



Domestic
Resource Mobilization
Trust Fund

Establishing a Benchmark: Bhutan - An example of a flexible approach

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Introduction

Remote TA to Bhutan provided by ADB, July 2022 to March 2023.

Objective: Tax expenditure assessment for the five major revenue streams:

- Corporate Income Tax
- Business Income Tax
- Personal Income Tax
- Sales Tax
- Custom Duties

Year of study: 2021

First ever detailed tax expenditure assessment conducted.



Establishing benchmark tax system: Subjective areas under either approach

VAT

- Zero-rating/exemptions
- Reduced rates
- Registration threshold

Personal income tax

- Tax-exempt allowance
- Pension contributions

Corporate Income Tax

- Deductions
- Research and Development
- Capital Expenditure
- Finance (interest)

Concept of 'Structural reliefs' – applied to Bhutan.



Legal Framework for Bhutan

Act	Tax impacted
Income Tax Act 2001	Part 1: Corporate Income Tax Part 2: Business Income Tax Part 3: Personal Income Tax
Sales Tax, Customs and Excise Act 2000	Sales Tax (and Customs until 2017).
Customs Acts 2017 and 2021	Repeals Customs section of above act.
Fiscal Incentives Acts 2017 and 2021	Provides clear sectoral exemptions from CIT, BIT, ST and CD's.
Civil Society and Religious Organisations Acts	Provides exemptions from CIT, ST and CD for registered organisations.



Direct Taxes

- Corporate Income Tax
- Business income Tax
- Personal Income Tax



Corporate Income Tax

2 sources of tax expenditures:

- i) Fiscal Incentives Acts 2017 and 2021
- ii) Income Tax Act 2000

FIA

Targeted tax holidays and exemptions to encourage investment.
All clear tax expenditures under any definition.

ITA

Standard deductions allowed under ITA, including:

- Employment Expenses
- Sales and marketing
- Losses carried forward – 3 years in ITA
- Depreciation – straight line



Corporate Income Tax

Approach for Bhutan:

1. Include all deductions under the ITA in the inventory
2. Use sampling technique to revenue foregone for the following deductions:
 - Employment Expenses
 - Depreciation
 - Interest deductions



Personal Income Tax

Source of Tax Expenditure: Income Tax Act only

Progressive income tax schedule, rates rising to 30%.

- Tax-free personal allowance – Nu 300,000 (US\$3,600).

All deductions allowed under ITA, including (non-exhaustive list)

- Deductions for pension and insurance contributions
- Rental income deductions (for interest, repair and maintenance)
- Deductions for education expenditure
- Exemption from income tax for first Nu 10,000 from dividends/interests
- 30 per cent of the cash crop income shall be allowed as a deduction



Major PIT tax expenditures and structural reliefs

- Revenue foregone from PIT tax expenditures is estimated at **Nu 2.35 billion**, ~1.25% of GDP.
- Personal allowance (first Nu 300,000 of income is tax exempt): **Nu 1.56 billion**, equivalent to approximately 0.83% of GDP.
- GFP and GIS: **Nu 210 million**, **Nu 20 million**.
- Deduction for insurance premium paid to a recognised insurance company (**Nu 164 million**).
- 20% of the rental income for the purpose of repair and maintenance cost (**Nu 166 million**).
- Education allowance for education inside Bhutan (**Nu 123 million**).



Indirect Taxes

- Sales Tax
- Custom Duties



Sales Tax

Sources of Tax Expenditure:

- Sales Tax Legislation
- Exempt organisations
- FIA

Tax expenditures:

- In sales tax legislation – ministerial discretion, plant and machinery, raw materials used solely in manufacturing, hotel rooms below Nu 100 per night, beer, cement, vehicles too.
- Exempt organisations.
- Exempt purchases by qualifying investments under the FIA

Statutory rates under sales tax legislation:

- a. Cement -5%
- b. Telecom Service (Tourist SIM) -7%
- c. Notified Hotels & Restaurants -10%
- d. Cinema Halls -30%
- e. Cable TV Operators -30%
- f. Aerated Water -30%
- g. Beer -100%

Excluded from analysis: 0% Sales Tax rate



Sales tax expenditures

ST exemptions on
imports from India: Nu
662 million

ST Rate	No of Exemptions	Revenue Foregone	% revenue foregone
5%	5,987	194,881,926.94	29.43%
10%	7,396	376,411,007.52	56.85%
15%	228	31,808,135.91	4.80%
20%	325	38,409,947.81	5.80%
30%	5	29,761.98	0.00%
50%	2	71,202.00	0.01%
100%	24	20,468,211.22	3.09%
Total	13,967	662,080,193.38	

ST exemptions on
non-Indian imports :
Nu 237 million

ST Rate	No of Exemptions	Revenue Foregone	% revenue foregone
5%	489	37,821,022.71	16%
10%	407	118,459,700.31	49.90%
15%	15	4,331,855.30	1.82%
20%	13	667,659.14	0.28%
30%	-	-	0.00%
50%	-	-	0.00%
100%	8	76,115,528.21	32.06%
Total	932	237,395,765.68	

Total : Nu 899 million
(~ 0.5% of GDP).



Custom Duties

Legal sources of tax expenditures:

- i) Fiscal Incentives Act
- ii) Customs Legislation (2017 and 2021)

Latest legislation, rates are either 0% or 10%, with the exception of higher alcohol and motor vehicle and vehicle parts.

Tax expenditures:

- i) Custom Duty zero-rating;
- ii) Exemptions arising from the FIA;
- iii) Exemptions arising from other legislation i.e. Custom Duty Act 2017.



Structural Reliefs

- For Personal Income Tax, Sales Tax and Custom Duties:
 - Multiple rates across different income/value levels, including a 0% rate.
 - Does 0% rate count as tax expenditure?
- Bhutan analysis
 - Bhutan analysis includes these for PIT and Custom Duties, but not for Sales Tax as legislation does not provide a benchmark.
 - Deliberate policy decisions, usually motivated by distributional concerns.
 - Have significant fiscal costs