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The Financing Capacity of Taxes and Its Effects on Developing the Tourism Sector in Iraq

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In order to achieve the desired level of development, the management of resources and the setting of priorities are very important. As taxes are the most important of these resources, it is one of the tools of economic policy necessary to achieve balance in fiscal policies. It is instituted to encourage investments and importation of local or foreign products. To identify the economic and social foundations that conform to the requirements of development is one of the most important factors for the success of the tax system. Oil as a semi-sustainable resource has become a sector isolated from the economic sectors with great negative effects. Thus, Iraq has faced a number of economic challenges, which was the obstacle to achieving the desired level of growth in the long term. Those resources that are related to the fluctuation of oil prices are scientifically the most important. Due to political control of the administration on the way they perform, this sector itself was suffering from worsening problems. This is in addition to the problem generated from crises in Iraq, especially the crisis of global debt and the spread of financial corruption. This has burdened the budget with so much financial trouble that it is unable to finance development plans. Many national plans on sustainable economic development were issued in cooperation with the concerned government agencies, international organisations and companies after 2003. However, due to waste of public funds and the spread of financial corruption, none of these plans and strategies has been implemented.

Key words: *Finance, tax, tourism.*

Introduction

In 1967, the concept of tax expenditures emerged when the Assistant Secretary of Treasury of the United States, Stanley Sai, introduced the term tax expenditures to refer to the tax provisions relating to exemptions, deductions, deferrals and incentives in the Income Tax Act as derogation from the provisions of the Income Tax Revenue, which indirectly subsidises the government. Stanley Sai mentioned that careful analysis and control of tax expenditures could help to reform the tax and control of tax expenditures. The first report on tax expenditures was published in the United States in 1976. The concept of tax expenditures within the provisions of the Financial Act of 1980 was adopted by the French Parliament in France.

The concept was adopted and published on a regular basis by nine countries under the OECD (MEF, 2005). A total number of nine countries are legally obliged to report public expenditure regularly out of 17 countries until 2013 in the EU countries (Fack & Landais, 2010). According to Marples (2015), tax expenditures are defined as those losses of revenue attributable to the provisions of federal tax laws that allow special exemption or deduction from gross income with provision of special credit, preferential tax rate, or deferred tax liability. According to the report of the OECD on tax expenditures, the concept is regarded as tax law provisions, regulations or practices that reduce or defer revenue for a relatively small number of taxpayers in relation to a standard tax.

In other words, Kemp & Pearson (2007) regard tax expenditures for the government as a loss of revenue, while for taxpayers it is an obligation; thus, tax expenditures can take several forms including discounts, exemptions, tax deferrals and credits. Sari believes that income tax consists of two distinct elements: the first component consists of the structural provisions necessary for the implementation of ordinary income tax such as the definition of net income, the specifications of accounting rules, the identification of taxable entities, the determination of the tax rate, the levels of exemption and the application of the tax on international transactions. There are special privileges that exist in each income tax and take many forms, such as permanent exceptions to income and deductions, deferral of tax obligations and credits against taxes, or special rates; this has facilitated the determination of the standard tax in income tax (Palisi, 2017).

The creation of a tax structure is required for the identification and assessment of tax expenditures. Certain standards are used to impose appropriate tax rates on a specific general tax base so that the tax expenditures can be defined as deviations from the normal standards used in calculating the difference between any taxes that would have been paid under a specific reference tax law (USAID, Jordan, 2011). The structure shows that the tax expense analysis can be applied to any type of tax law, such as personal income tax, corporate tax, VAT or estate tax. Invariably, they all contain tax expenses. The total value of the impact of tax expenditures on revenues should reach 10% of the GDP (De Renzio, & Angemi, 2012).

Methodology

One of the pillars of good governance is the rationalisation of tax expenditures using accountability, transparency and fairness as yardsticks in order to reduce waste of public funds. Public funds in the source and downstream are considered losses in the tax revenues that could have been obtained by the state and contribute to the financing of development. According to the plan for the period 2013-2017, there was increase of non-oil revenues as a primary goal of financing economic development where the amount of tax revenues increased to 200% from the 2013 budget in 2017. This was as a result of expansion of the tax base and the relative development in the efficiency of the tax system and a large reduction in tax exemptions.

Therefore, this study intends to find out to what extent the tax system contributes to the strengthening of financial resources in order to achieve basic financing and reach the goal of long-term growth in Iraq. The contributions of this study are derived from the importance of the tax issue and its impact on its role in ensuring provision of necessary resources needed to encourage growth and reduce waste in public funds; also to ensure the needs of current generations without wasting what is right for future generations. The aim of this study is to introduce the concept of tax expenditures and highlight their roles in financing sustainable economic development. This study also aims to highlight the size of tax expenditures in the Iraqi tax legislation and to rationalise it, and try to approach the situation in Iraq with concerned authorities in the world.

From all the challenges faced by Iraq in financing economic development, the most important is the dominance of the oil sector as the main source of financing development plans which led to negative effects. This is due to the fluctuation of its prices and the exacerbation of the phenomenon of inflation and the spread of financial corruption. This therefore has necessitated a new alternative that enhances the financial resources of the state and reduces waste of money. In many countries that have adopted this method, the increase in tax revenues through the method of analysing tax expenditures has proved effective.

The Financial Capacity of Tax from the Global Experiences

Tax revenues are particularly important in every country of the world. According to the Organisation for Economic Co-operation and Development (OECD), economic history indicates that in 2016, income and profit taxes such as personal and corporate income taxes as funded by public revenues, increased by 33.6% on average in 2016. In about 16 OECD countries, individual taxes and profits remain the most important source of public revenue financing.

The study found that there is a wide difference between the countries of the world in view of the tax standard as a percentage of the GDP. According to data from 2017, France is ranked first as the highest country in the OECD where the ratio to GDP was 46.2%, then Bulgaria by 44.1% and Sweden by 44%. The United States and Mexico were the least OECD countries with 27.1% for the United States and 16% for Mexico. Thus, it is clear that the effects of the global crisis have led countries such as the United States and Mexico to make moves to reduce tax measures as taxes are high in Europe.

There are fundamental differences in the nature of the global tax system in 2019. Foreign companies and taxes are taxed at 15% and local companies are exempted, with a record turnover of around 14 million in Albania. Local companies with an average return of less than 5 million are exempted from taxes while only a 5% sales tax is levied on annual sales ranging from 5 to 8 million. This tax system has also been implemented in Algeria. There are 19% taxes on non-local companies while local companies are exempted. Taxes amounted to 46% of profits, which were imposed on oil and gas exploration and extraction companies in Bahrain. Egypt also followed a similar Bahraini measure, but with little difference. According to reforms by Egyptian President, Abdel Fattah El Sisi, taxes on oil exploration and production companies were under 5% dividend tax.

In other countries that depend on financing budget through revenue sources, the contribution of tax to finance public expenditure is low. Total taxes and fees constitute 5% of the public revenues used to finance the budget for 2016. (Mohammed et al, 2019).

The Financial Effectiveness of Tax Expenditures

In order for the government to provide support to certain groups of individuals, projects or organisations, tax expenditures are used instead of direct spending. They are functionally linked to direct spending programs from a public finance perspective, but they have the added advantage of being largely invisible to tax policy makers without being dealt with (Burman & Marvin, 2012). They are spending as the tax cuts but there are several things that affect their effectiveness in achieving the goals they set such as (USAID, Jordan, 2010):

1. First, tax expenditures can represent a significant amount of lost revenue
2. Second, due to poor accountability in the annual budget cycle, it is possible that the effectiveness of tax expenditures may be gradually reduced.

3. Third, due to progressive income tax and tax incentives, tax expenditures may serve disproportionately high taxpayers as well as creating imbalances and complications in the tax system.

The states began to include in their public budgets an inventory of all tax expenditures as these expenditures reduce government revenues as a result of the privileges granted indirectly. The estimated cost of each year is calculated and the possibility of reducing or abandoning part of it is studied. The US Congress found through tax expenditure analysis that 66% of tax revenues are used by the tax to achieve the intended objectives. The government can achieve, through direct spending, the best utilisation of financial resources and reduce waste (Palisi, 2017). If the lost revenue is attributed to 10 per capita income tax expenditures, then the 51 per cent of the benefits went to the top 20 per cent of taxpayers (Marples, 2015).

The US Treasury estimated tax expenditure at $1.2 trillion in 2011. This shows that the largest income and defence spending will be roughly equal to total estimated spending. Income tax expenditures account for a quarter of total spending and about 8% of GDP. Without loss of net tax revenue, the elimination of income tax expenditures can reduce income tax rates by almost half of most projected budget deficits for the next 20 years (Burman, 2011). It was found in 2016 that reforms to some tax expenditures could increase tax revenues by $366.3 billion or almost half of the budget deficit (Burman, Toder, Berger, & Rohaly, 2017). Tax credits were found to cost more than the entire income collected through the personal income tax system in the Czech Republic and revenues lost due to tax allocations or tax credits exceeded 10% of total government revenues in Denmark, Germany and Spain altogether (Avram, 2014).

In 2012, the French budget attaché revealed that approximately €470 billion of the tax expenditure with a total cost of about €70 billion, where €35 billion corresponds to the relevant personal tax and expenses income tax with less than €9 billion are recoverable tax credits, calculated as overhead directly in public accounts. The most exciting fact concerning the expenditure is that the appendix to the budget for tax expenditures recognises that the €237 billion from the €470 billion tax expenditures cost can only be an approximate amount of volume. France has acknowledged that many of the current tax expenditures are ineffective and should be removed (Burman, 2014).

In another vein, tax revenues in the Arabian Peninsula of the Middle East and North Africa (MENA) region are lower than in emerging and other developing countries. This indicates a potential increase in tax revenue. Higher revenues will create fiscal space and allow more spending to meet the economic and social requirements of the Arab world. About two-thirds of taxes on personal and corporate income suffered from large tax expenditures (such as exemptions or allowances) that were designed to help the poor while ultimately benefiting the rich. The top quintile of the income distribution accounts for approximately 40% of VAT expenditures compared to less than 10% for the lower quintile (IMF, 2015).

Since 2005, the Kingdom of Morocco reports annually on tax expenditures for revaluation and costing which is found to be around 102 million dirhams. The cost of tax expenditures was estimated at 14.995 million dirhams in 2004 and 15.457 million dirhams in 2005 (MEF, 2005). Due to the increase in the percentage of expenditures, the cost of tax expenditures rose to 36.238 million dirhams in 2012 and to 34.173 million dirhams in 2013, but it has been rated and rose to about 412 million (MEF, 2014). One of the tax expenditure studies conducted by the Ministry of Finance in Jordan in 2002 assessed the tax exemptions and incentives under the Income Tax Law and found that the value of uncollected revenues for the year 2000 amounted to 210.6 million.

In Jordan, a report on tax expenditures showed the cost of tax expenditures for 2010 constituting 14 per cent of the GDP or 10.7 per cent of public expenditures of at least 5 per cent of the GDP. The tax revenue collection for the same year was 15.3% of the GDP while the income tax on individuals was the largest item of tax expenditures estimated to 6.1% of GDP. The second largest source of tax expenditures of 4.3% of the GDP came from exempted resources for a number of products under the General Sales Tax Law and the tax expenditures from customs duties ranked third at 1.3 percent of GDP while wasted income from real estate tax was estimated at 1% of GDP (USAID, Jordan, 2011).

Challenges of Sustainable Economic Development in Iraq and Analysis of Tax Expenses Economic Development in Iraq

After 2003, many national plans on sustainable economic development were issued in cooperation with relevant government agencies, international organisations and companies. For example, this was found in the cases of the five-year development plan, the anti-poverty strategy of the Ministry of Planning, the Education and Higher Education Strategy of the Ministries of Education and Higher Education, oil and private sector development strategy by the General Secretariat of the Council of Ministers and the National Energy Strategy of the Ministry of Energy. In addition to many development projects, none of these plans and strategies has been implemented while billions of dollars have been spent. However, the proportion of it is still low so far, but the completion of it lacks both economic and technical sustainability. Many infrastructure projects such as public buildings, schools, streets and gardens were completed after 2003 and are now in a state of catastrophe due to the spread of corruption.

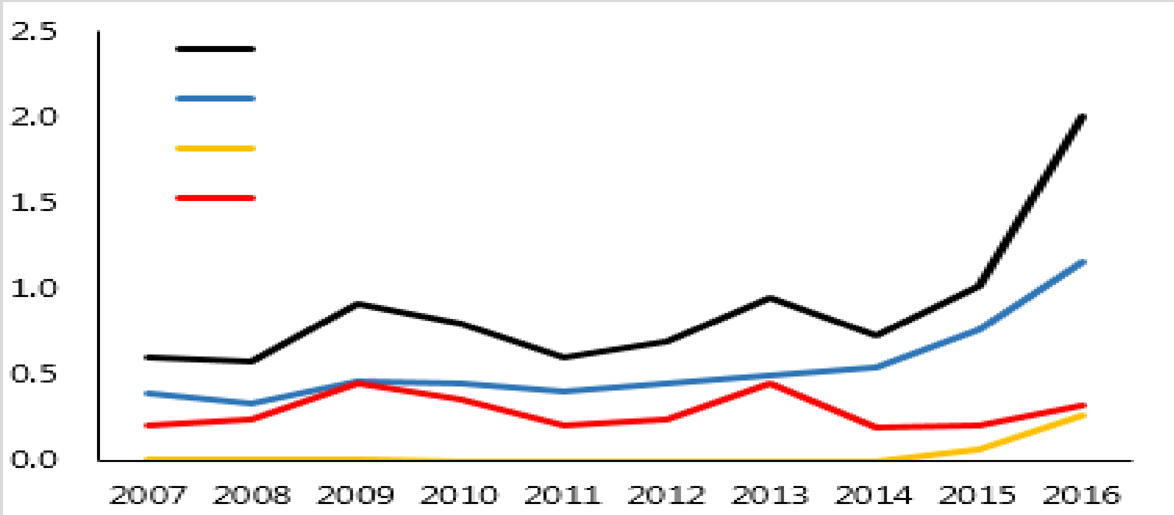
The NDP, for 2018-2022 confirms that the previous development plans did not achieve their stated objectives. Due to this, the Iraqi economy suffers from significant challenges which were parts of the most important deterioration of the investment climate affected by the political and economic factors. In terms of international indicators, Business Index showed that Iraq is ranked 165 out of 190 countries in 2016. Iraq was one of the weakest countries in the index of investment in terms of attractiveness which reached 3.27 out of 100 in 2016.

Oil is the most dominant sector contributing to the GDP. This has led to a clear imbalance in the trade in terms of the increase in the proportion of oil exports to 99% of the total Iraqi exports, with a striking diversity in all revenues. This has resulted in oil revenues taking the first place from the ladder of the general budget revenues, which constituted 9.85% of the total estimated revenues for 2017 amounting to 011.79 trillion dinars. This has made the budget to be responsive to external shocks and then suffers from the fluctuations of oil prices. The Iraqi economy suffers from underdevelopment of the banking system and the expansion of the informal sector. There is limited role in the private sector and low efficiency of institutional performance. The rate of unjustifiable wastefulness in wasting resources has deepened the apparent corruption and turned the corruption into a source of drain and waste of public money. The important part of the income and output has been truncated in terms of governance index. According to International Transparency Group, Iraq has become among the top ten the most corrupt countries in the world in 2015 (NDP, 2018-2022).

Tax Expenditures in Iraq

Tax revenues in Iraq are characterised by a significant decline. Throughout the history, the ratio of tax revenues to the GDP in Iraq has not exceeded 1% which is low compared to the same average rate in the Middle East and North Africa. In contrast, Afghanistan and Pakistan have more than 10 times compared with Iraq and smaller countries with the same economic situation (IMF, 2017).

Figure 1. Ratio of taxes to GDP



Black colour indicates the total taxes
Blue indicates income tax
Red indicates business taxes
Yellow refers to taxes on goods and services

Source: International Monetary Fund, Iraq Selected Issues (2017)

This is as a result of the tightness of the tax base, the weak legal basis, the low efforts of the tax and customs administration, the expansion of tax exemptions, the reduction of temporary liabilities and tax facilities. In addition, this is due to tax expenditures such as exemptions, allowances and discounts that lead to the erosion of the tax base (IMF, 2017). Finding a solution to these problems will encourage urban movement in the country in addition to the prevention of double taxation (Burman & Phaup, 2012).

Corporate income tax also suffers from a large number of temporary exemptions, tax incentives and exemptions. Income tax from corporate firms represents 0.2% of the GDP. This is reflected in the volume of customs tariff revenues which constituted 0.5% of the GDP (IMF, 2017). The higher tax rate was reduced to 15% compared to the previous tax rates of 40% for Iraqis living in Iraq and 45% for non-residents (Sabah, 2006).

Table 1: Tax Expenditure for each type of tax in Iraq

Tax type	Number of exemptions granted
Income Tax No. 113 of 1982 as amended	25 types of exemption in addition to 11 types of expenses allowed and download the loss for 5 consecutive years
Real Estate Tax No. 43 of 1971 as amended	12 full exemption and 5 temporary exemption
The tax of lates No. 26 of 1962 as amended	8 type of exemptions
Investment Law No. 13 of 2006 as amended by Law No. 2 of 2010	Exemption for (10) ten years from the date of commencement of operation and granting the right to the Council of Ministers to extend the exemption and granting additional exemption and granting the National Investment Authority to increase the number of years of exemption to 15 years in addition to 4 exemptions, including the project assets imported

The work of researchers depending on tax laws

Results

The Impact of Tax Deductions in Iraq from the Approach of other Countries

The nature of the tax system in Iraq indicates that it helps in eradicating corruption by giving support through the IAEA. The support agreement focused on raising the financial capacity of the financial system. Taxes were likely to play an important role in financing and stimulating investments. It has been concluded that tax laws (as in income tax) are the basis and most important factor in increasing financial capacity in Iraq. The situation in Iraq is very similar to other countries that put tax incentives under one government agency with the objective of providing financial support. The study concluded that tax systems that put tax administration under one body lead to corruption.

After 2003, Iraq was one of the countries that have been interested in rebuilding its tax system. The legal side was based on the adoption of corporate income tax as a new source of revenue to be adopted after 2008. However, this had led Iraq to incur debt by agreements and rehabilitation of infrastructure resulting to the low possibility of its adoption. Additionally, the non-large economy cannot tax capital invested as investors under globalisation, which will compare the local rate of return with the international rate of return. The important fact is that Iraq faces the difficulty of moving work with ease in the transfer of foreign capital inward after deducting taxes on investments abroad through comparison, which can lead to a reduction in the productivity of the local factor.

If the impact of the increase in tax expenditures on the total tax to be collected before Order 49 of the Coalition Authority 2004 is followed, then it can be presented as follows:

Table 2: The effect of increasing tax expenditures on the tax revenues of a family with one parent and four children

Annual income	The amount of tax before order 49	The amount of tax after order 49
1000000	0	0
1500000	10000	0
2000000	95000	0
3000000	355000	0
5000000	1115000	0
6000000	3515000	40000

Sabah, S. J. (2006), Tax Law Group, Legal Library, Baghdad

The table shows that the total tax revenue lost due to the increase of tax expenditures for one family is 3,050,000 per year.

Table 3: The impact of the increase in tax expenditures on the tax revenue of single parent who does not support anyone

Annual income	The amount of tax before order 49	The amount of tax after order 49
0	55000	0
0	155000	0
0	295000	0
20000	635000	20000
295000	1435000	295000
315000	1777000	315000

Sabah, S. J. (2006), Tax Law Group, Legal Library, Baghdad

The Table 3 shows the total tax revenues lost due to the increase of tax expenditures for one taxpayer is 630,000 per year. It also shows the plan 2013-2017 to increase non-oil revenues as a main goal to finance economic development, where the amount of tax revenues increased by 200% from 2013 to 2017 as a result of expansion of the tax base, the relative development in the efficiency of the authority and a wide reduction in tax exemptions and focus on the major companies invested in the oil and telecommunications sectors. Therefore, the government has begun to gradually reduce the price subsidies of services and push to raise the level of collection efficiency and collection of state dues. The outlets are found to increase the revenues on new services provided by the public sector and to encourage participation and investment. The custom system is improved through the activation of tools in order to reduce control and enforcement. This increased customs revenues by more than 200% in 2017 compared to 2013 (NDP, 2018).

The study found that income taxes in Iraq were greater than taxes on companies through an approach to the size of tax deductions and their effects. Iraq has been interested in applying the instructions of the World Bank to impose income tax, especially the entry of workers in the public sector. However, from the best cases, the rate did not reach 8% while Singapore, for example, has succeeded in imposing equivalent taxes on public and private incomes and corporate profits with a tax rate of 43% from public revenue. Hong Kong is 63%; Korea has 56% on the public wage and labour force, while 5% for the three countries: Singapore, Hong Kong and South Korea.

The discriminatory tax treatment has done well in favour of the labour force. Thus, these countries have been able to overcome the financial crises that hit the market recently. It was able to attract money at a time when the United States and Europe was mired in the financial crisis (mortgages).

Conclusions

From the result and discussion of this study, the following conclusions are arrived at:

1. It is important for tax policy makers to understand that tax expenditures are tied to revenues as a cost to the state treasury, which is linked to the state budget. Therefore, the increase in tax expenditures will be based on reducing the amount of tax revenues, thus, reducing the direct public expenditure which is considered to be economic effects of such decisions.
2. The approach of good governance is the basis for financial sustainable development, economic diversification and promotion of sustainable growth. Rationalisation of tax expenditures is one of its main pillars to enhance the capacity of financing sustainable development.
3. The elimination of financial corruption is supportive of the policy of rationalisation of tax expenditures and many national plans and strategies in addition to development projects, which billions of dollars have been spent on, due to lack of economic and technical sustainability and financial corruption.
4. Tax expenditures can encourage tax evasion or avoidance. Many tax expenditures can distort and lose value by increasing the flexibility of taxable income above its optimal level.

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