SDG & Tax Incentives

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INFF | Integrated National Financing Frameworks

The Kyrgyz Republic is introducing an article into the new Tax Code on principles of tax incentives effectiveness, which establishes a provision of tax incentives for promoting sustainable development of the country.

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CHALLENGE

One of the key instruments that the Kyrgyz Government is using to engage and attract private investment is tax incentives. These are significant in scale, estimated to cost around 5% of GDP in foregone revenue, and in 2020 it reached 32,3 billion som (see table 1). Yet the systems to monitor their use and impact, manage their effectiveness, and report on their costs and benefits, were underdeveloped.

The Kyrgyz Republic provides tax incentives both to support the development of a certain sector of the economy and certain categories of taxpayers. At the same time, some tax incentives are not well-targeted as some tax incentives have the same effect on all taxpayers: in particular, standard income tax deductions or deductible expenses for income tax, and zero rates of VAT for export supplies. The total amount of tax incentives, exemptions, and preferences granted under the Tax Code is estimated at about 30.0 billion som, this amount does not include the standard benefits, which have the same effect on all taxpayers. Despite the significant amount of tax incentives, exemptions and preferences granted, initiatives are periodically raised to provide additional benefits for certain taxpayers or sectors of the economy without well-grounded justification, based on certain methodology. One of the reasons of this situation is associated with the absence of a system to regularly assess the efficiency of provided tax incentives. While the Government has a methodology for assessing the efficiency of tax incentives, it was not operational, as the previous Tax Code had no such requirement.

SOLUTION

To address this challenge, INFF has provided support to the Ministry of Economy and Commerce (MoEC) in drafting and introducing an article into the new Tax Code on principles of tax incentives effectiveness, which establishes a provision of tax incentives for promoting the sustainable development of the country. In particular, it sets a framework for providing tax incentives only for the following purposes[1]:

- promoting **sustainable development** of the country;
- attracting investment and financing to priority sectors of the economy for **sustainable development**;
- achieving the priorities of the **National Development Strategy (NDS)**;

This article can serve a gatekeeper function in introducing new tax incentives and assessing the current incentives, as the authorities would be guided by the above-mentioned principles, stipulated in Article 14 of the Tax Code.

As the country's priorities may change over the years, the new Tax Code set a requirement to annually conduct the assessment of tax incentives to monitor their relevance. This approach will enable the authorities to regularly assess the efficiency of each tax incentive and take respective and timely decisions on their continuation or cancellation. This in turn will enable the authorities to generate more revenues for financing the NDS priorities and introduce new tax incentives that could attract private investment to the sustainable development priorities of the country.

In addition, the INFF supported an analysis of provided tax incentives against the SDGs[2] for the last five years. According to the analysis, 40% of the incentives are focused on SDG 8, 33% on SDG 1, which shows the government's efforts to ensure economic growth and end poverty through providing tax incentives in these directions. SDG 3 and 9 receive about 9% and 8% incentives respectively. The SDG 3 incentives were considerably increased in 2020 due to the COVID-19 outbreak. Other SDGs received less than 11% incentives during the considered period. Interestingly the SDG 4 related incentives were about 0.2%, which can be implied that there is room to utilize the tax incentives instrument to attract private investment into the sector. This will enable the country to improve the quality of education, which in turn will lead