TAX EXPENDITURES

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It is the basic purpose of every taxation system to collect sufficient tax revenue for the financing of government expenditure. The government also makes use of the tax system to achieve a broad spectrum of economic, social, cultural and other objectives of public policy. In the tax system, various tax measures are often used to achieve such objectives. One such measure is known as tax expenditures. In general, tax expenditures in the widest sense relate to all procedures that exceed the framework of the existing tax rules or criteria for taxation (OECD, 1996:9). Because of these various exemptions, some revenue does not get into the process of the calculation of the relevant form of taxation at all, and such an item constitutes the tax expenditure.

The application of tax expenditures is broad and diverse. In some countries they are used to back up economic development or to encourage savings for pensions, for investment in research and development or charitable donations. The fiscal authorities often endeavour to use them to encourage or, to say it more precisely, to favour the development of an individual branch of the economy or category of taxpayer (sector, corporation or individual) or, indeed, endeavour to encourage a certain economic activity and desirable model of behaviour. The form and scope to which they are used is closely connected with the fiscal policy of the state, for the government deliberately and consciously relinquishes its tax revenue so as, in return, to achieve certain previously proclaimed objectives.

Tax expenditures are a component part of various tax, and sometimes, non-tax laws. They appear in numerous forms, such as tax exemptions (when the income of a certain group of taxpayers is deducted from the tax base), preferential tax rates and abatements, discounts, deductions (for certain costs or amounts), exclusions, incentives, deferrals of tax (when the tax deadline can be deferred without any interest or penalty being incurred), as privileged or reduced tax rates, or as exemptions and reductions of the tax base or tax liabilities (tax credit). Most frequently, but not exclusively, they are introduced into the income tax and corporate income tax systems.

As an example, we will refer here to the tax expenditures in an income tax system. Let us hypothesise that some government wish-

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es to subsidise the wages of employees with the lowest wages. There are several ways in which it can do this. Firstly, it can define by law the minimum pay per hour that an employer is bound to pay to its employees. Secondly, the line ministry can give direct subsidies for all workers who meet the conditions. Thirdly, the tax authorities can settle the additional subsidy for the pay of such workers administratively by reducing the income tax liability for workers with the lowest wages. In practice, some governments achieve the aim in all three ways. Firstly, they prescribe a minimum wage. Secondly, many workers with the lowest receipts, as well as receiving pay, can also claim other benefits, such as food stamps, welfare payments or unemployment benefit. Finally, the tax law will often bring in deductions from income tax for working class families with low or rather modest wages.[1]

The Croatian tax system admits of tax expenditures that are created by the reduction of the tax base or the reduction of the tax amount due. These are the most common expenditures in the personal income tax and corporate income tax systems, and the best-known to the public. For example, all personal income tax payers have the right to a basic personal allowance, as basic tax deduction, which provides them with the basic standard of living. Taxpayers also have the right to additional tax allowances because of special circumstances (marital status, dependents). In recent times reductions of tax base for payments of life insurance, health insurance and interest for mortgages have been very popular. In the corporate tax system, it is incentives that are the most common. There are incentives for employment, for research and development and for training and personal professional development all of which can reduce the corporate income tax base. But as well as these, there are also capital investment incentives, which also reduce the corporate income tax liability.

Tax expenditures are no simple or easy measure, and are often exposed to numerous criticisms. As well as reducing tax revenue, tax expenditures also increase the administrative costs of taxation, distort neutrality, reduce transparency and introduce complexities into the tax system, and are often introduced without any analysis of the costs and benefits they might bring. The ever-increasing number, scope and amounts of the very various kinds of tax expenditures have led to the increasing need for them to be controlled, monitored and analysed. This places the emphasis on the tax authorities as well as on the creators of economic policy who make the decisions about tax expenditures. So as to forestall any possible criticisms relating to their introduction, it is necessary for them to have a precisely determined purpose, to be precisely targeted, and to be based on real needs, as well as to be in harmony with the proclaimed economic and social objectives of the government.

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[1] For more concerning the various kinds of tax expenditures, see Arbutina and Ott (1999).