

Conclusions and recommendations of the National Audit Office

Assessing the impacts of tax law reforms and tax expenditures

The purpose of taxation is to collect revenue for general government for financing public services and current transfers. A total of EUR 96.9 billion was collected in taxes and obligatory social security contributions in 2017. The tax base is narrowed and the nominal tax ratio is lowered by a broad range of different tax expenditures (= exceptions to the benchmark tax system). There are currently more than 180 different tax expenditures and for about one third of them, no euro amounts can be given and for some of the expenditures, only estimates can be produced. The total amount of tax expenditures in 2018 is put at about EUR 26.8 billion, and state tax expenditures account for EUR 17.5 billion of this total. Tax legislation has fiscal objectives and tax laws are also introduced to narrow income gaps. However, some of the tax laws are also aimed at guiding behaviour by means of tax cuts or sanctions. When tax law reforms are introduced it is important to ensure that the assessments of their impacts are sufficiently accurate and as up to date and comprehensive as possible. The purpose of the audit was to examine whether the impact assessments of tax law reforms and tax expenditures have been accurate and produced on the basis of comprehensive information.

Impact assessments of tax law reforms are based on an adequate information base

According to the audit findings, the impact assessments of tax law reforms provide a good information base for decision-making. The information for the assessments can be obtained from a broad range of different sources and several calculation models are also available. The impact assessments are made separately for each tax type and there are slight differences between the practices specific to tax types. The Tax Department of the Ministry of Finance should also have a uniform view on what impacts should be highlighted in the Government proposals. As the impact assessments are change-specific, the combined impacts of changes may be overlooked. For this reason, the Ministry of Finance should also produce assessments of the combined impacts of tax law reforms. Such impact assessments could cover the combined impacts of tax law reforms introduced for one year on the financial position of households, on employment or on specific taxpayer groups.

Even though a large amount of information and good calculation models are available for the assessments, there is a danger that the situation will get worse if not enough attention is paid to the matter. At the moment, there are three calculation models available for individual taxation. The TUJA model (the most widely used) is being phased out because of cuts in personnel resources. Moreover, the second important model used for the purpose must be rebuilt because the Finnish Tax Administration is upgrading its data system. At the same time, shrinking personnel resources may also mean lower-quality calculations. Setting up a system of stand-ins might reduce the risk arising from this.

There is little information available on the impacts of tax expenditures

Tax expenditures are tax laws that deviate from the benchmark tax system. The benchmark tax system and the tax expenditures currently used in Finland were defined in 2009. Since then, there have been changes in the tax legislation and the operating environment and for this reason, it should be examined whether the definition of the benchmark tax system and consequently the list of tax expenditures are still up to date.

Tax expenditures cause substantial reductions in tax revenue. Even though they have a significant impact on general government finances, their effects and the costs arising from them are not regularly monitored and little information is available on their impacts. Only the loss of revenue caused by the tax expenditures is calculated each year. Comprehensive impact assessments of individual tax expenditures have also been made. However, for one third of all tax expenditures, not even the reductions in tax revenue arising from them can be calculated.

Decision-makers need more information so that they can better assess the necessity and usefulness of each tax expenditure in effect. The currently used calculation practices are largely based on the definitions made in 2009. Since then, more information may have become available, which means that it might be possible to estimate the size of some of the tax expenditures. Moreover, the tax expenditures connected with the time-related allocation of revenue or expenditure should be shown separately in the list of tax expenditures. The objective of each tax expenditure should also be stated in the list.

In an audit carried out in 2007, the National Audit Office recommended that performance targets should be set for the tax expenditures and the progress towards the targets should be monitored. No such targets have been set and the actual impacts of the tax expenditures are not monitored. As the tax expenditures weaken central government finances by causing substantial reductions in tax revenue, their impacts and the costs arising from them should also be monitored.

When new tax expenditures are introduced, it should also be stated why a tax expenditure (and not a direct aid scheme or other tools) is selected as a policy instrument. The choice between a tax expenditure and a direct aid scheme should be on the basis of differences in efficiency. If the selection of the policy instrument is not based on genuine consideration and it is not properly justified there is a danger that tax expenditures are used to circumvent central government spending limits. Under the spending limits procedure, the introduction of new tax expenditures is not subject to the same restrictions as the granting of direct aid. Thus, by selecting tax expenditures as a policy instrument, the Government can remain within its spending limits even though expenditure and the need for new debt actually increase.

Recommendations of the National Audit Office

Considering the broad economic effects of taxation, it is important that the assessment of the impacts of taxation and the drafting of tax laws are properly carried out and based on the information available for the purpose. The National Audit Office recommends that the Ministry of Finance

1. should review the objectives of at least the most important tax expenditures and carry out more comprehensive assessments of the impacts of tax expenditures.
2. should ensure that the quality and the speed of delivery of the calculations remain unchanged when calculation models are updated. In this connection, it should also be ensured that the maintenance and usability of the models are not affected by personnel changes. Proper documentation should also be ensured.
3. should, in addition to assessing the impacts of individual tax law reforms, also examine the combined impacts of tax law reforms on economic actors and sectors.
4. should produce an evaluation of the current tax system so that the benchmark tax system can be updated and a new definition for tax s expenditures produced. The opinions of parties not connected with the tax law preparation process should also be heard in the evaluation.