associated revenue loss is not subtracted from aggregate cash revenues reported.
c. Fiscal costs in 1999, or the most recent year for which the requested data is available.

It would be very helpful to have a brief explanation of why you adopt the classification above, particularly if

(i) the credit is given at a flat rate rather than marginal tax rate;
(ii) there are difficulties in splitting between tax and expenditure components.

Are all of the tax credit programmes above included in the description of your country’s tax and benefit system in the Taxing Wages report? For any programmes not included in Taxing Wages, please give a brief description of how the programme works. Please also indicate if the classification of any non-wastable tax credits differs between the Taxing Wages and Revenue Statistics reports.

Please indicate in Table 2 whether your country will introduce new tax credits in years 2000 and 2001.

Table 2  Tax credits under consideration and potential revenue impact

<table>
<thead>
<tr>
<th>Name of programme</th>
<th>Year of introduction</th>
<th>Estimated revenue impact a)</th>
</tr>
</thead>
</table>
| Wastable tax credits
| [specify programme by programme] |
| Non-wastable tax credits
| [please specify programme by programme] |

a) When fully introduced and on an annual basis.

Please note that your reply is expected before 15 February 2000. Thank you for your kind co-operation.

Yours sincerely,

Flip de Kam
Head, Tax Analysis Unit