



WP/21/40

IMF Working Paper

Encouraging Formal Invoicing and Reducing the VAT
Impact on Low-Income individuals

by Ricardo Fenochietto and Juan Carlos Benítez

I N T E R N A T I O N A L M O N E T A R Y F U N D

IMF Working Paper

Fiscal Affairs Department

Encouraging Formal Invoicing and Reducing the VAT Impact on Low-Income Individuals

Prepared by Ricardo Fenochietto and Juan Carlos Benítez¹

Authorized for distribution by Ruud de Mooij

February 2021

IMF Working Papers describe research in progress by the author(s) and are published to elicit comments and to encourage debate. The views expressed in IMF Working Papers are those of the author(s) and do not necessarily represent the views of the IMF, its Executive Board, or IMF management.

Abstract

This paper analyses and compares two different groups of tools, the first to encourage the use of invoices (or payment systems) and the second to refund the VAT to low-income individuals. The analysis contributes to the existing literature by providing a clear characterization between these two groups of tools that are too often misunderstood and offers clear guidance to policymakers on the benefits and pitfalls of them based on available empirical studies and novel data analysis. Briefly, the first group includes a set of regressive and distortive tools (such as, allowing deducting the VAT paid on personal consumption from the PIT and reducing the VAT rate for using electronic means of payments or registration), while the second group includes tools that are less distortionary and improve income distribution (tax credits and VAT rate reduction targeted only at low-income individuals). This paper also finds that allowing the deduction of personal consumption against the PIT's taxable base (i) did not impact positively the VAT revenue in Guatemala and (ii) worsens the income distribution in Ecuador.

JEL Classification Numbers: D04, D31, H24, H26.

Keywords: PIT tax credit; VAT deduction from PIT; VAT rate reduction for electronic payments; electronic invoice; VAT impact on low-income individuals.

Author's E-Mail Address: Rfenochietto@imf.org; JBenitez@imf.org.

¹ We are grateful to Alexander Klemm, Katherine Baer, David Baar, Shafik Hebous, and Paulo Paz for their comments and suggestions.

Content	Page
Abstract _____	2
Acronyms _____	4
I. Introduction _____	5
II. Tools to Encourage the Use of Invoices or Payment Systems _____	5
A. The VAT Paid on Personal Consumption Creditable Against the PIT or Deductible Against Taxable Income _____	5
B. The Reduction of the VAT Rate for Using Electronic Means of Payments _____	12
C. Lottery Programs _____	14
III. Tools to Reduce the Impact of the VAT on Low-Income Individuals _____	17
A. Tax Credit to Low Income Taxpayers _____	17
B. Smart Cards to Refund the VAT to Low Income Individuals _____	19
C. The VAT Paid Creditable to all Taxpayers with Limits _____	20
IV. Conclusions and Policy Recommendations _____	21
References _____	29
Box	
1. The VAT Impact on Low Income Individuals in LICs and EMEs _____	19
Figures	
1. Bolivia, PIT (VCR) Revenue _____	9
2. VAT Revenue and VAT Non-Compliance (2008-2018) _____	11
3. Imports and VAT Revenue (2008-2018) _____	12
Tables	
1. Countries with VAT as a Credit or Deduction to the PIT _____	6
2. PIT and Tax Revenue by Group of Countries _____	8
3. Ecuador – The Revenue and Equity Impacts of Eliminating the PIT deduction allowed for Personal Expenses _____	10
4. Ownership of Financial Accounts and Digital Transactions by Income Group and Digital Transactions by Income Group and Gender (2017) _____	13
5. Portugal: Effect of the VAT Credit against the PIT _____	21
Appendices	
I. Measuring the Impact of the 2012 PIT Reform on VAT Revenue in Guatemala an Empirical Approach _____	23
II. The Impact on Income Distribution of Exemptions and Reduced Rates of Exemptions and Reduced Rates of Consumption Taxes _____	26

ACRONYMS

CAD	Canadian Dollars
CIT	Corporate Income Tax
EMEs	Emerging Markets and Developing Economies
ETR	Effective Tax Rate
FAD	Fiscal Affairs Department
GDP	Gross Domestic Product
GST	General Sales Tax
HST	Harmonized Sales Tax
LICs	Low Income Countries
PIT	Personal Income Tax
URU	Uruguay Peso
VAT	Value-Added Tax
VCR	VAT Complementary Regime