



DOMINICAN REPUBLIC TAX SYSTEM REVIEW

World Bank Policy Note

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DOMINICAN REPUBLIC

GOVERNMENT FISCAL YEAR

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CURRENCY EQUIVALENTS

Currency Unit: Dominican Peso (RD\$)
(Exchange Rate Effective as of 5/20/2020)
US\$1.00 = RD\$55.45

Abbreviations and Acronyms

AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BEPS	Base Erosion and Profit Shifting
CbCR	Country by Country Reporting
CIT	Corporate Income Tax
DGA	<i>Dirección General De Aduanas</i>
DGII	<i>Dirección General de Impuestos Internos</i>
DR	Dominican Republic
GDP	Gross Domestic Product
IF	Inclusive Framework
IMF	International Monetary Fund
ITBIS	<i>Impuesto sobre la transferencia de bienes industrializados y servicios</i>
LAC	Latin America and the Caribbean
LOB	Limitation of Benefit
MLI	Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (The ‘Multilateral Instrument’)
MNE	Multinational Enterprise
OECD	Organization for Economic Co-operation and Development
PE	Permanent Establishment
PIT	Personal Income Tax
PPT	Principal Purpose Test
RST	Simplified Tax Regime
TADAT	Tax Administration Diagnostic Assessment Tool
UBO	Ultimate Beneficial Ownership
VAT	Value Added Tax

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Preface

Across Latin America and the Caribbean, the challenge of enhancing domestic revenue mobilization has emerged as an important priority for achieving the Sustainable Development Goals and financing national development agendas.¹ Taxes are fundamental to public revenue, and the design of tax policy profoundly influences a wide range of social and economic outcomes. Understanding the complex implications of differences in tax rates and structures is therefore integral to both mobilizing revenue and achieving development objectives.

The deficiencies and idiosyncrasies of the Dominican Republic's tax system have posed a longstanding challenge to policymakers. The country's tax base is extremely narrow; revenue levels are very low relative to the size of the economy; and a dense web of exemptions and deductions raises the cost of tax compliance while undermining revenue administration. Increasing public revenue by broadening the tax base and/or streamlining the tax code has been a stated priority of multiple administrations, as enhanced revenue mobilization will be necessary to advance the country's social and economic development objectives by financing an expansion of public services coupled with fiscal support to poor and vulnerable households.

This note was prepared during the final months of 2020, shortly after a new administration took office amid the devastating and, as of yet, still unresolved Covid-19 pandemic. The unprecedented macroeconomic shock of the pandemic has greatly intensified the urgency of tax reform, but it has also reshaped the reform agenda. No tax increases are expected in the near term, as economic activity remains weak; household income is increasingly precarious; and employment dynamics are highly fragile. Meanwhile, emergency spending is expected to continue, and the ongoing economic contraction is further reducing public revenue. The objective of this note is to inform a medium-term strategy for leveraging tax reform in support of a broader effort to reestablish stable fiscal balances and sustainable long-term debt dynamics as the crisis subsides and economic activity normalizes.

This note complements the analysis presented in a concurrent public expenditure review (PER) series. The first volume in the series was completed in 2019 and covered electricity, healthcare, and education. A forthcoming second volume examines fiscal risks associated with state-owned enterprises and public-private partnerships, service provision in the water and sanitation sector, and the effectiveness of the social protection system. The PER series highlights the need for a fiscal adjustment implemented through coordinated reforms on both the revenue and expenditure sides of the budget. As a PER is naturally focused on expenditure-side measures, this note analyzes opportunities to boost revenue collection while addressing equity concerns and advancing other social and economic priorities.

¹ OECD et al. (2019), *Latin American Economic Outlook 2019: Development in Transition*, OECD Publishing, Paris, <https://doi.org/10.1787/q2q9ff18-en>.

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Executive Summary and Policy Recommendations

Despite decades of impressive economic growth, tax revenues in the Dominican Republic (DR) remain well below the regional average. The DR's average GDP growth rate exceeded 5 percent over the past 25 years and reached 6 percent during 2014-19, before the Covid-19 pandemic caused a deep contraction in 2020. Income per capita rose from 57 percent of the regional average in 1992 to 92 percent in 2016, yet revenue mobilization has remained extremely low by the standards of comparable countries. In 2018, the DR's total fiscal revenue equaled just 13.2 percent of GDP, well below the average for Latin America and the Caribbean (LAC) and one of the lowest levels among countries in the DR's global income group.

The DR's tax base is extremely narrow, with extensive exemptions, deductions, zero-ratings, and allowances across all major tax categories. Tax expenditures amounted to an estimated 4.8 percent of GDP in 2020, of which value-added tax (VAT) exemptions alone accounted for 2.5 percentage points. The extraordinary complexity of the tax regime undermines the revenue base, erodes the efficiency of tax administration, and contributes to the high degree of market concentration observed in the DR. Because large incumbent firms often have the greatest capacity to navigate the country's complex tax regime, they are better able to access tax benefits than smaller competitors, startups, or international investors. Moreover, the tax system has been subject to frequent changes, which diminish the DR's international competitiveness and discourage formalization.

High levels of tax noncompliance and low tax morale further diminish revenue collection. In 2017, tax evasion cost the government the equivalent of an estimated 9.5 percent of GDP in forgone revenue, a much larger share than in most LAC countries. Revenue losses due to tax evasion range from 44 percent for VAT to 57 percent for personal income tax (PIT) and reach as high as 62 percent for corporate income tax (CIT). Though it has the lowest rate of tax evasion, VAT accounts for the largest share of tax revenue, and thus VAT evasion entails the greatest total cost in forgone revenue at an average of 5.8 percent of GDP. Reducing tax evasion could significantly increase revenues while contributing to a more progressive fiscal system. In addition, low public confidence in the government weakens tax morale, which will complicate efforts to improve compliance.

An excessively complex and overly generous array of tax incentives weakens the performance of CIT while doing little to advance the government's economic development objectives. CIT is the government's second-largest source of revenue, but collection rates are below regional average due to tax incentives and evasion, with the former encouraging the latter. The discretionary use of tax concessions to incentivize private-sector activity is especially problematic, as it contributes to an opaque and unpredictable tax administration. The experience of other LAC countries demonstrates that CIT revenue can be increased solely through efficiency gains without the need to raise the CIT rate. The government should rationalize its multiple tax regimes by shifting from profit-based tax incentives to an investment-targeting model.

A high eligibility threshold and various exemptions narrow the PIT tax base. Because the eligibility threshold effectively exempts taxpayers who receive the average wage, most PIT revenue is collected from a relatively small share of salaried workers. PIT deductions and allowances disproportionately benefit middle- and upper-income taxpayers and are susceptible to abuse. During economic expansions, the narrowness of the PIT tax base reduces tax revenue and distorts the tax structure, and during recessions it limits the scope of tax-based stimulus policies to a small fraction of the employed workforce.

The COVID-19 crisis has highlighted this challenge, as PIT deferrals, rebates, and similar policies have proven inadequate to either bolster aggregate demand or safeguard household welfare.

The CIT and PIT bases remain narrow, while VAT, which is the main source of revenue, is riddled with exemptions and zero-ratings that heavily favor wealthier households. In addition, the DR has one of the world's lowest collection rates for property taxes and bringing property-tax revenue as a share of GDP in line with the LAC average would increase collection of property tax revenue by more than 400 percent. Improving tax compliance and tightening enforcement will require more efficient tax administration methods, including innovative approaches to combatting tax fraud, the evasion of VAT arrears, underreporting, and the shadow economy. Streamlining tax exemptions could facilitate this effort by reducing the administrative burden on the tax authorities.

Tax reforms should be phased in over time with broad public support. In the current macroeconomic climate, the sudden withdrawal of the debt-financed fiscal stimulus would have deeply negative repercussions. While current policies favor large firms, many of these firms would not be able to withstand the abrupt termination of incentives on which they have come to rely. Similarly, small and medium-sized firms will need time to adjust to a more favorable tax regime. Moreover, the elimination of some tax expenditures may lead to price increases, which would require fiscal expenditures to mitigate their impact on poor and vulnerable households. The reforms themselves must be designed to minimize the distortions of the tax structure in terms of its impact on savings, investment, and consumption decisions. Key considerations include the amount of revenue mobilized by each tax type; the ability of firms and sectors to adapt to changes in the tax structure; the effects of the tax structure on income distribution; the environmental and social aspects of tax policy; and the administrative capacity necessary to offset the impact of tax increases on poor and vulnerable households.

Key findings for a future tax reform

Tax policy should focus on the small number of taxes that generate the majority of tax revenue. To increase revenue mobilization and enhance the effectiveness of tax-based fiscal policy, the government should prioritize reforms aiming at broadening the base by rationalizing tax expenditures. Streamlining exemptions, deductions, zero-ratings, and other tax expenditures that have proliferated at every level of the tax system would increase revenue mobilization and simplify tax administration. Building the institutional capacity of the tax authorities and strengthening oversight and enforcement mechanisms could further expand the effective tax base and raise additional revenues by reducing tax evasion. Measures to encourage formalization and reinforce public confidence in the integrity of revenue management could bolster tax morale, contributing to a virtuous cycle of transparent enforcement and voluntary compliance.

Streamline tax expenditures

The DR's tax-expenditure framework falls short of international good practices. Tax expenditures are fragmented across numerous legal instruments and are regulated by different administrative agencies, which exercise considerable discretion. Phasing out tax expenditures could increase net revenue while simplifying tax administration and promoting compliance. Most tax expenditures are in the form of VAT exemptions, PIT deductions, and special tax incentives targeted to the private sector. For example, firms located in special economic zones (SEZs) receive over half of all CIT expenditures, including generous tax holidays. Many CIT incentives are limited to specific sectors or even individual firms, and some—such as exemptions on food products that are not part of the basic consumption basket—have little or no

demonstrable impact on the government’s policy objectives. While this report identifies several important tax expenditures that can be phased out in the near term, additional cost-benefit analyses of individual incentives will be necessary to develop a comprehensive consolidation agenda focused on simplifying the tax regime while using transparent public expenditure policies to ensure that tax reforms make a positive contribution to distributional equity. As eliminating tax exemptions can be politically difficult, such an agenda must be supported by clear and compelling evidence.

Widen the tax base and increase the efficiency of the main tax categories

The standard VAT rate could be applied to most currently exempted goods, provided some of the revenue mobilized could be used to finance service delivery by the government. Based on a 2016 WB CEQ analysis eliminating all VAT exemptions could boost revenue collection by about 2.2 percent of disposable income (after direct transfers) while eliminating exemptions on education, healthcare and electricity alone could increase revenue by 1.7 percent of disposable income. Phasing out VAT exemptions and zero ratings could generate considerable additional revenue, but these measures must be combined with additional fiscal spending to counter their adverse impact on poor and vulnerable households such to finance direct cash transfers to vulnerable households, offsetting any adverse welfare impact while improving economic efficiency. The post-pandemic recovery offers an opportunity to streamline the most costly and least efficient tax expenditures while other factors dominate macroeconomic developments.

A well-designed PIT reform program could advance key social objectives, including lowering the PIT’s eligibility threshold would broaden the tax base and improve the effectiveness of fiscal policy. While lowering the threshold would increase the tax burden on the middle class, applying higher marginal rates to high-income earners and reducing the minimum marginal tax rate would enhance the structural progressivity of the tax system. Deductions and credits not related to income generation should be reviewed and possibly eliminated, as they further narrow the base and while disproportionately benefiting wealthier households.

To restore tax neutrality among firms and sectors, policymakers must review and consolidate the elaborate array of CIT incentives. A cost-benefit analysis of SEZ tax holidays and the preferential tax treatment offered to sectors such as manufacturing and tourism could help build consensus around the need for reform. Establishing a level playing field of for all companies could broaden the tax base, facilitate the integration of smaller firms into the network of larger firms thus supporting technology transfer and boosting employment creation. Thus, the government should also review the design and performance of the recently created Simplified Tax Regime (*Régimen Simplificado de Tributación*, RST) to determine whether its threshold incentivizes tax bunching or the creation of parallel systems.

Increasing excise taxes on fuel, alcoholic beverages, and tobacco could further bolster revenue mobilization, while addressing negative externalities. Taxes on fuels, cigarettes, and alcohol help internalize the social and environmental costs associated with the consumption of these goods. Setting the appropriate rate for each tax requires quantifying the costs of the various negative externalities linked to each product. Cross-country comparisons indicate that raising the DR’s excise taxes, especially on fuels, would be consistent with international best practices.

Implement international tax measures to prevent profit shifting and effectively tax e-commerce

Although the DR is a party to the Convention on Mutual Administrative Assistance in Tax Matters, the government has yet to enact domestic tax legislation on country-by-country (CbC) reporting or sign the Multilateral Competent Authorities Agreement for exchanging CbC information. The sharing of CbC reports between tax administrations is vital to inform high-level transfer pricing and base erosion and profit shifting (BEPS) risk assessments. To ensure tax compliance by multinational firms, the government should implement a domestic legal and administrative framework to impose and enforce CbC reporting requirements, along with a communications framework that allows the automatic exchange of information.

The COVID-19 pandemic has heightened the importance of effectively taxing e-commerce. Pandemic-related lockdown measures and precautionary behaviors have accelerated the growth of online economic activity. Levying VAT on digital services would help boost revenues while levelling the competitive playing field between e-commerce operators and traditional firms.

Redesign the property-tax regime to increase collection

Property-tax bases and rates should be adjusted regularly to reflect changes in market value and to help address equity concerns. Tax collection should be supported by modern administrative systems, including up-to-date land and property registration in the central cadasters, and the exemption threshold should be reviewed with a view to broadening the base. Generating support for increased property taxation is likely to be challenging, and political resistance should be expected, but strengthening the design of the property tax could greatly increase revenues.

Inclusion of environmental aspects and climate change for a sustainable fiscal policy

Given the DR's exceptional vulnerability to natural disasters, ecological degradation, and climate change, aligning tax policies with environmental objectives is an urgent priority. A tax on vehicle emissions was introduced in 2013, but as of 2018 it contributed just 0.1 percent to total tax revenue. **Tighter monitoring and enforcement could increase revenue collection while incentivizing fuel efficiency and reducing greenhouse gas emissions.** The DR's fuel subsidies are at cross-purposes with its tax on vehicle emissions. **The current slump in international fuel prices offers an opportunity to reduce the subsidy while keeping fuel prices consistent with historical averages and consumer expectations.** In addition, **the economic crisis creates opportunity** around green public investments in renewables, climate adaptation, clean water systems or public green transport as these would not only serve as catalyst for restarting the economy but also tilt it towards green growth.

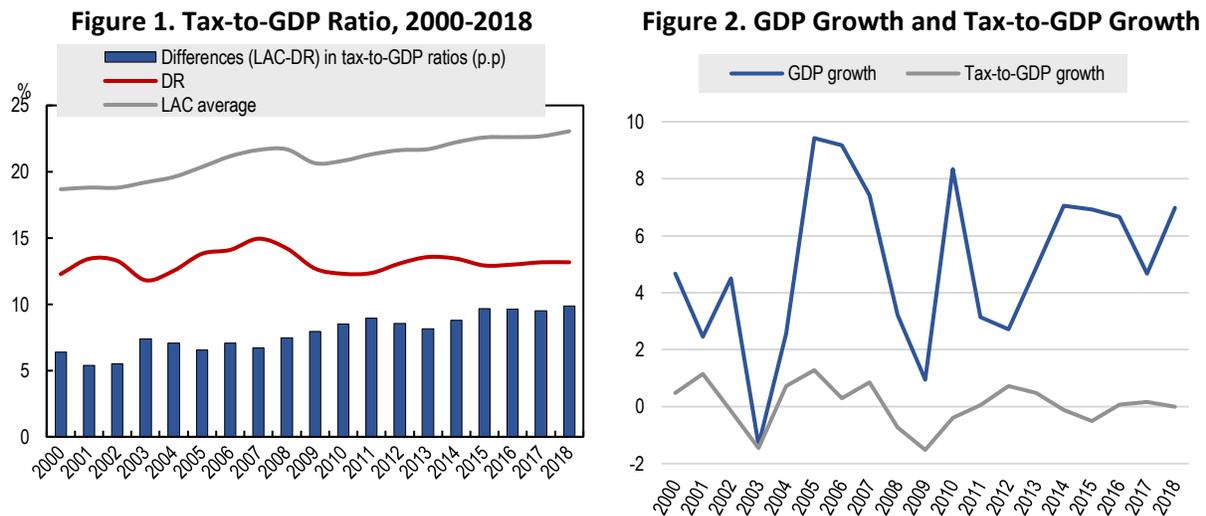
Continue improving revenue administration

Continued administrative reforms could boost public confidence and boost tax morale. Although the tax authorities have made significant efforts to improve compliance, remaining weaknesses in tax administration incentivize evasion and undermine tax morale. Auditing capabilities could be improved by shifting to a risk-management approach supported by a new control and audit strategy, which would focus efforts on areas with the greatest risk of evasion while increasing voluntary compliance. Enhancing coordination between the tax authority and the customs service could further strengthen the audit function. Finally, simplifying tax and customs procedures could help broaden the tax base by alleviating a significant constraint on formalization.

Tax reform is subject to a variety of political, economic, and administrative challenges that must be addressed as part of a broader fiscal strategy that provides predictability to the private sector and enjoys substantial public support. Implementing even the most urgently necessary tax reforms requires overcoming opposition from vested interests that benefit from the status quo. Proactive outreach to the private sector and the public can help build a robust consensus around the pressing need to mobilize additional tax revenue and the benefits of streamlining tax policy and administration. In parallel, the government must ensure that it has adequate administrative capacity to offset the impact of measures that might adversely affect poor and vulnerable households. The government’s fiscal strategy should reflect the lessons of the international experience, and it should be informed by a thorough and detailed analysis of the economic and distributional implications of tax reform.

I. Context

1. The Dominican Republic (DR) experienced decades of robust economic growth prior to the COVID-19 pandemic, but its sustained expansion was not accompanied by a commensurate increase in revenue mobilization. While the country’s per capita GDP grew by an average of 5 percent in 2000-2018 (higher than the regional average), with low inflation and a relatively strong stable external position, economic growth has only had a modest impact on poverty and inequality.² Moreover, the authorities have not been able to achieve sustainable growth in tax collection, as the country’s tax base remains narrow by international standards and has changed little since 2009 (Figure 1 and Figure 2). The tax burden averaged 13 percent of GDP over the last 10 years—below the government’s medium-term plan of 16 percent³—and grew by a mere average of 0.1 percentage points of GDP per annum during the same period.



Source: World Bank staff calculations based on data from Organisation for Economic Co-operation and Development (OECD) 2020 and 2019. Source: World Bank staff calculations based on data from World Development Indicators (WDI) and OECD 2020.
 Note: Unweighted average of selected countries in Latin America and the Caribbean (LAC).

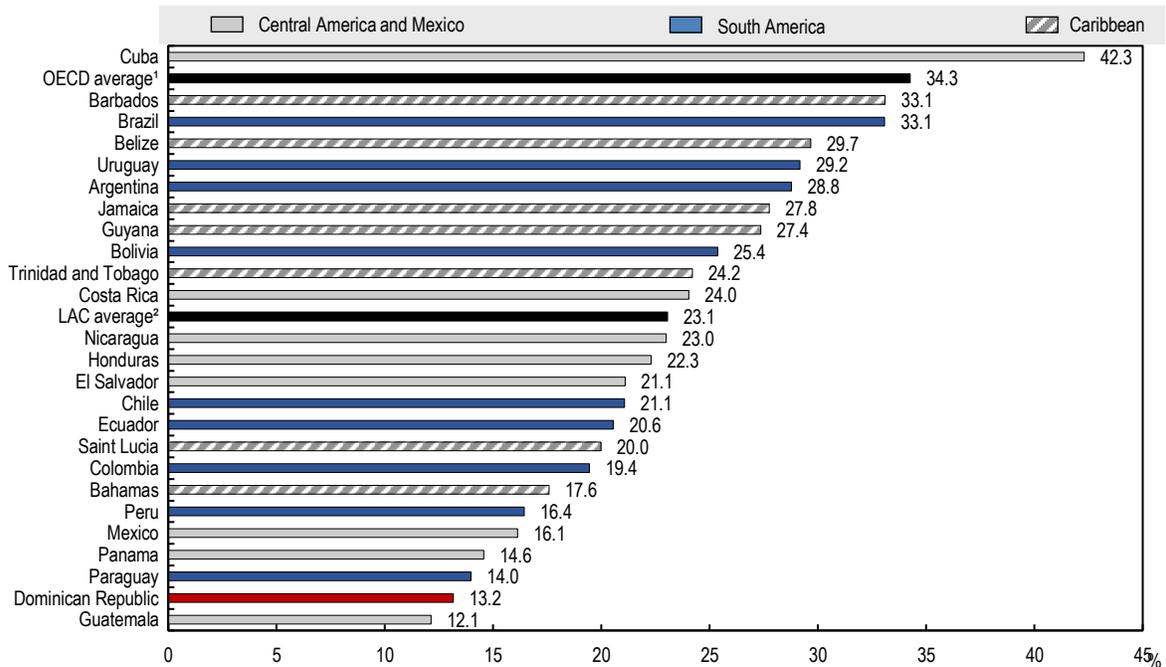
2. There is considerable potential to raise more revenue from taxes in the DR. The country’s tax-to-GDP ratio is lower than what is expected for countries with similar income per capita, partially because of its narrow tax base, which in turn is due to widespread exemptions and a high level of tax evasion and informality. Including social security contributions (SCCs), tax revenue as share of GDP in the DR was 13.2 percent (13.1 percent without SCCs) in 2018, much lower than the Organisation for Economic Co-operation and Development (OECD) average of 34.3 percent (25.1 percent) and the Latin American and the Caribbean (LAC) average of 23.1 percent (19.2 percent) (Figure 3).

Figure 3. Tax-to-GDP Ratio in LAC, 2018

² Income inequality fell slightly in 2012-15, as the Gini coefficient fell from 0.465 to 0.454, but this trend was not uniform across the region. Source: World Bank. 2017. “Dominican Republic Gearing Up for a More Efficient Tax System: An Assessment of Tax Efficiency, a Cost-Benefit Analysis of Tax Expenditures, and an Exploration of Labor Informality and its Tax Implications.” Washington DC: The World Bank.

³ The National Development Strategy (NDS) 2030 envisions the tax burden to increase from 16 percent of GDP in 2015 to 21 percent in 2020, before reaching 24 percent of GDP by 2030.

(Total Tax Revenue as a Share of GDP)



Source: OECD et al. 2020, Table 4.1.⁴

Notes: Include social security contributions.

1. Represents the unweighted average of the 36 OECD member countries, including Chile and Mexico.
2. Represents the unweighted average of 25 Latin American and Caribbean countries, excluding Venezuela.

3. In addition to having one of lowest tax-to-GDP ratios in the region, the DR's tax revenue effort is lower than that of comparable countries, with an average revenue gap of 7 percent of GDP.⁵⁶ The country collects an average of 60 percent of expected tax revenue based on its level of development, trade, and economic structure, much lower than the LAC average of 80 percent (Figure 4).⁷ The DR's tax effort is well below the average of Caribbean countries and other island nations, which share many structural similarities with the DR, and very few countries with a per capita GNI similar to that of the DR collect a lower level of tax revenue.

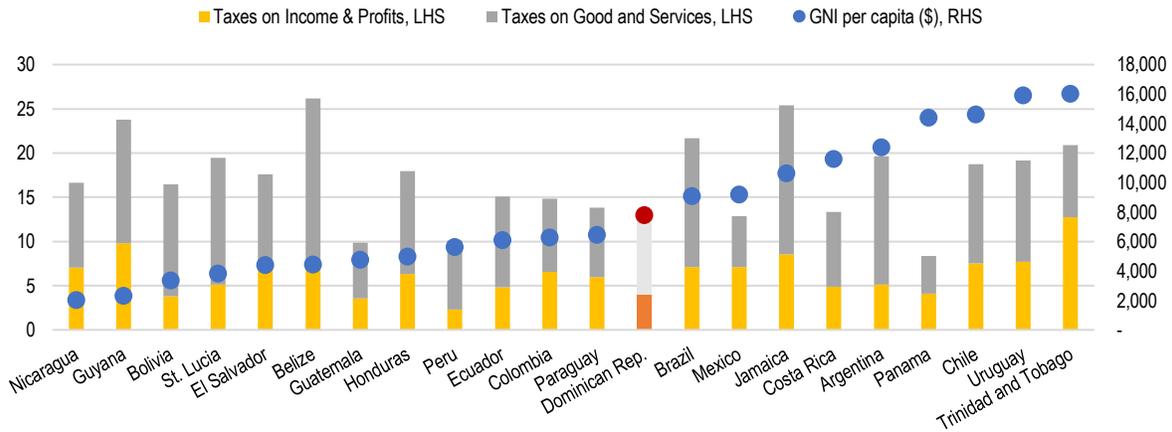
⁴ OCDE et al. 2020, *Estadísticas tributarias en América Latina y el Caribe 2020*, OECD Publishing, Paris, <https://doi.org/10.1787/35745b02-en>.

⁵ Although this revenue gap corresponds to 2010, there have not been any significant changes in tax collection in the DR.

⁶ Garza, M., P. Morra and D. Simard. 2012. "The Fiscal Position: Prospects and Options for Adjustment." In Piñon et al. *Central America, Panama, and the Dominican Republic. Challenges following the 2018-19 Global Crisis*. IMF, Washington DC. The revenue gap is measured as the difference between the current level of tax collections and the level that would result from achieving the tax effort prevailing in countries with the same per capita income level.

⁷ OECD, 2013. "Fiscal policy for development in the Dominican Republic." *Making Development Happen*, No. 2, OECD Publishing, Paris.

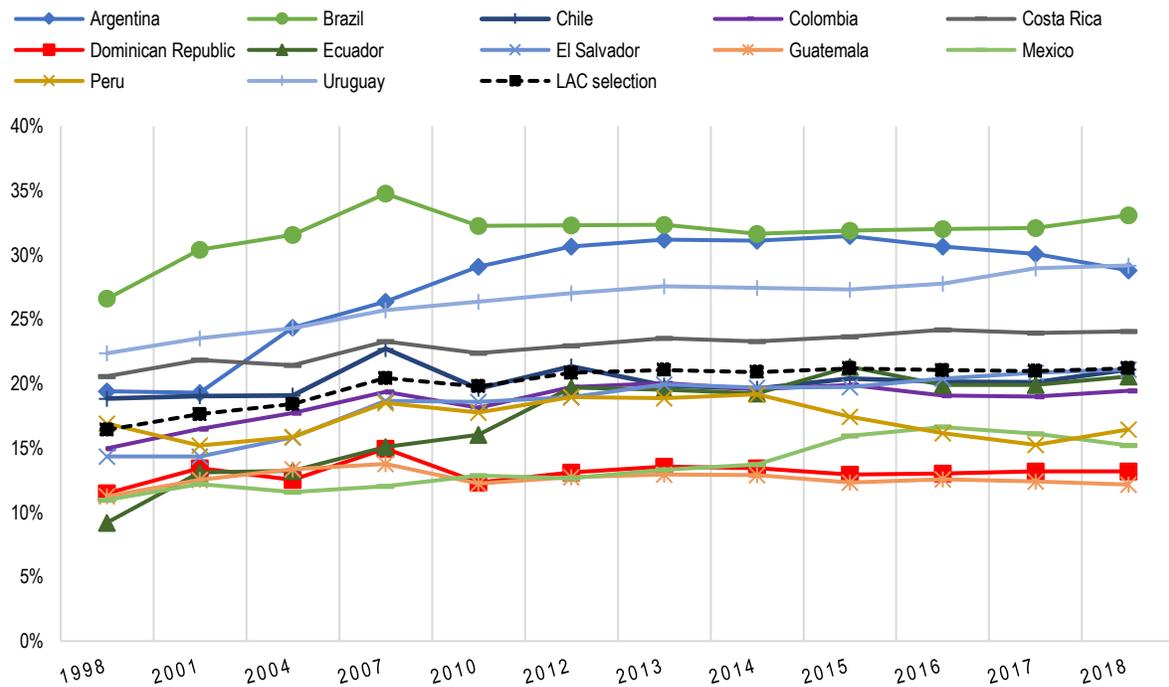
Figure 4. Tax Revenue and GNI per Capita, 2018



Source: World Bank staff calculations based on data from WDI and OECD 2020.

4. A comparison of the tax burden during the last 20 years reveals that the DR ranks second to last in LAC, outperforming only Guatemala. Including SSCs, tax revenues in the DR reached 13.2 percent of GDP in 2018, 3 percentage points of GDP lower than the third-lowest taxed country—Mexico— and 8 percentage points of GDP below the average of LAC (Figure 5). While it reached 14.9 percent of GDP in 2007, the country’s tax burden averaged 13 percent of GDP in 1998-2018, lower than the average of 20 percent in LAC during the same period. More worrisome than the low tax burden is the insipid growth in the DR’s tax-to-GDP ratio of 0.5 percent of GDP since 2009, much lower than the average of 1.5 percent of GDP in LAC.

Figure 5. Tax Burden in LAC, 1998-2018
(Share of GDP)



Source: OECD 2020.

5. Tax revenues constitute the largest revenue component in the DR. Tax revenues accounted for 92 percent of the central government’s revenues in 2018, followed by non-tax revenues at 7.7 percent and contributions and grants at 0.6 percent. Total tax collection increased from 8.3 percent of GDP in 1990 to 13.4 percent of GDP in 2001, exceeding the average increase in LAC over the same period. The increase in tax collection was due to a series of structural reforms in the 1990s to improve the tax system. This included efforts to improve the performance of the value-added tax (VAT) and the corporate income tax (CIT) to mitigate the fall in revenues from customs and import duties due to the reduction and/or elimination of tariffs to open up the economy. However, the DR’s tax-to-GDP ratio has averaged 13 percent since 2000 (except in 2006-08 when it averaged above 14 percent), making it one of the lowest in LAC.

6. The country’s capacity to collect taxes has been undermined by high levels of tax evasion and avoidance as well as widespread use of tax expenditures. Non-tax compliance due to tax evasion and avoidance is a critical challenge for revenue mobilization in the DR. The estimated rate of tax evasion in 2017 was 61.9 percent for the CIT (4.2 percent of GDP), 57.1 percent for the personal income tax (PIT) (1.68 percent of GDP), and 43.6 percent for the VAT, which in the DR is called Tax on the Transfer of Industrialized Goods and Services, *Impuesto sobre la transferencia de bienes industrializados y servicios*, ITBIS). This level of tax evasion is higher than in any other country in LAC⁸ and represented 9.5 percent of GDP in 2017.⁹ It has not decreased significantly since 2007, despite the government’s efforts to prevent

⁸ Tax evasion for the corporate income tax was 39.6% in Uruguay, 49.7% in Argentina, 31.4% in Mexico, and 26.6% in Brazil (Gobierno de la República Dominicana: Equipo Interinstitucional, 2018)

⁹ Gobierno de la República Dominicana. Estimación del Incumplimiento Tributario en la República Dominicana, Equipo interinstitucional, 2018

tax evasion such as raising penalties, adopting new technologies such as voluntary e-invoicing and VAT withholding systems, and increasing the number of audited taxpayers. In addition, tax expenditures amounted to an estimated 4.8 percent of GDP in 2020, of which VAT exemptions alone accounted for 2.5 percent of GDP.¹⁰ A 15-year CIT holiday for companies in special economic zones (SEZs) has added to total tax expenditures, and the threshold for the PIT remains high.

7. The complexity and unpredictability of the tax system also contributes to low levels of revenue collection. A complex tax system affects a country's ability to effectively and efficiently raise revenue, redistribute income, and correct for externalities. Moreover, the tax administration's workload has increased on cumbersome tasks such as the control of multiple tax incentives that limits its ability to perform a more substantive risk management analysis of revenue collection. The DR's tax system is highly complex, and tax rates have been subject to frequent changes, with little impact on revenue collection. As a result, there is a lack of competitiveness in the business sector and formalization is discouraged, especially among small and medium-sized enterprises (SMEs). The increase in the tax-to-GDP ratio of 0.4 percent of GDP in 2013-14 was mainly due to an increase in the VAT rate and the repeal of some exemptions on basic goods in the 2012 tax reform. Since 2014, however, growth in the tax-to-GDP ratio has not been maintained, stagnating at around 13 percent of GDP, highlighting the need for more comprehensive tax reforms.

8. Tax revenues are also influenced by the country's low tax morale. Low public confidence in the government makes people less willing to pay taxes, which has an impact on the long-term sustainability of tax revenues. While mistrust in the government has been increasing across all economies in LAC, the level of confidence in the government in the DR is among the lowest in the region, with almost half of all respondents in the Latinobarometro survey¹¹ report no confidence in the government in 2018, more than the average of 43 percent in LAC. In addition, a high level of perception of corruption is an important driver of mistrust in public institutions, and 48 percent of the Dominican population believes corruption is widespread within the tax administration. In the Transparency International's Corruption Perceptions Index, the DR ranked 137th out of 198 countries in 2019, the same position as Liberia and Papua New Guinea and close to Mexico, Paraguay, Honduras, Guatemala, and Mexico.¹² Since this high level of perception of corruption reduces people's willingness to pay taxes, increasing trust between taxpayers and the authorities is critical for sustainable revenue growth.

9. The authorities have made progress in strengthening the revenue administration in recent years, although more efforts are needed to broaden the tax base. The last administration focused on institutionally strengthening both internal and external revenue administration functions, including: (i) creating an online system connecting the two institutions that manage revenue collection—the General Directorate of Internal Revenues (DGII) and the General Directorate of Customs (DGA); (ii) developing a risk-based revenue collection strategy to increase taxpayer compliance; (iii) implementing a traceability system for alcoholic beverages and cigarettes to reduce tax evasion; and (iv) introducing a new simplified tax regime for small enterprises.¹³ While reforms adopted in 2017-18 have likely improved compliance, the government needs to also expand the current tax base to improve tax revenue collection.

¹⁰ Gastos Tributarios en República Dominicana: Estimación para el Presupuesto General del Estado del año 2020. Ministerio de Hacienda. September 2019.

¹¹ <https://www.latinobarometro.org/lat.jsp>

¹² <https://www.transparency.org/en/cpi/2019/results>

¹³ IMF Country Report No. 19/273:2019 Article IV Consultation, August 2019, International Monetary Fund, Washington, D.C.

10. Aligning with international standards on Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) and Tax transparency has helped to improve transparency in the DR. Efforts to improve transparency have reduced the likelihood of money laundering and tax evasion (including offshore) and aided tax collection efforts. The establishment of the Ultimate Beneficiary Ownership (UBO) registry, if properly maintained and monitored, will constitute an important step in tackling domestic money laundering and tax evasion and mobilizing domestic revenues.¹⁴ Moreover, the DR joined the OECD’s Inclusive Framework on Base Erosion and Profit Shifting (BEPS) in 2018 to address tax avoidance and evasion. It is also a member of the Global Forum on Transparency and Exchange of information (EOI) for Tax Purposes, and the DR was deemed “largely compliant” in the second round of peer reviews in 2019. The DR also signed the OECD’s Multilateral Convention on Mutual Administrative Assistance in Tax Matters in 2016, which entered into force at the end of 2019. This convention facilitates the exchange of tax information, and it serves as a potential international legal framework to implement the standard for automatic exchange of information in tax matters (AEOI), including the Model Competent Authority Agreement (Model CAA) and the Common Reporting Standard (CRS), which establishes the reporting and due diligence requirements for the automatic exchange of information for financial accounts. As a Global Forum (GF) member, the DR is committed to implement the AEOI standard, although it has not yet been required to commit to a date to commence information exchange.¹⁵

11. The COVID-19 crisis presents unprecedented challenges to domestic revenue mobilization (DRM) in the DR. Experience from past crises shows that their effect on taxes (especially direct taxes) exceeds the economic impact in both scale and duration (Box 1). By end-2021, GDP growth is not expected to have returned to pre-COVID-19 levels in most countries. Compared to pre-crisis budget projections, tax revenues in the DR are projected to fall by 2 percentage points of GDP in 2020.¹⁶ The crisis has resulted in a slowdown in international tourism and exports, important sources of revenue and employment. Domestically, the crisis has increased government spending related to healthcare and support for vulnerable businesses and households while having a negative impact on the government’s tax receipts. In this environment, tax policy and tax administration reforms play a key role in lessening the impact of the crisis and ensuring an inclusive and fiscally sustainable economic recovery.

12. The current crisis may also offer opportunities to overcome challenges related to tax incentive reforms. The authorities need to conduct a cost-benefit analysis of tax concessions to identify the best policy options to provide targeted support once the health crisis has stabilized. Since it is a political decision to eliminate or reduce tax relief, showcasing the economic benefits of reforms could help garner the political support, along with support from civil society, needed to implement base-broadening reforms. The DR should focus on closing the revenue gap by reducing tax expenditures through a comprehensive strategy that includes reducing income tax exemptions (e.g., incentives and tax holidays in free-trade zones and other key sectors such as manufacturing and tourism), broadening the tax base (by limiting the use of zero rating and reduced rates on goods and services), and continuing improving the revenue administration.

13. Given that more than 90 percent of total government revenue in the DR comes from taxes, it is important for the authorities to adopt reforms aimed at increasing tax revenues. For example, instead of tax exemptions, the government could increase public spending and make more resources available for

¹⁴ GAFILAT. 2018. *Mutual Evaluation Report of the Fourth Round – Dominican Republic*.

¹⁵ <https://www.oecd.org/tax/beps/>

¹⁶ WB 2020. Dominican Republic Covid-19 Crisis Response Support, June 2020.

targeted programs. Streamlining tax exemptions and replacing them with targeted subsidies should be a part of the strategy of raising tax revenues, as tax exemptions and incentives have negatively influenced tax collection in the DR.

Box 1. Specific aspects of the revenue system that affect collection in the COVID-19 context

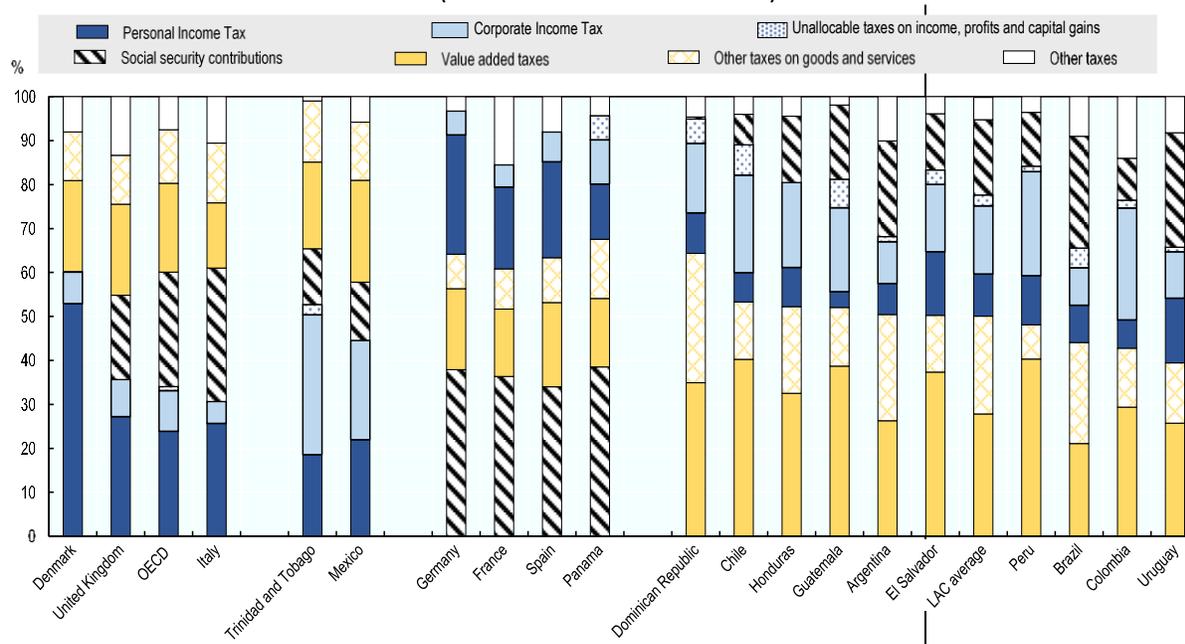
- **Customs and trade taxes.** In open economies, interruption of global value chains has a direct and immediate negative impact on the revenue collected by customs (i.e., excise taxes, import duties, and VAT). In African and other developing countries, the slowdown in economic activity in China that started in January 2020 has already led to a decline in manufacturing imports, which will worsen as the pandemic continues to spread across the globe.
- **Consumption taxes (inland).** A large share of goods consumed in developing countries are imported, or include parts, from China and other countries where production has been affected by the pandemic. With supply chains interrupted, local traders selling imported items such as textiles, electronics, or household goods are not supplied. As the pandemic continues to affect countries around the globe, the situation is likely to deteriorate further as demand responds to supply shocks.
- **Direct taxes.** Over the next year, revenues from the CIT and PIT are likely to decrease as income-generating activities slow down and the authorities grant leeway in paying taxes. The collection of payroll and wage taxes may experience the most immediate effects, as they have a shorter lag.
- **Revenue from natural resources.** The COVID-19 pandemic initially coincides with an increase in gold prices and a major drop in the price of oil and other commodities. Commodity-importing countries generally benefit from a drop in oil prices, but revenue could be adversely affected to the extent that taxes are based on the value of oil products (i.e., ad valorem instead of specific rates for fuel and other products).
- **Tax administration and compliance.** Health measures can disrupt the operations of revenue administrations, including enforcement and taxpayer service activities. For example, some tax administrations have already suspended audits and tax collection because of the COVID-19 crisis. Reduced enforcement activity would likely increase taxpayers' risk tolerance for tax avoidance and evasion and thereby reduce tax compliance. Moreover, tax arrears may increase as taxpayers divert constrained cash flows to their business operations. Businesses may also protect their cashflow by suspending or delaying payment of salaries, supplies, loans, and other obligations, which could further reduce taxes collected.

Source: The Fiscal Impact and Policy Response to COVID-19, Fiscal Policy and Sustainable Development Unit (MTI GP), April 3, 2020.

II. Tax structure

14. In 2018, governments in LAC relied heavily on revenue from taxes on goods and services, while revenue from income taxes and SSCs was low relative to the OECD average. Taxes on goods and services constituted, on average, more than half of overall tax revenues in LAC (except for in Mexico, Panama, and Trinidad and Tobago), higher than around one-third of tax revenues in the OECD (Figure 6). However, as a share of GDP, tax revenue from goods and services in LAC and the OECD was similar in 2017 at an average of 11.4 percent and 10.9 percent, respectively. The share of revenue from the VAT was also similar at an average of 5.9 percent of GDP in LAC and 6.8 percent of GDP in the OECD. By contrast, the combined share of taxes on income, profits, and SSCs was much lower in LAC (average of 44.6 percent in 2017) than in the OECD (60.1 percent), in part due to the prevalence of private provision of social security in many LAC countries. As a share of GDP, taxes on income, profits, and SSCs amounted to 10.0 percent in LAC, less than half the OECD average (20.7 percent). The most striking difference between LAC and the OECD relates to revenues from the PIT, which averaged 23.9 percent of total tax revenues (8.3 percent of GDP) in the OECD in 2017, much higher than 9.7 percent (2.2 percent of GDP) in LAC. However, the CIT generated 15.3 percent of total tax revenue (3.4 percent of GDP) in LAC, higher than 9.3 percent (3.0 percent of GDP) in the OECD. Finally, environmentally-related tax revenues (ERTRs) amounted to an average of 1.1 percent of GDP in LAC in 2018, lower than the OECD average of 2.3 percent, and taxes on immovable property and payroll are less important sources of revenue in LAC than in the OECD.¹⁷

Figure 6. Tax Structure by Country, 2018
(Share of Total Tax Revenue)



Source: World Bank staff calculations based on data from OECD 2020 and 2019. Data for 2018 are used for LAC countries and data for 2017 are used for OECD countries.

15. Like in other LAC countries, taxes on goods and services generate the largest share of total tax revenues in the DR, representing almost one-third of total taxation in 2018. Taxes on goods and services

¹⁷ OECD 2020.

in the DR accounted for 64.4 percent of all tax revenues in 2018, higher than both the LAC average of 50.0 percent¹⁸ and the OECD average of 32.4 percent (Figure 7). In the DR, the largest share of tax revenue came from the VAT (34.9 percent) in 2018. Taxation on income and profits represented 30.6 percent of total tax revenues in the same year, higher than the LAC average of 27.6 percent and close to the OECD average of 34 percent. In 2018, property taxes accounted for less than 0.5 percent of total tax revenues in the DR, the lowest share in LAC, due to tax evasion and avoidance as well as outdated property cadasters and valuation methods. ERTRs, including motor vehicle and transport services taxes, amounted to 1.1 percent of the DR's GDP in the same year, and revenues from SSCs accounted for less than 0.5 percent of total revenues.

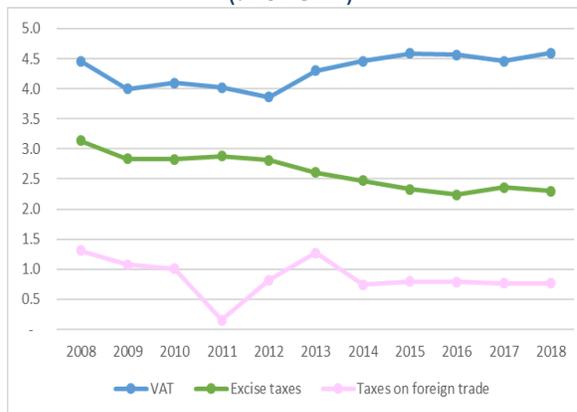
16. The VAT and excise taxes have increased considerably in the DR while taxes on foreign trade have been reduced, which has contributed to a more balanced tax structure. Revenue from indirect taxation make up almost half of the country's total tax revenues, higher than one-third of total revenues in the OECD (Figure 8). The country's heavily reliance on indirect taxation is partly due to the modest role played by the PIT (which features a relatively high exemption threshold) and CIT (with many companies in SEZs benefiting from tax exemptions) in tax collection. Indirect taxes, which include the VAT, excise taxes on the consumption of certain goods and services, and customs duties on imports, represented more than half of all taxes collected in 2000-2018 (average of 8.5 percent of GDP). Over this period, the share of the VAT in total revenue increased from 20.5 percent to 34.9 percent, as the VAT rate increased from 16 percent in 2004 to 18 percent in 2012, while the share of taxes on trade in total revenue fell from 27.8 percent to 5.8 percent, as the country has been lowering tariff rates since 2007, as mandated by the CAFTA-DR regional free trade agreement. While the VAT accounted for 34.9 percent of total taxes in 2018, it only represented 4.6 percent of GDP, below the regional average of 6 percent of GDP. Moreover, excise taxes accounted for 17.4 percent of total revenue in 2018, driven by excise taxes on oil derivatives, which accounted for 1.3 percent of GDP and represented more than half of total revenues from excise taxes.

Figure 7. Tax Revenues by Main Tax, 2008-18
(% of GDP)



Source: OECD 2020.

Figure 8. Indirect Taxes, 2008-18
(% of GDP)



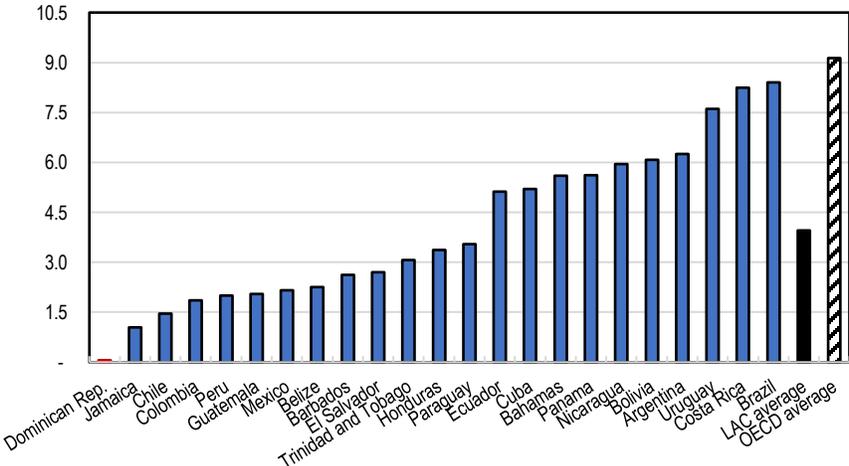
17. Although indirect taxes account for most of the DR's tax revenues, the share of direct taxes in total revenues (as a share of GDP) has increased over the last 20 years. Direct taxes, which include taxes on income and property, represented 4.6 percent of GDP in 2018, up from 2.9 percent of GDP in 2000.

¹⁸ There has been an increase in consumption taxes during the last 20 years throughout the LAC region.

The CIT is the largest direct tax, with revenues of 2.1 percent of GDP in 2018, and it nearly doubled as share of GDP since 2000, mainly driven by the boom in commodity prices after 2003. Revenues from the PIT have remained low at an average of 1 percent of GDP over the last 10 years due to high labor informality, which means there is likely a potential to increase PIT revenues in the DR. Property taxes, which include taxes on urban properties, assets, inheritance and gifts, and transfers, generated revenue worth a mere 0.6 percent of GDP in 2018. While property taxes represent a small part of the overall tax burden in all LAC countries, they could be another source of tax revenue worth improving.

18. SSCs explain almost 40 percent of the difference with the LAC average and OECD countries. Low levels of revenue collection in CIT, PIT and VAT together account for 40 percent of the difference with the LAC average. In the DR, SSCs represented 0.5 percent of GDP in 2018, the lowest among regional peers and far below the average for LAC (4 percent of GDP) and the OECD (9.1 percent of GDP). One reason for the low share of SSCs in public revenues is the prevalence of private provision of social security in LAC. In countries with public or mixed social security schemes (e.g., Argentina, Brazil, Costa Rica, Panama, and Uruguay), SSCs represent a larger share of total tax revenues.¹⁹ The increase in CIT and VAT revenue over the last two decades in the DR was insufficient to reach the LAC average (2.1 and 4.6 percent of GDP, respectively in the DR in 2018, lower than the average of 3.5 and 6.0 percent of GDP, respectively in LAC), and public revenues from these two taxes are still lower in the DR than in comparator countries. Nevertheless, public revenue from the PIT reached 1.2 percent of GDP in 2018, only 1.1 percentage point of GDP lower than the LAC average. The authorities in the DR will need to increase the revenue contribution of its main taxes to successfully mobilize additional revenues.

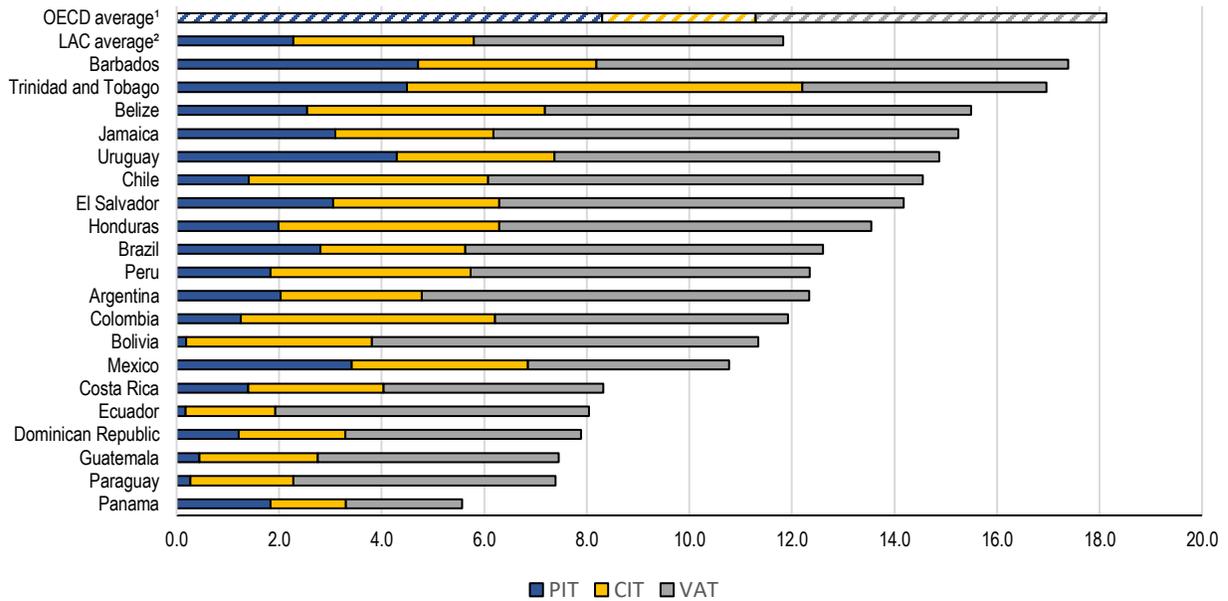
Figure 9. Social Security Contributions in LAC, 2018
(Share of GDP)



Source: OECD 2020

¹⁹ OECD 2020.

Figure 10. PIT, CIT, and VAT in LAC, 2018
(Share of GDP)



Source: OECD 2020, 2018, and 2017.

Note: OECD average data are from 2017 and average data for LAC countries are from 2018.

19. Similar to many countries in the region, the central government collects most of the tax revenues in the DR. However, the central government collected about 99.5 percent of the country’s total tax revenues in 2018, much higher than the average of LAC which accounted for two-thirds or more of the total collected, and the average of about 60 percent in the OECD.²⁰ This dominant role of the central government in tax collection could reflect a lack of administrative and technical capacity at the sub-national level. Despite the low potential for local authorities to generate revenue, delegating tax collection to sub-national entities for taxes such as property taxes, motor-vehicle licenses, transfer of movable property, and taxes on specific services could decrease administrative costs.

20. There are two institutions that manage revenue collections in the DR: The General Directorate of Internal Revenues (DGII) and the General Directorate of Customs (DGA). The DGII is an independent government body responsible for internal revenue collection and administration on behalf of the central government, and it is also responsible for the AML supervision of non-financial obliged entities. The DGII is primarily responsible for most of the country’s tax revenues, and it collected 75 percent of all tax revenues in 2018. Five taxes accounted for more than 80 percent of total tax revenue collected by the DGII in 2015: the VAT (domestic ITBIS), the CIT, a fixed tax on the consumption of hydrocarbon fuels, the PIT, and an excise tax on the domestic consumption of fuels.²¹ Meanwhile, the DGA is responsible for the collection and administration of all taxes and duties related to foreign trade. In 2018, it collected the remaining 25 percent of tax revenue, with VAT (ITBIS) on imports representing almost 70 percent of revenue collected.

²⁰ OECD 2020.

²¹ World Bank 2017.

21. The DR’s high reliance on revenue from the VAT necessitates close coordination between the DGII and DGA to enhance monitoring and enforcement of VAT compliance. The 2016 assessment by the Tax Administration Diagnostic Assessment Tool (TADAT)²² found that the DGII does not quantify or monitor all inaccurate reporting, and it does not systematically calculate tax evasion related to the VAT. The creation of an inter-institutional team in 2016, made up by the Treasury, central bank, Ministry of Economy, Planning and Development, DGII, and the DGA, to study the VAT and the income tax gap was a step in the right direction to improve the monitoring of tax evasion.²³ However, given that VAT revenue is collected by both tax agencies, clear synergies in administration across agencies is needed to design and implement an audit and enforcement strategy and increase voluntary compliance.

22. The consolidation of a large number of minor taxes administered by the DGII could strengthen the administration of high revenue-generating taxes. The DGII is responsible for the collection of several minor taxes that generated, on average, less than 0.1 percent of its tax revenues in 2018. More than 10 different types of taxes together accounted for just 0.07 percent of the tax revenue collected by the DGII in 2015. These include taxes on cellular gaming, replacement license plates, matches, land-title registration, transferring motor vehicle ownership, and sports betting, as well as excise taxes on cigarettes and alcohol.²⁴ Some of these taxes such as taxes on replacement license plates and matches have extremely limited revenue potential and serve no clear policy purpose, while the low revenue generated by others could indicate serious lack of collection capacity. The authorities could review all minor taxes to consolidate or eliminate them, which could strengthen the administration of taxes with high revenue potential while lowering administrative costs.

23. Paying taxes in Dominican Republic remains time-consuming. According to the Doing Business (DB) 2020 report, which covers calendar year 2018 (January 1 – December 31, 2018), ranks Dominican Republic in the 150th position out of 190 economies for the Paying Taxes indicator, two positions below the previous DB report although none of the indicators have changed from the previous report. DR scores 57.4 for paying taxes, which is lower than the score of its peers: Dominica, Jamaica and Haiti, and the LAC average. According to the same indicator, medium-sized companies in DR make 7 tax-related payments per year which is much lower than the LAC regional average (27.1 payments) and the OECD (11.2). However, in terms of hours devoted to pay three major taxes (CIT, VAT and labor taxes) DR devotes 317 hours per year to pay taxes. It is still significantly higher than the OECD average but slightly below the regional average of 332 hours per year. This shows that compliance of main tax obligations is excessively burdensome.

24. Electronic invoicing is expected to reduce tax compliance costs while strengthening fiscal control, although it is currently in a voluntary phase. A more extensive use of electronic invoices is expected to contribute to higher tax compliance, increasing the efficiency of the fiscal control through an optimal use of the information received, while reducing processing time and costs for companies. E-invoicing will also improve efficiency by streamlining the tax credit and refund process, benefiting taxpayers while reducing administrative costs. The pilot phase of the electronic invoice was concluded in 2019 and has been successful, with all major taxpayers participating on a voluntary basis. Since 2020 the enrollment is voluntary, taxpayers that meet the requirements established in the regulation issued by the DGII have been allowed to issue Electronic Tax Receipts (e-CFs). However, the goal is the mandatory issuance of e-

²² Tax Administration Diagnostic Assessment Tool. 2016. “Performance Assessment Report Dominican Republic”, December 2016.

²³ TADAT 2016.

²⁴ World Bank 2017.

invoices, and, for that purpose, a phased schedule for the compulsory roll-out is needed to be approved by the tax authorities.

III. Tax System

25. Taxation in the DR is governed by the Tax Code²⁵ and special complementary laws. The Tax Code sets out the general tax principles and rules for the administration of taxes, penalties, procedures, and collections. It comprises the general regulations related to the main four taxes: i) income tax (*impuesto sobre la Renta*, ISR), ii) VAT (ITBIS), iii) excise tax (*impuesto selectivo al consumo*), and iv) tax on assets (*impuesto sobre activos*). The Tax Code has been modified several times since its inception 28 years ago. Several tax reforms were passed between 2007 and 2011, resulting in a significant drop in public revenue, from 14.9 percent of GDP in 2007 to 12.4 percent of GDP in 2011.²⁶ In addition, the 2012 tax reform,²⁷ one of the largest in the last decade, was focused primarily on adjusting tax rates to increase DRM.

²⁵ Law No. 11-92 from May 16, 1992, commonly known as the Tax Code (*Código Tributario*) and its amendments, provides general provisions for taxes and legal interactions.

²⁶ The main tax changes during this period included: (i) cuts to the PIT and CIT in 2007; (ii) the elimination of tariffs through the Dominican Republic Central America Free Trade Agreement and the European Union); (iii) increased tax expenditures and special regimes; and vi) the non-indexation of the excise duty on hydrocarbon. (OECD 2013).

²⁷ The tax reform introduced by Law No. 253-12 in 2012 (*Ley para el fortalecimiento de la capacidad recaudatoria del estado para la sostenibilidad fiscal y el desarrollo sostenible*). The main reforms included: (i) keeping the progressive PIT rate fixed until 2015; (ii) increasing the VAT rate from 16 percent to 18 percent and removing the tax exemption status or special treatment of various categories of basic goods; (iii) setting the CIT rate at 29 percent for 2013, 28 percent for 2014, and 27 percent for 2015 and onwards; iv) implementing a dual tax system with flat rates on capital income (10 percent for dividends, interests); and (v) increasing the basic exemption of the property tax to RD\$ 6.5 million.

Table 1. Composition of Taxes in the DR's Central Government, 2018

	2010	2011	2012	2013	2014	2015	2016	2017	2018
	Percent of GDP								
Total tax revenues	12.3	12.4	13.1	13.6	13.4	12.9	13.0	13.2	13.2
Taxes on income, profits and capital gains	2.7	3.0	3.9	4.2	4.3	3.7	3.9	4.1	4.0
Personal income tax	0.9	0.9	0.9	1.0	1.1	1.1	1.2	1.1	1.2
Corporate income tax	1.1	1.1	2.0	2.2	2.5	1.9	2.0	2.2	2.1
Other taxes on income	0.8	0.9	1.0	0.9	0.7	0.7	0.7	0.7	0.7
Taxes on property	0.7	0.7	0.8	0.9	0.6	0.6	0.6	0.6	0.6
Property tax	0.0	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Other taxes on property	0.6	0.7	0.8	0.8	0.6	0.5	0.5	0.5	0.5
Taxes on goods and services	8.8	8.6	8.3	8.5	8.5	8.5	8.5	8.4	8.5
VAT (ITBIS)	4.1	4.0	3.9	4.3	4.5	4.6	4.6	4.5	4.6
Excises on Alcoholic beverages	0.8	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Excises on Tobacco	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1
Excises on Oil Derivatives	1.7	1.8	1.8	1.6	1.5	1.4	1.3	1.4	1.3
Customs and import duties	1.0	0.1	0.8	0.7	0.7	0.8	0.8	0.8	0.8
Other indirect taxes	1.0	1.7	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Social security contributions	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.1	0.1
	Percent of total tax revenues								
Total tax revenues	100	100	100	100	100	100	100	100	100
Taxes on income, profits and capital gains	22.0	24.0	29.8	30.6	31.8	28.9	3.9	31.0	30.6
Personal income tax	7.0	7.6	7.0	7.6	8.0	8.6	8.9	8.7	9.2
Corporate income tax	8.8	9.2	15.0	16.6	18.5	14.9	15.3	16.6	15.8
Other taxes on income	6.2	7.2	7.7	6.4	5.3	5.4	5.8	5.7	5.6
Taxes on property	5.5	5.8	6.3	6.5	4.6	4.6	4.6	4.6	4.6
Property tax	0.2	0.2	0.2	0.4	0.4	0.4	0.4	0.4	0.5
Other taxes on property	5.2	5.6	6.1	6.0	4.2	4.2	4.1	4.2	4.2
Taxes on goods and services	71.8	69.7	63.6	62.5	63.2	66.1	65.1	63.9	64.4
VAT (ITBIS)	33.3	32.5	29.5	31.7	33.2	35.5	35.1	33.9	34.9
Excises on Alcoholic beverages	6.2	5.9	5.5	5.1	5.0	5.4	5.2	5.1	5.2
Excises on Tobacco	1.9	1.6	1.4	1.2	1.1	1.1	0.9	1.0	0.8
Excises on Oil Derivatives	14.2	14.8	13.6	11.9	11.3	10.5	10.1	10.6	10.2
Customs and import duties	8.0	6.9	6.1	5.4	5.4	6.1	6.0	5.7	5.8
Other indirect taxes	8.3	8.0	7.5	7.2	7.1	7.6	7.8	7.5	7.5
Social security contributions	0.8	0.5	0.4	0.4	0.4	0.4	0.3	0.5	0.5

Source: OECD 2020.

26. The DR's tax system is characterized by a narrow tax base due to widespread tax expenditures, tax evasion and avoidance, and informality. A 2020 World Bank analysis of the DR's fiscal policy and redistribution²⁸ revealed that some of the country's direct taxes (i.e., taxes on wages, interest income, and dividends) and indirect taxes (i.e., the VAT and excise taxes on alcoholic beverages, beer, cigarettes, oil products, telecommunications and insurance services, and several other imported goods) are progressive. A previous similar analysis also found that its tax expenditures were poorly targeted and regressively distributed and imposed considerable fiscal and economic costs.²⁹ Revenue collection in the DR is also hampered by informality, including informal labor.

²⁸ World Bank. (2021, forthcoming). *Poverty and Distributional Impacts of Fiscal Policy in Dominican Republic*. Washington, DC.

²⁹ World Bank, 2016. "Fiscal Policy and Redistribution in the Dominican Republic." Washington DC: The World Bank.

27. Given that the country’s statutory tax rates are broadly in line with those of its peers, broadening the tax base by eliminating tax exemptions and tackling informality is key to increase revenue. While the DR’s statutory rates for the CIT and PIT are aligned with LAC averages, its VAT rate is slightly higher than the average in LAC (Table 2). Therefore, to increase revenues from the CIT, the authorities need to focus not so much on higher rates but on broadening the base by reducing special tax regimes that incentivize arbitrage opportunities. The authorities should consider harmonizing rates and ensure similar activities are taxed at the same rate.

Table 2. Statutory Income Tax Rates in Selected Countries in LAC

Country	CIT rate	PIT rate	VAT rate
Argentina	30	35	21
Bolivia	25	13	13
Brazil	34	28	18
Chile	27	35	19
Colombia	32	39	19
Costa Rica	30	25	13
Dominican Rep.	27	25	18
Ecuador	25	35	12
El Salvador	30	30	13
Guatemala	25	7	12
Honduras	30	25	15
Mexico	30	35	16
Nicaragua	30	30	15
Panama	25	25	7
Paraguay	10	10	10
Peru	29.5	30	18
Uruguay	25	36	22
LAC average selected countries	27.3	27.2	15.4
OECD average	21.8	42.8	19.3

* Highest statutory rate. Source: IBDF, CIAT

A. Income Taxes

28. The DR has mainly a territorial system of taxation. All income derived from Dominican sources is subject to income tax, including income from commercial, industrial, agricultural, mining, and similar activities in the country as well as income generated from capital, property, or other rights located, placed, or used economically in the DR. In addition, financial income (e.g., dividends, interest, and bonds) earned by a Dominican resident, regardless of location, is also taxable in the DR. Permanent establishments of nonresident legal entities, foreign companies and entities, and branches of foreign companies that do not have their effective management and control in the DR are subject to the CIT on their local income at the same tax rate as resident companies. While non-residents are subject to withholding taxes on their Dominican-sourced income, and the DR has thin capitalization rules, there is a risk of base erosion from profit shifting by multinational and domestic companies in FTZs, as the DR lacks effective transfer pricing documentation rules.³⁰

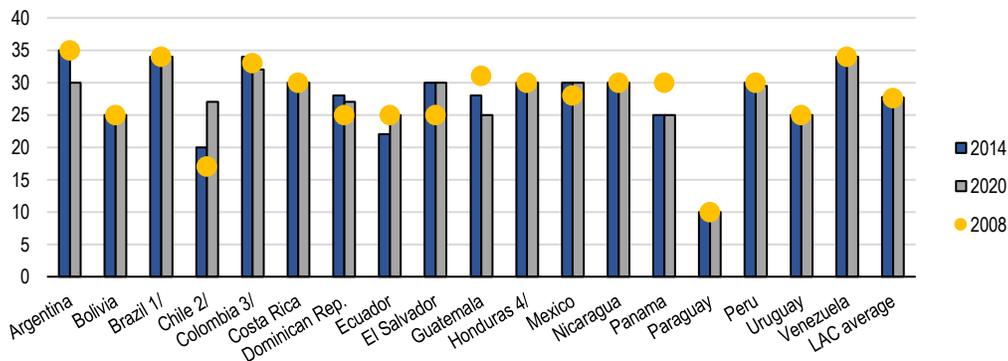
³⁰ See Annex I. International Taxation for more information.

1. Corporate Income Tax

29. The CIT is the DR's second largest source of tax revenue.³¹ The CIT was equivalent to 2.1 percent of GDP and 15.8 percent of total tax revenues in 2018. Between 2000 and 2018, corporate tax collection increased from 1.2 percent of GDP in 2000 to 2.1 percent in 2018, mainly due to an increase in the CIT rate from 25 percent to 29 percent in 2011, as well as high commodity prices. However, the country's share of revenue derived from the CIT is still below the average of both LAC (3.5 percent of GDP) and the OECD (3.0 percent of GDP).

30. The country reduced its CIT rate to 27 percent in response to international competition for foreign investment. Companies are liable to pay the higher amount for the CIT levied at 27 percent on the net taxable profit or a tax on assets levied at 1 percent, the latter of which works as a minimum tax. The DR's CIT standard rate has been changed several times since 2000, following the worldwide trend.³² By 2011, CIT rates fell below 30 percent in 26 out of the 34 OECD member countries. This reduction of the CIT rate was accompanied by a series of reforms to widen the tax base, reduce distortions in the tax system, and increase tax revenues. Although the DR's CIT rate is currently below the regional average of 28 percent, it is still above the OECD average of about 22 percent.

Figure 11. Statutory Corporate Income Tax Rates in LAC



Source: IBFD.

Notes: 1/ Tax rate includes social contributions on profits (CSLL); 2/ A 25 percent CIT rate is applied for SMEs and a 27 percent CIT rate for entities subject to the partially integrated system (PIS) on the entity's worldwide income; 3/ For the year 2008 and 2014, the income tax for equality (CREE) of 9 percent is included.; 4/ A 5 percent surtax (*Aportación Solidaria*) is included.

31. Effective tax rates in the DR are lower than statutory rates due to extensive exemptions for certain investments, suggesting harmful tax competition. Although the country's CIT statutory rate is on par with the LAC average, its effective tax rates are low and often zero due to generous preferential treatments that reduce or eliminate the tax burden for certain investments, sectors, and regions. A 2019 International Development Bank (IDB) study³³ revealed large variations in the income tax and effective

³¹ Excises taxes represented 2.3 percent of GDP in 2018.

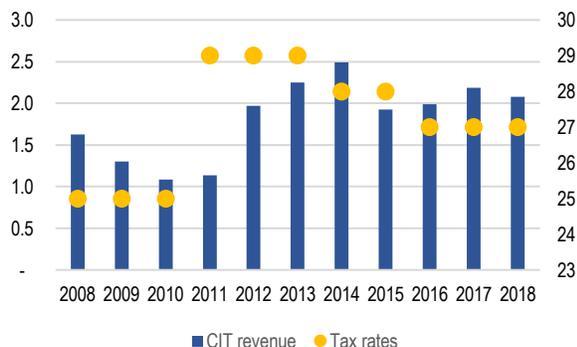
³² Article 4 of Law 557-05 on Tax Reform set the CIT rate at 30 percent for 2006, 29 percent for 2007, 27 percent for 2008, and 25 percent for 2009. However, Law 172-07 of 2007 set the CIT rate at 25 percent starting in fiscal year 2007. Subsequently, Law 139-11 raised the CIT to 29 percent starting in fiscal year 2011, while Law No. 253-12 reduced the CIT rate to 28 percent for fiscal year 2014 and 27 percent for 2016.

³³ IDB 2019. Azuero, R., Bosch, M., Cardoza, M. and Sanchez, D. "Productivity, misallocation, and special tax regimes in the Dominican Republic." IDB Working Paper 1050.

tax rates across economic activities due to special tax regimes. For instance, measuring size by both labor and capital investments, the evidence suggests that the effective tax rate decreases as firm size increases. Larger firms have a comparative advantage in navigating the DR's complex tax system, and they are more able to find loopholes to reduce their tax burden than their smaller counterparts. Rather than making changes to its general CIT rate, the DR should concentrate on rationalizing its multiple tax regimes that influence its effective tax rate and could create harmful tax competition.

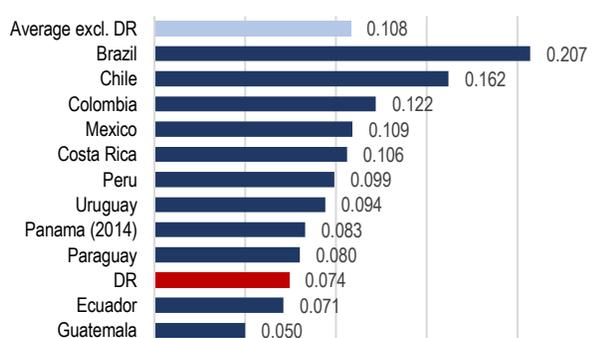
32. The revenue efficiency of the country's CIT is lower than that of comparator countries. While the efficiency of the DR's CIT appears to be sensitive to changes in the tax rate, it is less sensitive to changes in tax administration (Figure 12). This is supported by a 2017 World Bank study on tax collection efficiency, which found that the efficiency of tax collection tended to decline during periods when the CIT tax rate was unchanged. The study also reported that the country's CIT revenue efficiency³⁴ is lower than that of comparator countries, such as Brazil, Chile, and Colombia, which had lower CIT rates than the DR in 2015. Moreover, Peru, which has a similar tax rate to that of the DR, had a CIT revenue efficiency of 0.099, much higher than the DR's 0.074 (Figure 13). Increasing the revenue efficiency of the DR's CIT from 0.074 to the comparator group average of 0.108 would boost revenue collection by an estimated 0.9 percent of GDP.³⁵

Figure 12. CIT Rate and Revenue (% of GDP), 2008-18



Source: OECD 2020, IBFD, CIAT.

Figure 13. CIT Revenue Efficiency, 2015



Source: WB 2017.

33. Low CIT revenue efficiency and collection could be due to the prevalence of tax expenditures. Certain sections of the Tax Code and specific laws in the DR provide for lower tax rates or more generous deductions for specific sectors or economic activities, such as a corporate income tax rate below 27 percent, tax holidays in certain sectors and FTZs, accelerated depreciation, and deductions for training (Box 2). Lowering the tax rate for particular interest groups requires increasing the tax rates on others, and high and uneven tax rates for different activities and sectors distort the allocation of resources, lowering productivity and economic growth. Most of the tax expenditures related to the CIT are concentrated in the FTZs and the tourism sector. While both FTZs and tourism are important for generating foreign exchange and employment, the overall condition of the economy may have influenced their development more than tax incentives. The authorities should consider shifting tax expenditures

³⁴ CIT revenue efficiency is the ratio between the actual tax revenue and the tax revenue potential calculated at the statutory rate.

³⁵ World Bank 2017. Although this study measured the revenue efficiency of the CIT as of 2015, there has only been a slight increase in revenue, and the rate was reduced from 28 percent to 27 percent.

from profit-based tax incentives (e.g., tax holidays, preferential tax rates, or income exemptions) to an investment targeting model (e.g., special tax deductions or credits), as it has proved to be more effective in attracting investment.

Box 2. CIT Exemptions and Deductions

- *Exemptions* include: stock dividends; dividends in cash from which tax has been withheld at the time of the distribution; proceeds from a life insurance policy; and income from projects, programs, and artistic and cultural activities declared of cultural interest by the Council of Patronage (Law 340-19).
- *Deductions* include: fiscal depreciation; amortization of intangible property; interest payments (with limitations for interest paid pursuant to the withholding tax of 10 percent); research and development expenses previously approved by the tax administration; certain charitable contributions; and education expenses for employees and their dependents (Law 179-09). A special depreciation base applies in respect to certain leased or purchased assets under Law 392-07 on Innovation and Competitiveness.
- CIT special regimes: (i) FTZ and border zone; (ii) tourism; (iii) textile sector; (iv) renewable energy; (v) competitiveness and industrial innovation; (vi) books and libraries; and (vii) film industry.

Source: IBFD and PwC Tax summaries.

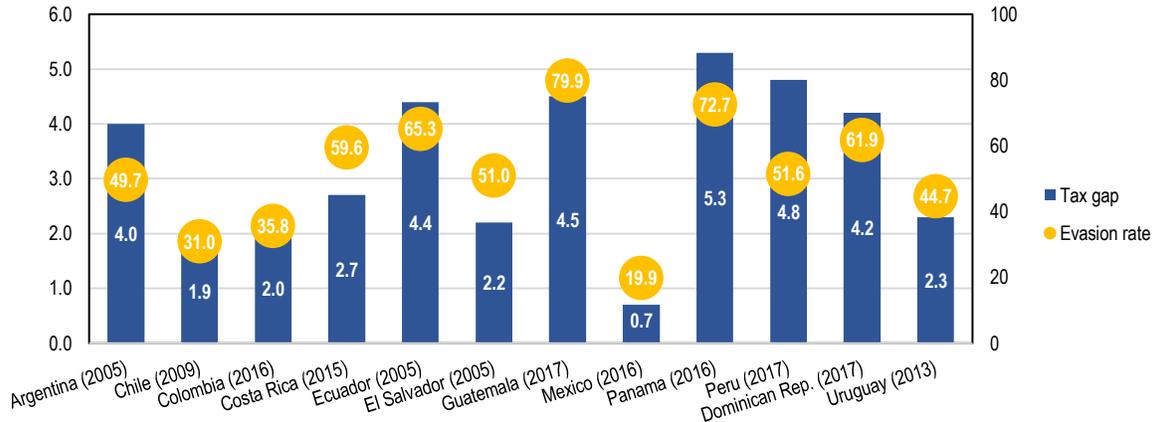
34. The prevalence of tax evasion in the DR also contributes to the low CIT collection rate, highlighting the need to strengthen the tax administration to reduce the grey economy. Given that the CIT accounts for the majority of income tax revenues, and estimated evasion rates are generally higher for the CIT than for the PIT, the implicit level of lost tax and potential revenue is estimated to be high in the DR and other countries in Central America and the Andean region.³⁶ For example, the most recent official studies estimate the tax gap in the DR to be equivalent to 4.2 percent of GDP in 2017, while the tax evasion rate reached 61.9 percent in the same year (Figure 14). Having different income tax regimes for different sectors makes tax planning and evasion easier while increasing the workload for the tax administration. The success of the tax administration in detecting and penalizing non-compliance should be reflected in a higher level of tax compliance and a lower level of tax evasion. Studies show that countries with a relatively efficient tax administration have a significantly smaller grey economy.³⁷ According to the TADAT 2016, the DGII does not quantify or monitor the full extent of inaccurate reporting, and it does not systematically calculate tax evasion (it only occasionally calculates evasion rates for the main taxes).³⁸

³⁶ Economic Commission for Latin America and the Caribbean (ECLAC), Fiscal Panorama of Latin America and the Caribbean 2020 (LC/PUB.2020/6-P), Santiago, 2020.

³⁷ Gordana Savić, Aleksandar Dragojlović, Mirko Vujošević, Miloško Arsić & Milan Martić (2015) Impact of the efficiency of the tax administration on tax evasion, Economic Research-Ekonomska Istraživanja, 28:1, 1138-1148, DOI: [10.1080/1331677X.2015.1100838](https://doi.org/10.1080/1331677X.2015.1100838)

³⁸ Tax Administration Diagnostic Assessment Tool (TADAT). Performance Assessment Report Dominican Republic, December 2016.

**Figure 14. Evasion Rates and the CIT Gap
(Share of GDP)**

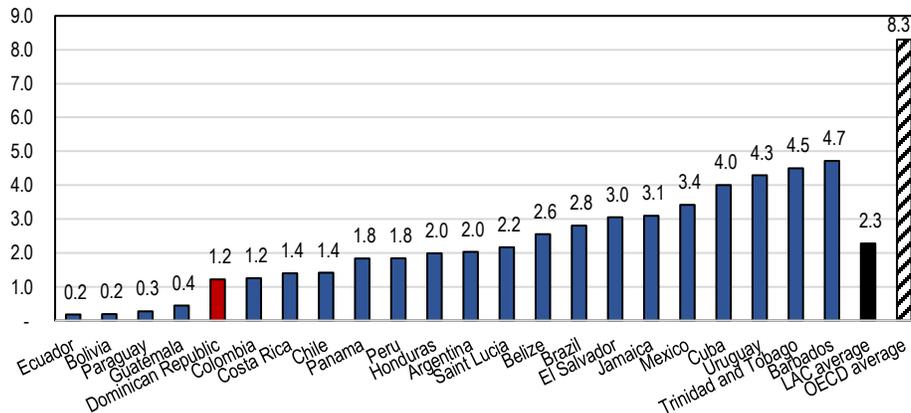


Source: Economic Commission for Latin America and the Caribbean (ECLAC) 2020.

2. Personal Income Tax

35. PIT collection is also low in the DR, representing an average of 7.9 percent of total tax revenues and 1 percent of GDP over the last decade. In 2018, PIT revenue accounted for 1.2 percent of GDP (9.2 percent of total tax revenues), almost half of the LAC average of 2.3 percent of GDP and far below the OECD average of 8.3 percent of GDP. It is also lower than that of some comparable countries in LAC such as Peru (1.8 percent of GDP and 11.1 percent of total tax revenues). The low level of PIT collection in the DR may be partly explained by the low revenue efficiency of the PIT due to several exemptions and deductions, its high exempted income threshold, and its low marginal tax rate.

**Figure 15. PIT Collection in LAC, 2018
(Share of GDP)**



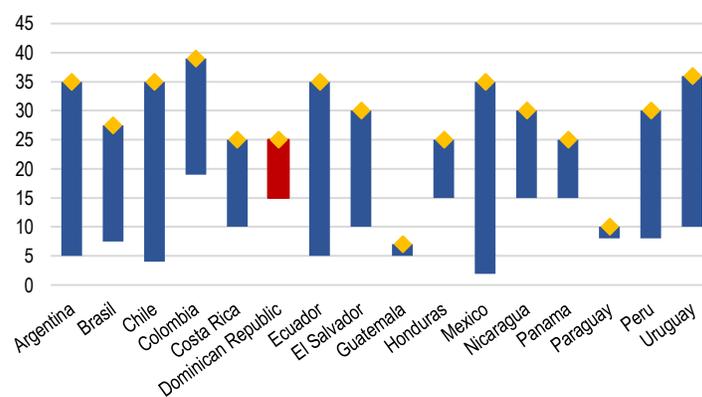
Source: OECD 2017 and 2018.

Note: 2017 data for OECD and 2018 data for LAC.

36. PIT rates in the DR are broadly in line with those of international comparators. Like the CIT, resident individuals are subject to the PIT on their Dominican-sourced income as well as on their foreign-sourced taxable income from investments and financial gains. In the DR, as in many other countries, the

marginal tax rate on labor income is progressive (i.e., it increases with income). The country’s PIT has three brackets, ranging from 15 percent (for income between DOP 416,2020 and DOP 624,329) to 20 percent (for income between DOP 624,329 and DOP 867,123) and a maximum of 25 percent (for income higher than DOP 867,123). The DR’s PIT rate is largely in line with the regional average, although the minimum marginal rate is above the regional average (10.0 percent), while the maximum marginal rate is slightly lower than the regional average (27.6 percent) and far lower than the OECD average (42.8 percent) (Figure 16).³⁹ With only three progressive brackets, its rate structure follows the global trend. Nonetheless, if the tax exemption threshold is reduced, there could be some room to improve the marginal rate structure by increasing the top marginal tax rate and reducing the minimum marginal rate, which could increase tax collection and make rates more progressive. Lastly, capital gains are taxed as ordinary taxable income under the same PIT schedule, and are determined by deducting the acquisition cost, adjusted for inflation, from the sale amount. Dividends and interest income are taxed at 10 percent.⁴⁰

Figure 16. Lowest and Highest Marginal PIT Rates by Country, 2018



Source: OECD, IBFD, and CIAT.

Note: 2019 data for OECD countries 2020 data for LAC countries.

37. The revenue efficiency of the country’s PIT is lower than that of its peers. While the DR’s PIT revenue efficiency (as with the CIT and VAT) tends to rise in response to increase in tax rates and decline gradually over time, it is lower than that of comparable countries that have lower weighted PIT rates (Figure 17).⁴¹ For instance, the revenue efficiency of the PIT in Brazil and Costa Rica, which have lower PIT rates, is higher than that of the DR. This shows that strengthening collection enforcement and broadening the tax base can have a more sustainable impact on tax revenue than only increasing the tax rate. Bringing the DR’s PIT revenues efficiency from 0.053 to the regional average of 0.065 would increase total tax revenue by 0.26 percent of GDP.⁴²

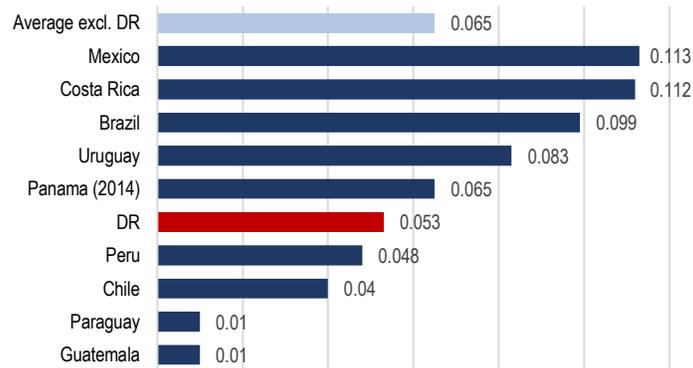
³⁹ OECD. <https://stats.oecd.org/#>.

⁴⁰ Final withholding tax rates are applied to the following income: (i) 2 percent on income from work provided by subcontractors and foremen working in the construction industry and income earned by independent drivers providing transportation services; (ii) 25 percent on income from prizes or gains from lotteries, raffles, lotto, electronic games, advertisement campaigns, and any other type of bet not specified; (iii) 10 percent on income from prizes or gains from slot machines; and (iv) progressive tax rates 15 percent or 25 percent on income from sports betting or specific lotteries, with an exemption of the first DOP 100,000. Source: IBFD.

⁴¹ PIT collection efficiency is estimated by dividing PIT revenue (as a percentage of GDP) by the average weighted tax rate. There have not been any significant changes in PIT collection or rates since 2015.

⁴² WB 2017.

Figure 17. PIT Revenue Efficiency in DR and Regional Comparators, 2015



Source: WB 2017.

38. The World Bank’s 2020 Commitment to Equity (CEQ) analysis suggests that the DR could make the PIT more progressive by broadening the tax base.⁴³ This is partly explained by the country’s high exemption threshold of DOP 416,220 (DOP 34,685 per month, or around US\$594), resulting in the lowest share of direct taxes to GDP among countries surveyed in the study. Exemptions, deductions, and credits, beyond those related to income generation, narrow the base and make the PIT less progressive (Box 3). When determining what income should be exempted, the authorities should consider the impact on equity and efficiency as well as the administrative feasibility of the exemption. Given that deductions erode the tax base, the design of the PIT plays an important role in the progressivity of the overall tax system by accounting for the ability of taxpayers to pay. The trend in OECD countries has been toward replacing PIT deductions with tax credits to create uniform incentives across the income scale.⁴⁴ Therefore, the DR should consider simplifying its PIT legislation by reducing the number of applicable deductions and exemptions.

Box 3. PIT Exemptions, Deductions, and Credits in the DR as of 2020

- **Main exemptions** include travel allowances, the Christmas bonus (i.e., 13th annual salary payment), and other extraordinary payments such as in-kind benefits provided by employers.
- **Deductions** include education expenses (up to 10 percent of net income up to DOP 104,055); SSCs; 20 percent of total investment on a rolling 5-year basis to individuals investing in projects classified under the Tourism Incentive Law 158-01; and a special deduction of 2.5 percent of net taxable income for individuals who contribute to the Solidarity Fund for Cultural Patronage.
- **Credits** available to individuals are those withheld from income taxes (except for dividends and interest) that are considered advance payments of the PIT.

Source: IBFD.

39. The PIT’s eligibility threshold effectively exempts taxpayers who receive the average wage. A 2016 OECD analysis found that workers in LAC countries, except for Mexico, did not pay any PIT at the average

⁴³ WB 2020 (forthcoming).

⁴⁴ OECD 2013.

wage level in 2013. By contrast, the income tax burden of a worker with an average wage in the OECD was 15.5 percent, and higher than that including the employees' SSCs (Figure 18).⁴⁵ This illustrates the high PIT threshold—the income level at which a person begins paying income taxes—and the weakness of the PIT as an instrument for collecting tax revenues from wages in LAC. Even though the PIT underperforms across LAC countries, taxpayers in the highest income decile in the DR—individuals earning more than three times the average wage (i.e., more than DOP 754,652)—paid just 1.5 percent of their gross income in PIT in 2013.⁴⁶ In the same year, workers in other LAC countries, such as El Salvador, Uruguay, and Mexico, started to pay the PIT at around the 8th income decile and were subject to higher effective tax rates than their counterparts in the DR. While the PIT threshold in the DR is currently lower in terms of GDP per capita than in 2013,⁴⁷ it is still equivalent to the country's GDP per capita.⁴⁸ Applying the PIT to only a small part of the population severely limits its role in reducing income inequality.

⁴⁵ OECD/IDB/CIAT. 2016. *Taxing Wages in Latin America and the Caribbean 2016*. OECD Publishing. Paris, <https://doi.org/10.1787/9789264262607-en>.

⁴⁶ Single individuals without children in the 10th income decile are subject to tax rate of 1.5 percent.

⁴⁷ It represented 1.5 times the GDP per capita, was 77 percent higher than the average wage (DOP 225,961) and was almost four times the minimum wage (DOP 102,549).

⁴⁸ The threshold is DOP 416,220 (US\$7,112.4), equivalent to 98 percent of the 2019 GDP per capita local currency LCU. Source: WDI Indicators.

Figure 18. Income Tax and Employees' Social Security Contributions, * 2013
(% of Gross Wage Earnings)

Country ¹	Total payments	Income tax	Social security contributions	Average wage USD	Average wage PPP ²
Chile	19.1	0.0	19.1	13 334	19 127
Uruguay	18.0	0.0	18.0	12 616	14 576
Argentina	17.0	0.0	17.0	21 155	31 808
Panama	11.4	0.0	11.4	9 202	16 202
Mexico	11.0	8.5	2.5	7 748	12 705
Peru	10.9	0.0	10.9	6 267	11 185
Bolivia	10.6	0.0	10.6	5 791	12 510
Ecuador	9.5	0.0	9.5	8 007	14 559
Costa Rica	9.2	0.0	9.2	11 428	15 430
Brazil	9.0	0.0	9.0	10 525	14 152
Paraguay	9.0	0.0	9.0	8 106	15 602
El Salvador	8.9	0.0	8.9	5 308	10 766
Colombia	7.0	0.0	7.0	7 466	11 878
Jamaica	6.7	0.0	6.7	3 653	5 932
Dominican Rep.	6.0	0.0	6.0	5 405	11 212
Nicaragua	5.7	0.0	5.7	3 205	8 239
Venezuela	5.5	0.0	5.5	8 671	13 701
Trinidad and Tobago	4.5	0.0	4.5	7 718	11 906
Guatemala	4.0	0.0	4.0	5 925	12 443
Honduras	3.6	0.0	3.6	5 851	11 480
<i>Unweighted averages</i>					
LAC	9.3	0.4	8.9	8 369	13 771
OECD³	25.4	15.5	9.9	43 631	40 292

Source: OCDE, Taxing Wages 2016.

Notes: *Single individual without children with an average wage income; 1. Countries ranked by decreasing total payments; 2. Expressed in U.S. dollars with equal purchasing power; 3. OECD average based on OCDE 2014, Taxing Wages, Table 0.3.

40. Lowering the PIT eligibility threshold would improve its progressivity while bringing it closer to international standards. Given the structure of the DR's marginal tax rates, reducing the threshold would imply higher taxes for all taxpayers who are above the new threshold. In many countries in LAC, the PIT eligibility threshold is higher than GNI per capita, except in Brazil, Panama and Uruguay, which coincidentally collect higher tax revenues from the PIT (2.8, 1.8, and 4.3 percent of GDP, respectively) (Table 3). One purpose of an eligibility threshold is to support low-income households by ensuring that a minimum level of income is not taxed. Therefore, it is generally common in poor countries that a significant part of the population is not subject to the PIT. Nonetheless, having a threshold as high as a country's GNI per capita, as in the DR, reduces the number of potential taxpayers and makes the overall tax system less progressive. To determine the income threshold for the PIT, the authorities need to evaluate a series of trade-offs, ranging from fairness and efficiency to the allocation of scarce resources and revenue needs, as well as concerns related to political economy and the design of the PIT, including

exemptions and deductions. The current crisis may offer an opportunity to overcome political challenges and make the needed changes to the PIT such as lowering the eligibility threshold.

Table 3. PIT Threshold and GNI per Capita in Selected Countries in Latin America, 2018

Country	GNI per capita, current LCU, 2018	PIT threshold, LCU, 2018	PIT threshold, share of GNI per capita	Gini*
Brazil	31,958.8	22,847.8	71%	53.9
Chile	9,773,037.2	652,765.5	7%	44.4
Colombia	19,355,598.2	36,140,040.0	187%	50.4
Costa Rica	6,608,967.6	799,000.0	12%	48
Dominican Rep.	380,673.6	416,220.0	109%	43.7
Ecuador	6,130.3	11,270.0	184%	45.4
El Salvador	3,838.7	4,064.0	106%	38.6
Honduras	55,171.2	198,995.1	361%	52.1
Nicaragua	62,243.8	100,000.0	161%	46.2
Panama	14,414.1	11,000.0	76%	49.2
Peru	21,692.3	29,050.0	134%	42.8
Uruguay	494,135.7	184,704.0	37%	39.7

Source: WDI 2018 and CIAT 2018.

* GINI 2018 or last available year (2017 for Chile and 2014 for Nicaragua).

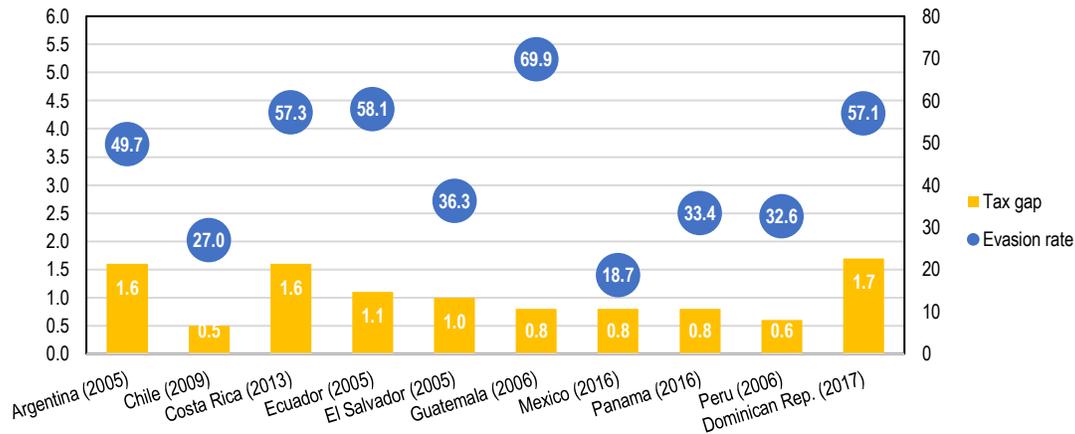
41. There are also other factors, such as the high concentration of salaried labor and high levels of evasion and informality, that limit PIT revenues in the DR. ECLAC 2020 estimates that about half of potential revenue from the PIT is lost through tax evasion in Latin America (Figure 19).⁴⁹ In several countries in the region, tax evasion is more widespread among high earnings self-employed workers than wage earners, as the latter are usually subject to withholding taxes, limiting the potential for tax non-compliance. In the DR, the estimated rate of PIT evasion was 57.1 percent in 2017, one of the highest in LAC, while its tax gap from PIT non-compliance reached 1.7 percent of GDP. Tax collection from salaried labor income was the main source of tax revenue from the PIT in 2019, accounting for about 73 percent of total PIT revenues.⁵⁰ Tax revenue from self-employed workers represented a mere 8 percent of total PIT revenue due to high informality among this group of taxpayers. Therefore, efforts to reduce informality, which currently accounts for 55 percent of labor activity,⁵¹ could have a positive effect on PIT revenues.

⁴⁹ ECLAC 2020.

⁵⁰ Monthly economic classification, *Dirección General de Presupuesto of Ministerio de Hacienda*, December 2019.

⁵¹ <https://www.heritage.org/index/country/dominicanrepublic>.

Figure 19. PIT: Tax Evasion and Estimated Tax Gap in LAC
(% and Share of GDP)



Source: ECLAC 2020.

42. The DR needs to strengthen its capacity for large-scale automated crosschecking to verify tax declarations. According to TADAT 2016, CIT and PIT declarations are routinely and systematically cross-checked with information from VAT declarations as well as with information from government agencies (e.g., customs, Social Security Administration, and the Ministry of Finance, MoF) and data on withholding on interest from banks and financial institutions. However, other relevant tax information is only reviewed on a case-by-case basis. In addition, TADAT 2016 found that there is no large-scale automated data collection and crosschecking of PIT and CIT declarations with information from internet-based vendors, which could help increase voluntary compliance.

3. Micro, Small, and Medium-Sized Enterprise Taxation

43. International experience show that the complexity of the standard tax regime can constitute a barrier to formalization and business growth, particularly among micro, small, and medium-sized enterprises (MSMEs). To encourage the formalization and growth of MSMEs, many countries have introduced tax policy and tax administration measures that target MSMEs, including special tax regimes. Simplified tax systems for MSMEs aim to formalize taxpayers traditionally excluded from the general tax regime due regulatory complexity and high compliance costs. To effectively design tax policies aimed at this group of businesses, the authorities should primarily target micro and small businesses most in need of support, including: (i) family subsistence entrepreneurs, which could be considered micro enterprises; and (ii) businesses with limited capacity to meet their tax obligations in terms of compliance costs, which could be considered small enterprises.

44. Simplified tax systems are necessary to facilitate the effective administration of the tax system. Tax authorities have limited resources, so they need to focus on high-risk taxpayers. Since MSME taxpayers are different from their larger counterparts, simplified systems for MSMEs can reduce administration costs, which can be high relative to their revenue contribution. Under simplified systems, control may be based on verifications and cross-checking that do not require costly tax auditors. However, the design needs to include provisions to avoid common pitfalls of these types of systems such as disincentives to firm growth and tax bunching.

45. The main purpose of MSME tax regimes is not to increase tax collection but to improve the equity and efficiency of the overall tax system, as these businesses represent a very small share of total tax collection in LAC. If all potential taxpayers contribute to the tax system according to their capacity, compliance and tax morale would improve, which would strengthen the legitimacy of the tax system. In 2010, the average collection of tax regimes implemented for MSMEs in LAC reached 1 percent of total tax revenue and less than 0.5 percent of GDP, and these shares do not seem to have changed in the last ten years. While the average collection of Brazil's SIMPLES tax regime represented 2.8 percent of total tax revenue and 1 percent of GDP in 2010 (the highest rates in LAC), the previous SM tax regime in the DR (Tax Simplified Procedure, *Procedimiento Simplificado de Tributación*, PST)⁵² represented only 0.05 percent of total tax revenue and 0.01 percent of GDP in the same year, far below comparator countries in LAC.⁵³

Box 4. Simplified Fiscal Regime (*Régimen Simplificado de Tributación*, RST)

- **Eligibility:** Individuals and corporations with income less than DOP 8.7 million (*method based on income*) or purchases of goods to be sold worth less than DOP 40 million (*method based on purchases*) in a taxable year may apply for the RST. These methods facilitate payment of and compliance with income taxes and the VAT (ITBIS), and values are adjusted for inflation annually.
- **Rates:**
 - *Method based on income:* A flat rate of 7 percent on the annual gross income declared to corporations. For both individuals and corporations in the agriculture sector, an annual effective tax rate (EFT) is applied to gross income, with the rate determined by the DGII. For individuals, this amount is integrated into the PIT determination, and standard tax brackets apply. This method replaces the income tax and the VAT (ITBIS).
 - *Method based on annual purchases:* Tax payable is determined by applying the current CIT rate to a gross marketing margin percentage determined by the DGII to the total purchase amount. It includes a simplified determination of the VAT (ITBIS).
- **Exemptions and deductions:** Forty percent of gross income can be deducted to obtain the net income, and the annual exemption of DOP 416,220 and allowances for educational expenses can also be used.
- **Transition to CIT:** RST corporate taxpayers are assigned to the standard regime if they exceed their gross revenues by 5 percent in a given year that they are subject to the RST regime.
- **Tax obligations:** Taxpayers are required to: (i) issue authorized sequence invoices (*número de comprobante fiscal*, NCF); (ii) request receipts with an NCF from vendors and suppliers (for archiving purposes only); and (iii) maintain documentation supporting the annual tax calculation. Taxpayers under the RST are not required to maintain an organized accounting system, which the previous PST required.
- **Advantages:** The new regime has no asset tax, no advance income tax payments, and no obligation to submit monthly information (as compared to the standard regime); and there is an automatic payment of income tax based on two or four payments.
- This regime is not applicable to construction and related real estate services; manufacturing and distribution of tobacco products, alcohol and fuels; insurance services; telecommunication services; financial services (e.g., banks and savings and loans associations/cooperatives); pension services (e.g., pension funds); stock market services (e.g., brokerage houses, exchanges, investment funds, etc.); entertainment services, and impresario services.

Source: IBFD, Presidential Decree No. 265-19 of 1 August 2019.

⁵² The PST was in force until July 2019.

⁵³ Pecho. 2012. Regímenes Simplificados de Tributación para Pequeños Contribuyentes en América Latina, Documento de Trabajo del CIAT No. 2-2012, Panamá.

46. Like in many countries, there is no specific definition of an SME for tax purposes in the DR. However, Law 488-08, which established the regulatory system for the development and competitiveness of MSMEs, classifies businesses according to the number of workers and gross sales.⁵⁴ In addition, the Simplified Fiscal Regime (*Régimen Simplificado de Tributación*, RST) also establishes criteria that businesses have to meet to register. The thresholds established by both methods are generally in line with the definition of micro and small enterprises in the Competitiveness Law. In some cases, high thresholds to register can create incentives for businesses to stay small, downsize, or split to avoid migrating into the standard tax regime, raising administration costs and contributing to horizontal inequity in the tax system.

Table 4. SME Regime Thresholds in Selected LAC Countries, 2020

Country	Simplified tax regime	Eligible for	Tax threshold in USD	Tax threshold as a % of GDP per capita
Argentina	Monotax (goods)	Ind.	43,569.7	4.4
	Monotax (services)		29,046.5	2.9
Bolivia	Simplified Tax Regime (RTS)	Ind.	19,200.0	5.4
Brazil	Simples (ME)	Corp.	89,474.9	10.3
	Simples (SE)	Corp.	1,193,000.0	136.9
	Regime for Microentrepreneur individual (MEI)	Ind.	20,131.9	2.3
Chile	Presumptive income scheme (RPP)	Ind.	653,157.0	43.8
	General Pro SME (Pyme)	Ind./Corp.	3,265,790.0	219.2
	Transparent Pro SME (Pyme)	Ind./Corp.	3,265,790.0	219.2
Colombia	Simple Tax Regime	Ind./Corp.	865,139.0	134.5
Costa Rica	Simplified tax regime	Ind./Corp.	116,215.0	9.5
Ecuador	Ecuadorian simplified tax regime (RISE)	Ind.	60,000.0	9.7
Mexico	Fiscal incorporation regime (RIF)	Ind.	105,747.0	10.7
Peru	New simplified single regime (NRUS)	Ind.	28,488.7	4.1
	Special income regime (RER)	Ind./Corp.	155,797.0	22.3
	MYPE tax regime (RMT)	Ind./Corp.	2,118,850.0	303.7
Dominican Rep.	RST (method based on income)	Ind./Corp.	162,416.0	19.6
	RST (method based on purchases)	Ind./Corp.	746,738.0	90.2
Uruguay	Monotax (sole proprietorship)	Ind.	21,310.8	1.3
	Monotax (partnership)	Corp.	35,518.0	2.2

Source: Webpages of Tax Administrations in LAC countries; WDI.

47. The threshold to register under the SME tax regime in the DR is relatively high. Thresholds are generally high throughout the LAC region compared to some developed countries that also use special

⁵⁴ Law 488-08 includes the following classification of enterprises: (i) microenterprise: up to 10 workers and annual gross sales of up to RD\$8,000,000; (ii) small enterprise: 11-50 workers and annual gross sales of up to RD\$54,000,000; and (iii) medium enterprise: 51-150 workers and annual gross sales of up to RD \$202,000,000. <https://dgii.gov.do/contribuyentesRegistrados/mipymes/Paginas/default.aspx>.

regimes for these business segments.⁵⁵ The threshold for SME tax regimes varies by country and depend on the size (i.e., micro or small) and type (i.e., individuals or companies) of entity. For instance, the gross sales threshold to register with the individuals/microentrepreneurs' regime (MEI) in Brazil is 2 times GDP per capita, while the threshold to register with the NRUS regime in Peru is 4 times GDP per capita. Moreover, the threshold for Brazil's SIMPLES regime for microenterprises (legal entities) is set at 10 times the country's per capita income, while Uruguay's monotax regime for microenterprises (partnerships) is set at 2 times GDP per capita. In the case of small business regimes, the threshold for Mexico's Fiscal Incorporation regime (for individuals) is set at 11 times GDP per capita, while it is 43 times GDP per capita for Chile's presumptive income scheme for micro and small entrepreneurs; and the threshold for Brazil's SIMPLES regime for small companies (legal entities) is 137 times GDP per capita, Chile's Pro SME regime is 219 times GDP per capita; and Peru's RMT is 300 times GDP per capita. In the DR, the RST is available to both individuals and corporations at different thresholds. The threshold for the RST based on income is 19.8 times the country's GDP per capita, while the threshold for the RST based on purchases equals 90.2 times GDP per capita. The country's threshold for microenterprises is high when compared to countries like Brazil, Costa Rica, and Uruguay (which also offer special tax regimes targeted to legal entities), increasing the number of taxpayers who do not necessarily need support to comply with their tax obligations. It is, however, not clear if the RST also targets small enterprises, as its thresholds are more in line with the Competitiveness Law's definition of micro enterprises.

48. The authorities could consider reviewing the design and performance of the RST. The simplified tax regime was created when the former PST regime was effectively repealed in August 2019. The new regime covers individuals and corporations, and it also includes agricultural businesses and individuals and corporations doing business as traders. More taxpayers are eligible for the RST, as both of its eligibility methods apply to individuals and corporations, unlike the PST's method based on income, which was only eligible for individuals. The new regime also eliminates the PST's requirement of an organized accounting system and SME certification issued by the Ministry of Industry and Commerce, and it exempts corporations from the tax on assets. However, both regimes have similar eligibility thresholds, benefits, and tax obligations (Box 4). Therefore, the DR should consider reviewing the design and performance of the RST to see if the threshold: (i) incentivizes tax bunching or the creation of parallel systems; (ii) accelerates business growth; (iii) reduces tax compliance costs of micro and small taxpayers and overall administrative costs; or (iv) interferes with the transition to the general tax regime.

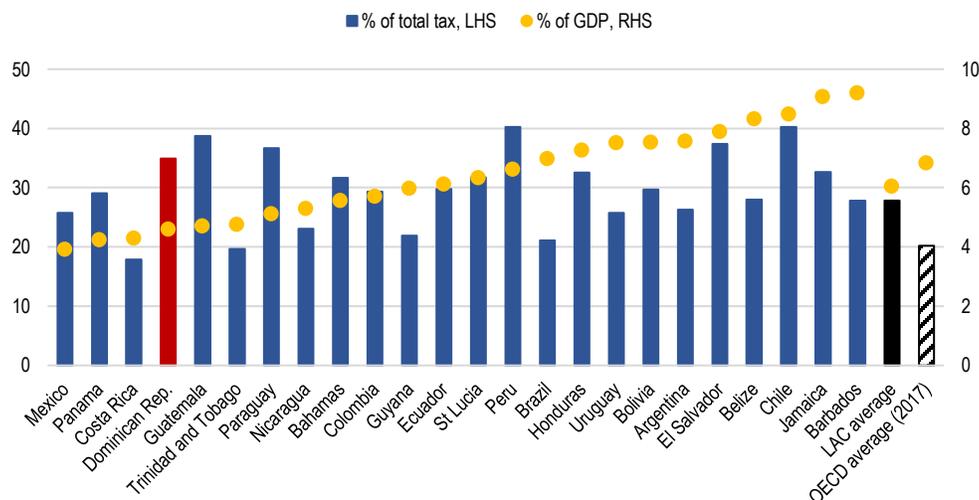
B. Indirect Taxes: VAT and Excise Taxes

1. Valued-Added Tax

49. The VAT is the largest source of tax revenues in the DR. VAT collection has grown steadily over the last decade. Between 2000 and 2018, the VAT accounted for, on average, one-third of total tax revenue, and its collection grew by 2 percentage points of GDP, driven by an increase in the VAT rate in response to a reduction of taxes on foreign trade. In 2018, the VAT accounted for 34.9 percent of total taxes, and it amounted to 4.5 percent of GDP, lower than the regional average of 6.0 percent and the OECD average of 7.0 percent.

Figure 20. VAT in LAC Countries, 2018
(Share of GDP and Share of Total Taxes)

⁵⁵ IDB. 2012. CORBACHO, A.; FRETES-CIBILS, V.; LORA, E. (Ed.), Recaudar no basta: los impuestos como instrumento de desarrollo. <https://publications.iadb.org/handle/11319/3473#sthash.7fML6C1C.dpuf>.



Source: OECD 2020 and 2019.

50. The country's standard VAT rate has increased by 12 percentage points since 1990. Between 1990 and 2018, the government tripled the standard VAT (ITBIS) rate from 6 to 18 percent progressively, which had a significant impact on revenue collection. The rate increased from 12 percent in 2004 to 16 percent (law 288-04) and finally 18 percent in 2012 (law 253-12). The 2012 VAT increase was originally planned to only apply for two years (2013 and 2014), before falling back to 16 percent in 2015. However, this reduction was conditional on achieving a tax pressure of 16 percent, which did not occur.

51. At 18 percent, the standard VAT rate is slightly higher than the regional average but in line with the OECD average. The VAT (ITBIS) works like a usual VAT, and it is levied on taxable goods and services, including imports. Only the value added to the taxpayer's supplies is taxed and transferred to the last consumer, applying to all stages of the distribution process. Exports are zero rated, and many goods and services are exempt. At the standard rate of 18 percent,⁵⁶ the DR has a higher VAT rate than the LAC average of 15 percent, but it is in line with the OECD average of 19 percent. Yet, VAT revenue in terms of GDP is at or below that of international comparators, which is indicative of lower tax efficiency.

52. There is no threshold for VAT registration in the DR. The VAT (ITBIS) law does not contain any provision for voluntary VAT registration, as there is no registration threshold (i.e., all individuals or business entities that provide taxable goods or services (including exempted) are obliged to register for the VAT (ITBIS). However, under the RST based on income for microenterprises, the VAT (ITBIS) and income tax are replaced by a flat rate. Thus, the threshold eligibility to qualify for the RST could be used as an implicit proxy for the VAT (ITBIS), as micro taxpayers will be exempt from declaring and paying the VAT (ITBIS). While a relatively high VAT threshold could frustrate efforts to grow the formal economy, a relatively low VAT threshold could disincentivize growth. Therefore, a review of the eligibility threshold for the RST needs to consider the potential VAT forgone from micro enterprises. An optimal VAT threshold would be the level at which compliance and administrative cost savings are similar to losses in VAT collection from small businesses.

53. The DR's VAT collection efficiency is far below the average of LAC and comparable countries. The revenue efficiency of the VAT (ITBIS) tends to rise whenever changes are made to the tax code or the tax

⁵⁶ A lower rate of 16% is applied to specific goods (sugar, yogurt, chocolate, oil, butter and coffee).

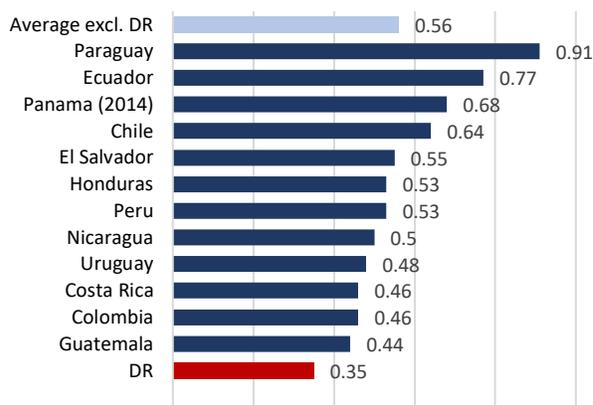
administration, but it tends to gradually fall until new adjustments are introduced. A 2017 World Bank analysis on the C-efficiency index—the ratio of VAT revenue to consumption divided by the standard tax rate—showed that the collection efficiency of value-added taxation in the DR is very low. At 0.35, it is far below the LAC average of 0.56 and the levels of comparable countries, such as Honduras, Costa Rica, and El Salvador, that had lower CIT rates than the DR in 2015.⁵⁷ The C-efficiency can provide a first assessment of the VAT gap and the potential revenue gain from narrowing the VAT gap through improved compliance and the adoption of appropriate policies (e.g., policies aimed at widening the tax base). Increasing the DR’s VAT revenue efficiency from its current level of 0.35 to the LAC average of 0.56 would increase total revenues by an estimated 2.8 percent of GDP.⁵⁸

Figure 21. VAT Rate and VAT Revenue, 2008-2018 (% of GDP)



Source: OECD 2020, IBFD, and CIAT.

Figure 22. VAT Revenue Efficiency in the DR and Regional Peers, 2015



Source: World Bank 2017.

54. A narrow tax base due to generous exemptions and widespread fraud, tax evasion, and non-compliance significantly reduces the potential VAT collection. A decomposition of VAT collection efficiency into the “policy gap” and “compliance gap” can provide insight into its drivers. The policy gap is a measure of tax expenditures under the VAT relative to a scenario of a single standard rate on all consumption, assuming full compliance. The compliance gap is the difference between the VAT payable (under the current tax code) and actual VAT collected by the government, and the difference is due to imperfect compliance, evasion, and/or fraud. A World Bank 2017 analysis of these two indicators confirms that the DR has considerable scope to boost tax revenue by streamlining VAT (ITBIS) exemptions and reducing tax evasion, fraud, and mismanagement. It also suggests that the VAT (ITBIS) compliance gap is the largest factor explaining the country’s large potential efficiency gap.

55. Foregone revenue from VAT exemptions averaged 3.3 percent of GDP in 2008-15, reaching a peak of 3.9 percent of GDP in 2009. During this period, the DR’s policy gap, measured by the G-inefficiency ratio,⁵⁹ averaged 0.246.⁶⁰ Even at its lowest point, the country’s policy gap was slightly above the LAC

⁵⁷ Tax rates and tax collection of VAT have not varied significantly since 2015.

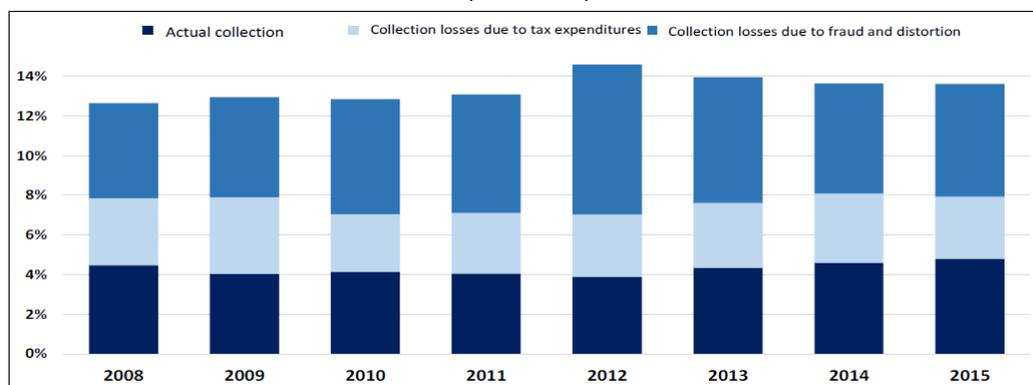
⁵⁸ WB 2017.

⁵⁹ The G-inefficiency ratio measures revenue losses due to tax expenditure, supplementing the C-efficiency index. It is calculated by dividing foregone ITBIS revenue by actual ITBIS collections.

⁶⁰ World Bank 2017.

average of 0.21, indicating that it is significantly wider than that of peer countries such as Peru.⁶¹ VAT exemptions in the DR include primary goods (not processed); exported goods and services; services rendered in the areas of financial services (including insurance), local ground transportation, energy supply, water supply, rubbish collection, health, education, and culture; and transfer and leasing of intangible assets (e.g., copyright, trademarks, industrial processes, and software). Given the vast range of sectors and activities exempt from taxation, eliminating exemptions and zero-rated products would increase potential revenue.

Figure 23. Decomposition of Actual and Potential VAT (ITBIS) Revenue in the DR, 2008-2015
(% of GDP)



Source: World Bank 2017.

56. In addition, VAT revenue losses due to fraud, evasion, and non-compliance averaged 5.8 percent of GDP in 2008-15, reaching a peak of 7.6 percent of GDP in 2012. During this period, the DR's compliance gap, measured by the X-inefficiency ratio, averaged 0.434, much higher than the LAC average of 0.294 and among the highest in the region (only Mexico and Guatemala have wider compliance gaps).⁶² Between 2008 and 2015, VAT (ITBIS) losses due to the compliance gap were greater than both the cost of VAT (ITBIS) exemptions and the total value of VAT (ITBIS) revenue. Furthermore, ECLAC 2020 estimates that in 2017 the estimated rate of VAT evasion was 43.8 percent, one of the highest rates of tax evasion in the region and higher than the LAC average of 30.0 percent.⁶³ While it is difficult to reduce tax evasion below a minimum level (including in developed countries), as it is often complex and deeply rooted, the authorities in the DR should focus on comprehensive policies to reduce tax evasion, as its compliance gap is very wide. The administration of many exemptions and zero-rated products has also a negative effect on tax non-compliance, as it creates additional administrative costs and reduces the capacity of the tax administration to focus resources on monitoring and auditing high-risk taxpayers.⁶⁴

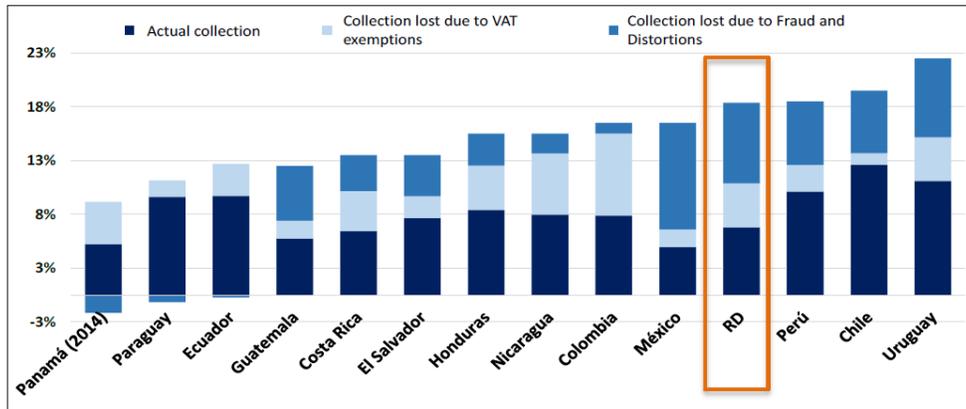
⁶¹ World Bank 2017.

⁶² World Bank 2017.

⁶³ ECLAC 2020.

⁶⁴ OECD 2013.

Figure 24. Decomposition of Actual and Potential VAT (ITBIS) Revenue in the DR and Regional Comparators, 2015
(% of Net Consumption)



Source: WB 2017.

57. VAT withholding systems that are already in place in the DR could be used to reduce VAT evasion. The Dominican Republic implemented a VAT withholding mechanism on transactions using credit and debit cards since January 2005. To facilitate the VAT withholding mechanism, designated ‘acquisition companies’ act as intermediaries between the credit and debit card issuing banks and the seller who accepts the cards as payment. 30% of the VAT is withheld by the ‘acquisition companies’ and reported weekly to the tax authority. Some supplies, such as medicines, books, newspapers and education services, are exempt from VAT withholding and businesses involved in the sale of these goods can request a VAT withholding exemption from the tax authority. The data withdrawn from these systems should be used to enhance the compliance risk strategy to reduce tax evasion.

58. The country’s VAT is slightly progressive. A 2020 World Bank study on Fiscal Policy and Redistribution that used the CEQ methodology found that the VAT (ITBIS) is barely progressive because: (i) the contribution of individuals in the top income decile is slightly above their 79.5 percent share of market income;⁶⁵ and (ii) VAT (ITBIS) expenditures heavily favor wealthier households. While zero rates and exemptions are generally introduced to make the VAT less regressive, a tax incidence analysis in LAC shows that they benefit high-income earners more than poor households.⁶⁶ A reduction of the VAT rate for certain products is unlikely to improve the redistribution of income, as higher earners consume more of all types of goods, except for basic goods. Instead, broadening the tax base would generate additional revenues that can be distributed to lower earners to compensate for the removal of subsidies for certain products.

2. Excise Taxes

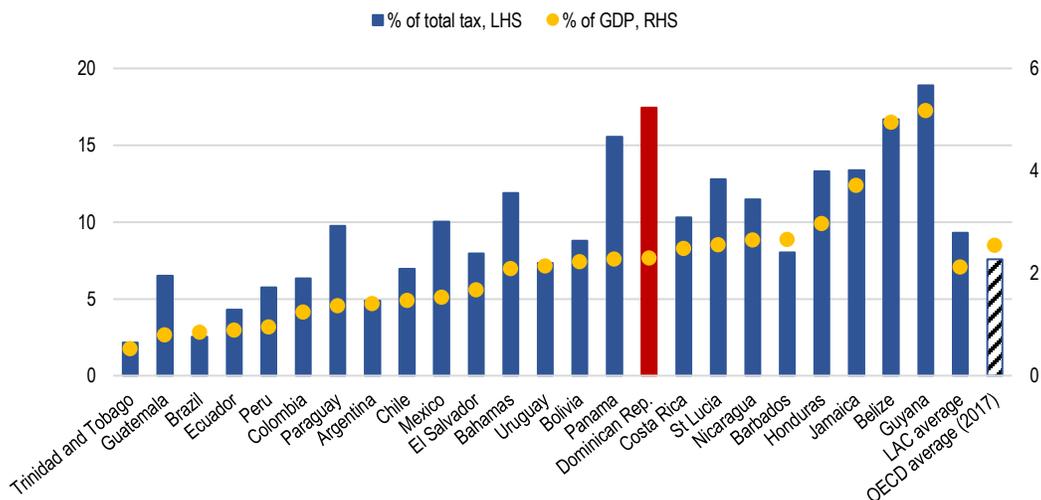
59. Excise taxes contribute significantly to the DR’s tax revenues, although their share of tax revenue has fallen dramatically over the last decade. Excise taxes are applied to the acquisition or import of certain goods and services such as fuels and petroleum derivatives, alcoholic beverages, cigarettes and

⁶⁵ The ITBIS reduces average market income by an estimated 5 percent, and it reduces the market income of ultra-poor households, extreme poor households, and middle and upper-class households by 3.9 percent, 3.8 percent, 5 percent and 5.6 percent, respectively.

⁶⁶ OECD 2013.

other tobacco products, and telecommunication, insurance, and banking services. In the last decade, excise tax collection fell from about 3.1 percent of GDP in 2008 to 2.3 percent of GDP in 2018, mainly due to lower fuel taxes. In 2018, excise taxes accounted for 17.4 percent of total revenues and represented 2.3 percent of GDP in the DR, in line with the LAC average of 2.1 percent of GDP and slightly below the OECD average of 2.5 percent of GDP (Figure 25).

Figure 25. Excises Taxes in LAC, 2018



Source: OECD 2020.

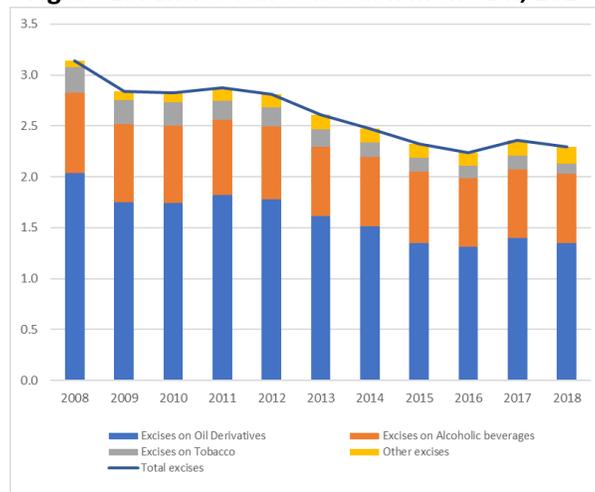
60. Excise taxes are progressive in the DR. Excise taxes on consumption (e.g., alcoholic beverages, cigarettes, oil products, telecommunications and insurance services, and several types of imported goods) are more progressive than the VAT (ITBIS), according to the 2020 World Bank CEQ study. They reduce the market income of earners in the top income decile by 5.7 percent, significantly more than 2 percent of the market income of the poorest taxpayers. Nevertheless, excise taxes on gasoline are more progressive than those on tobacco and alcohol, as the former represents a higher share of the income of high-income earners, while the latter usually represents a higher share of the income of poor households.

61. Taxes on fuels and petroleum derivatives constitute the largest driver of revenue from excise taxes. In 2018, it represented more than half of total excise tax revenues and accounted for a nontrivial 1.3 percent of the country's GDP. The tax rates on the consumption of fuel oil, gasoline, and natural gas depend on the kind of fuel (e.g., premium gasoline, regular gasoline, diesel oil, etc.), ranging from zero to DOP 18 per gallon.⁶⁷ There is also a 16 percent ad valorem excise tax for fossil fuel and petroleum derivatives. Lastly, there is a tax of DOP 2 per gallon of regular and premium fuel and diesel (adjustable for inflation on a quarterly basis) since 2018, which is collected by the DGA.⁶⁸

⁶⁷ IBFD.

⁶⁸ PwC Tax Summaries.

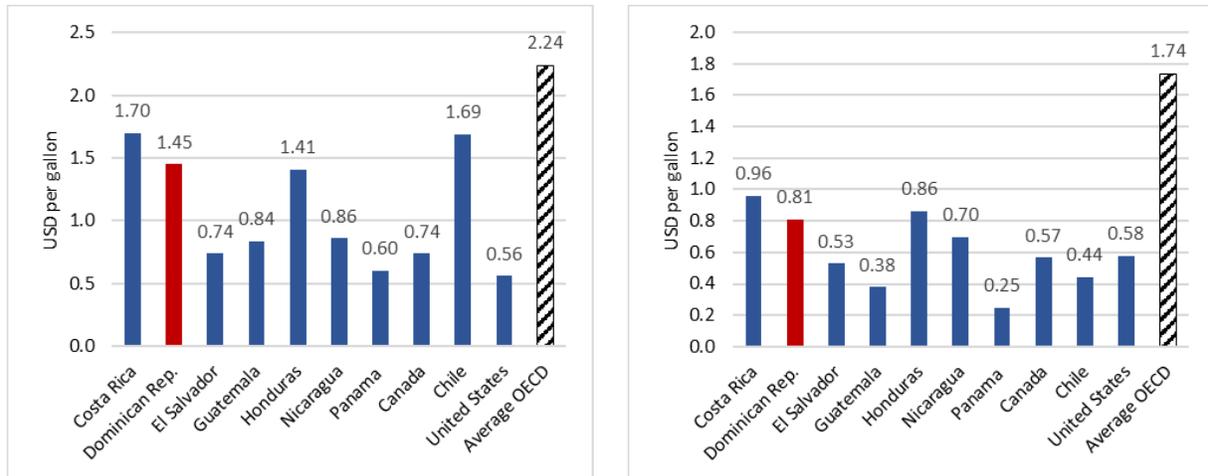
Figure 26. Excise Tax Collection in the DR, 2018



Source: OECD 2020.

62. The country’s fuel excise tax rates are below the OECD average. Its tax rate on gasoline is US\$1.45 per gallon, significantly lower than the simple OECD average of US\$2.24 per gallon (Figure 27). The tax rate on diesel in the DR is US\$0.81 per gallon, also lower than the simple OECD average of US\$1.74 per gallon.^{69,70} Therefore, the country should consider adjusting its excise taxes on fuel to better align tax rates with global oil prices.

Figure 27. Excise Tax Rates on Gasoline and Diesel, 2020



Source: Acodeco 2020, “Consumption Tax Trends 2018, OECD.

Note: 2020 data for LAC and 2017 data for the OECD.

63. Tax revenue from excise taxes on alcoholic beverages and tobacco amounted to less than 0.8 of GDP in 2018. These excise taxes are calculated on the basis of a mix of *ad valorem* and *ad quantum* taxes.

⁶⁹ http://www.acodeco.gob.pa/acodeco/uploads/pdf/combustibles/CombustibleCentroamerica_26Jul-1Ago2020.pdf

⁷⁰ OECD (2018), *Consumption Tax Trends 2018: VAT/GST and Excise Rates, Trends and Policy Issues*, OECD Publishing, Paris, <https://doi.org/10.1787/ctt-2018-en>.

Ad quantum taxes require a precise definition of the nature and characteristics of the tax base, while an ad valorem tax is simply based on the price of the excisable good. In the DR, the tax equals DOP 633.85 for every liter of pure alcohol; and DOP 53.62 for a 20 pack and DOP 26.81 for a 10 pack of cigarettes, adjusted for inflation annually. In addition, products derived from alcohol and cigarettes are subject to an ad valorem ISC of 10 percent on the transfer of alcoholic beverages and 20 percent on the transfer of tobacco products, both applied on the retail price. Local manufacturers responsible for imports and transfers are accountable for these taxes.⁷¹ In 2018, excise taxes on alcoholic beverages and tobacco only amounted to 0.7 percent of GDP and 0.1 percent of GDP, respectively. Excise tax collection accounted for less than 6 percent of total tax collection in 2019, with taxes on beer representing more than 30 percent of revenue from excise taxes (Table 6). Aside from beer, low collection rates for taxes on alcoholic beverages and tobacco suggest serious weaknesses in collection efficiency.

Table 5. Tax Revenue from Excise Taxes on Alcohol and Tobacco, 2019
(% of Total Taxes)

Type of alcohol	Revenue
Undenatured ethyl alcohol	0.018%
Rum and other cane spirits	0.908%
Brandy, Gin, Whisky, Vodka and other alcoholic beverages	0.084%
Wine, vermouth and derivatives	0.046%
Beer	2.611%
Other fermented drinks	0.002%
Alcohol derivatives	1.335%
Tobacco and cigarettes	0.641%

Source:
Ministerio
Hacienda,

de
DIRECCIÓN GENERAL DE PRESUPUESTO

64. Plans to increase the tax rate on tobacco products need to include a strategy to combat smuggling.

In recent years, several countries in LAC have raised their cigarette taxes, and excise taxes levied on cigarettes in the DR represented 43.6 percent of the retail price in 2014, higher than some comparator countries in LAC (Table 6). While raising the price of tobacco through increased taxation is the most effective and efficient way to reduce tobacco use, it could also have some unintended consequences, such as an increase in smuggling that may offset the increase in tax collection. The effect of a tax raise would depend on the relative tax rate in the DR compared to that in neighboring countries. Moreover, traceability systems for excise products can be employed to significantly reduce the opportunities for smuggling.

⁷¹<https://dgii.gov.do/cicloContribuyente/obligacionesTributarias/principalesImpuestos/Paginas/impuestoSelectivoConsumo.aspx>

Table 6. Excise Taxes and Retail Prices for Cigarettes in Selected LAC Countries, 2014

COUNTRY	PRICE OF A 20-CIGARETTE PACK OF THE MOST SOLD BRAND		EXCISE TAXES AS A % OF PRICE OF THE MOST SOLD BRAND		
	INTERNATIONAL DOLLARS (AT PPP)	IN US\$ AT OFFICIAL EXCHANGE RATES	SPECIFIC EXCISE	AD VALOREM EXCISE	TOTAL EXCISES
Honduras **	3.56	1.72	21.51%	0.00%	21.51 %
Peru	3.81	2.22	22.58%	0.00%	22.58 %
Brazil **	2.75	2.54	20.87%	8.10%	28.97 %
Colombia **	1.82	1.32	25.65%	10.00%	35.65 %
Guatemala	2.98	2.05	0.00%	38.27%	38.27 %
El Salvador	3.85	0.23	22.50%	18.52%	41.02 %
Panama	6.4	4.25	0.00%	43.48%	43.48 %
Dominican Republic **	5.93	3.43	26.67%	16.95%	43.62 %
Saint Lucia **	4.4	2.69	48.55%	0.00%	48.55 %
Uruguay **	3.62	3.35	48.72%	0.00%	48.72 %
Mexico	5.08	3.45	15.56%	36.52%	52.08 %
Costa Rica **	3.85	2.97	27.38%	30.88%	58.26 %
Ecuador **	5.14	3.1	59.68%	0.00%	59.68 %
Argentina	3.42	1.77	0.00%	64.33%	64.33 %
Chile **	5.98	4.38	4.35%	60.50%	64.85 %

Source: World Health Organization (WHO) report on the global tobacco epidemic, 2015: raising taxes on tobacco.

Note: ** While the country has increased tobacco excise taxes since 2012, the effect is not necessarily apparent in tax indicators due to price variability.

65. There is room to raise taxes on fuels, alcoholic beverages, and tobacco in the DR, especially since tax collection on fuels declined over the last decade. Taxes on fuels, cigarettes, and alcohol help correct the negative externalities produced by the consumption of these goods. Setting the appropriate rate for each tax requires a thorough study aimed at quantifying the costs of the different negative externalities associated with the consumption of each product. International comparisons show that the country's excise taxes, especially on fuels, could be increased to be more in line with best practices.

IV. Tax expenditures

A. Context

66. The Dominican Republic offers a wide variety of tax exemptions and incentives which impose a substantial cost to the budget. Tax expenditures are the revenues forgone due to tax concessions including tax deductions, exemptions, tax holidays, preferential rates and other policies that reduce the liability of specific taxpayers or groups of taxpayers, with the goal of encouraging them to invest in favored sectors or regions.⁷² Tax expenditures are not recorded as outlays in the budget, and the most common technique for estimating them is the foregone-revenue method, which is typically a static exercise that calculated the loss incurred by tax concessions without taking into consideration potential changes in taxpayer behavior. This methodology is also used in the Dominican Republic.⁷³

67. The DR has introduced various tax incentives to attract foreign direct investment (FDI) and advance strategic development objectives. Tax incentives are used to achieve policy objectives, such as encouraging investment, increasing employment and training, improving the availability of goods to their customers, and increasing access to new technology. However, their effectiveness in achieving these objectives is controversial and the high risks imposed in the overall tax system may not outweigh the benefits, as they create horizontal inequities, distort production efficiency, increase the complexity of the tax system and raise tax compliance costs. While their effectiveness is questioned, developing countries nonetheless make use of them as they act as a substitute for a poor overall business climate.⁷⁴ The country experimented with tax incentives before the enactment of the tax code in 1992, however, from that moment several bills were enacted putting in place different tax incentives, a process that accelerated in 2000. Currently, there are 35 different laws that provide for 140 types of tax relief.⁷⁵ Many of these systems have been passed outside the tax code, complicating the administration of the tax system and concealing beneficiaries' effective tax burden.

68. Tax holidays are prevalent in all regions except the OECD countries, showing a gradual move away from the use of this type of scheme due to their ineffectiveness in aligning the incentives of increased investment with the tax benefits. Super-deductions – an incentive where deductions are allowed for more than the actual cost of certain expenses – are most prevalent in South Asia mainly to reduce and subsidize the cost of investment when starting a business,⁷⁶ especially investments in R&D and training, and for defraying start-up capital costs. There is much higher prevalence of reduced tax rate regimes and all countries use tax incentives within Free Trade Zones or Special Economic Zones (Table 7). Further, there is a lower prevalence of investment allowances which is a superior form of tax incentive as compared to tax holidays. Some countries provide tax incentives in a discretionary manner, i.e. on a case-by-case basis

⁷² In this note, we use tax incentives and tax expenditures interchangeably, even though tax expenditure is the revenue foregone while tax incentives are the instrument that results in foregoing such revenue.

⁷³ WB 2017

⁷⁴ Daude, C., H. Gutiérrez and Á. Melguizo (2014), "The Political Economy of Tax Incentives for Investment in the Dominican Republic: "Doctoring the Ball"", OECD Development Centre Working Papers, No. 322, OECD Publishing, Paris, <https://doi.org/10.1787/5jz3wkh45kmw-en>.

⁷⁵ DGPLT, Ministerio de Hacienda. List does not include special contracts.

⁷⁶ James, Sebastian. Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications, June 2014 (updated 2020). WB Investment Climate Advisory Services.

through an administrative process, instead of an automatic approval through the law and via the filing of tax returns. Discretion on provision of tax incentives reduces the efficacy of the investment policy regime as it creates a barrier for the investment opportunity, and compromises transparency.

Table 7. Prevalence of Income Tax Incentives around the World

	# of countries	Tax holiday/Tax exemption	Reduced tax rate	Investment allowance / tax credit	R&D tax incentive	Super-deductions	SEZ/Free zones/ EPZ/Freeport	Discretionary process
East Asia and Pacific	12	92%	75%	67%	83%	33%	92%	83%
Eastern Europe and Central Asia	17	88%	71%	18%	53%	6%	100%	41%
Latin America and the Caribbean	24	92%	33%	50%	8%	4%	71%	42%
Middle East and North Africa	15	80%	40%	13%	0%	0%	80%	40%
OECD	34	12%	32%	65%	76%	21%	68%	35%
South Asia	8	100%	38%	75%	25%	63%	63%	38%
Sub-Saharan Africa	44	80%	64%	77%	11%	18%	66%	77%

Source: James. S (2020).

69. The DR offers all incentives commonly used around the world, focusing mostly on tax holidays. There are also reliefs for VAT and custom duties. Goods exempted include not only machinery and capital, but also inputs and raw materials. Additionally, the Border Zones scheme grants exemption to excise taxes (Table 8).⁷⁷ Despite R&D incentives are becoming increasingly used around the world, the DR has not implemented them. The country also uses a discretionary approach in providing some tax incentives.

⁷⁷ OECD/UNCTAD/ECLAC (2020), Production Transformation Policy Review of the Dominican Republic: Preserving Growth, Achieving Resilience, OECD Development Pathways, OECD Publishing, Paris

Table 8. Main fiscal regimes for selected production activities, Dominican Republic, 2019

	Legislative framework	Incentive package	Beneficiaries	Responsible institutions	Conditionalities
Targeted to specific industries					
Tourism	Law 158-01 and subsequent modification (Law 184-02 – law 266-04)	<ul style="list-style-type: none"> - 100% exemption for local and national taxes on registration, construction, gross sales and transfer of industrial goods (i.e. VAT) - Deduction of investment cost from other taxable income at the rate of 20% per year for five years 	<p>All domestic and foreign investors</p> <p>Number of beneficiaries: 111</p>	CONFOTUR, Ministry of Finance	From 2013 the application of the regime only in specific touristic poles is removed.
Creative industry	Law 108-10	<ul style="list-style-type: none"> - Tax credit of 25% of all expenses incurred. - 100% VAT exception - Temporary duty-free access to imported goods and services 	All domestic and foreign investors	Intrasectoral council for the promotion cinema activities (CIPAC)	<ul style="list-style-type: none"> - Minimum investment USD 500,000 - Productions must have a minimum of 25% Dominicans members
Renewable energies	Law 57-07	<ul style="list-style-type: none"> - Duty-free access to imported inputs and capital goods - 100% exemption for taxes on gross sales and income taxes until 2020 - 5% tax relief for interest on loans for the development of projects 	<p>All domestic and foreign investors</p> <p>Number of beneficiaries: 5</p>	National commission for energy (CNE)	<ul style="list-style-type: none"> - Equipment, parts and systems must be produced locally with a minimum aggregate value of 35% - Incentives are subject to maximum installation capacity depending on the energy source
Territoriality targeted					
FTZs and border Zones	FTZs: Law 8-90 and subsequent modification (Law 56-07 – Law 139-11) Border zones: Law 28-01	<ul style="list-style-type: none"> - Duty-free access to imported inputs and capital goods (15-years for regular FTZs, 20 years for firms located in border zones) - 100% exemption for taxes on registration, construction, gross sales and transfer of 	<p>Operators, firms and investors of FTZs</p> <p>Number of beneficiaries: 671 for FTZ and 83 for border zones</p>	CNFZE, Ministry of Finance	<ul style="list-style-type: none"> - Access to domestic is subject to import duty, 3.5% tax on gross sales and 18% VAT - Non-FTZs firms in priority sectors (textile, footwear, and leather industries) have similar package to those available to the FTZ and enjoyed duty-free access to

		industrial goods (i.e. VAT) - 50% exemption of fees for use of ports and airports			126 HS 6-digit key imported inputs - Renewable at the discretion of CNFZE
Fiscal incentives to foster competitiveness of local firms					
Simplified tax regime (RST)	Presidential Decree 265-19	The definition of the taxable income for income tax and VAT is a function of intermediated purchases or income for businesses and individuals	Micro and SMEs	Ministry of Finance	Eligibility is subject to the firm size
Local industry (Proindustria)	Law 392-07 and subsequent modification (Law 542-14 – Law 690-12)	- 50% discount of VAT on imported machinery and capital goods, differed VAT scheme and exemption on other taxes - 50% exemption of customs duties for imports and re-exported goods from and to FTZs	Local manufacturing firms	Proindustria, Ministry of Finance	Applicable to manufacturing firms that obtain the industrial qualification subject to 0.1% fees on capital equity

Source: OECD/UNCTAD/ECLAC (2020).

70. The Dominican government conducts tax expenditures analysis in compliance with the Budget Law and has committed to enhance the efficiency of the tax expenditures. Since 2008, the authorities publish these estimates in a dedicated budget annex.⁷⁸ In addition, according to the DR's National Development Strategy 2030 the government is committed to consolidate all existing tax expenditure schemes into a single section of the tax code, establishing a coherent and sustainable approach to tax that reduces their fiscal impact and minimizes their distortive effect on economic. Cost-benefit analysis of all special tax regimes have not been conducted in the DR. Although, this type of analysis was done to measure the cost-benefits of Free Trade Zones between 2008-2018. Cost-benefit analysis should be conducted more regularly to see whether the tax incentives were effective in accomplishing their intended goals. The adoption of clear sunset clauses should be included into all legislation that creates and modifies tax incentives.

⁷⁸ According to the provisions of the Organic Budget Law for the Public Sector (Law No. 423-2006). The report is prepared by an inter-ministerial commission coordinated by the Directorate General of Policy and Tax Legislation (DGPLT) and composed of the Directorate General of Internal Revenue (DGII), the Directorate General of Customs (DGA), and representatives from the Ministry of Economy, Planning and Development (MEPyD). The Ministry of Finance prepares an explanatory report to accompany the Draft Budget Law. Source: WB2017, <https://www.hacienda.gob.do/publicaciones-presupuesto/#47>

B. Revenue cost of tax incentives

71. DR's overall tax expenditures remained costly at 4.8 percent of the GDP in 2020,⁷⁹ almost a third of budgetary revenues. Although, there was a decrease of 0.28 percentage points with respect to the estimated data for the 2019 Budget, the estimated data for 2020 is still higher the regional average of 4.1 percent of GDP,⁸⁰ and represented a similar amount of public expenditures such as Health and Education.⁸¹ These figures exclude administrative exemptions that are not classified as tax expenditures, such as exemptions on fuel rebates for public transportation, and exemptions for natural gas excise taxes. In general, the amount of tax expenditures indicates the potential for increasing government revenues if they were eliminated.

72. VAT concentrates the highest share of tax expenditures, followed by CIT incentives, estate tax deductions and preferential rates for fuel products. Indirect taxes accounts for seventy percent of all (3.4 percent of GDP, in 2020), while 16 percent comes from direct taxes in 2020. VAT concentrates the highest share of tax expenditures (52 percent) and is expected to reach 2.5 of GDP in 2020 (Table 9). VAT tax expenditures include those applied to individuals for goods exempt from basic consumption, health and education. Within the specific exemptions to economic sectors, VAT expenditures are concentrated in internet sales, renewable energy and mining contracts. Income tax incentives are expected at 0.7 of GDP, real estate deductions at 0.6, and reduced rates on fuel products at 0.5 of GDP in 2020.

**Table 9. DR Tax expenditures by type of taxes,
2020**

	% of GDP	% of Total Tax Expenditure
VAT (ITBIS)	2.52	52.1
Income tax	0.78	16.2
Real estate taxes	0.63	13.1
Fuel taxes	0.55	11.3
Import duties	0.24	5.0
Other excises	0.10	2.1
Other taxes	0.01	0.2
Total	4.84	100.0

Source: Treasury (Ministerio de Hacienda)

⁷⁹ Gastos Tributarios en República Dominicana: Estimación para el Presupuesto General del Estado del año 2020. Ministerio de Hacienda. September 2019.

⁸⁰ Pelaez Longinotti, Fernando. Tax Expenditures in the CIAT Member Countries, WP 06-2019, Inter-American Center of Tax Administration (CIAT). It is worth stressing that cross-country comparisons of tax expenditures magnitudes should be taken as a reference because they face severe technical limits such as the scope may differ between countries.

⁸¹ The Health item represented 2% of GDP and Education was 4% of GDP, according to the average 2016-2018 executed budget of the Directorate of General Budget.

73. General exemptions for individuals (*exenciones generalizadas para las personas físicas*) are the largest tax expenditure when dividing tax expenditures by sector (Table 10). It represents more than one third of all exemptions. SEZs exemptions are the second largest item, representing roughly 11.4 percent of all tax exemptions, and tax expenditures in the electricity sector (8 percent) and tourism (3 percent) also stand out. Together these four tax instruments account for over almost 60 percent of all tax expenditures in the country. Economic efficiency considerations point to the advantages of a reduction in tax expenditures on less elastic bases (such as fuel consumption).

Table 10. Tax Expenditures by Sector, 2020

Sector	VAT	Income Tax	Fuel taxes	Other excises	Estate taxes	Other taxes	Total	% of GDP	% of total expenditures
General exemptions for individuals 1/	73,145.1	4,533.9	-	-	7,897.5	-	85,669.1	1.7	36.1
CIT related 2/	2,816.4	312.3	4,259.6	4,110.4	15,864.4	107.9	28,175.5	0.6	11.9
SEZs	-	18,359.5	150.1	167.4	3,475.7	9.1	27,165.7	0.6	11.4
Health	23,374.0	-	-	-	-	-	23,374.0	0.5	9.8
Electricity (generation)	-	-	18,648.4	-	-	-	18,648.4	0.4	7.9
Education	13,427.4	24.3	-	3.9	39.1	0.5	13,510.6	0.3	5.7
Tourism	782.4	2,051.5	-	46.7	3,128.3	-	6,398.0	0.1	2.7
Internet sales	3,098.5	-	-	418.0	-	-	5,311.6	0.1	2.2
Mining	1,310.6	-	3,683.2	3.1	-	9.2	5,242.3	0.1	2.2
Private Non-Profit Institutions	233.3	4,182.0	-	6.3	137.9	5.6	4,581.0	0.1	1.9
Vehicle Importers	533.8	-	-	-	-	238.7	3,872.4	0.1	1.6
Renewable energy	2,664.3	844.5	-	-	23.8	-	3,585.4	0.1	1.5
Stock market	-	3,415.8	-	-	-	-	3,415.8	0.1	1.4
Public sector contracts/concessions	1,134.9	1,776.5	55.0	1.2	-	-	3,027.5	0.1	1.3
Others	1,417.7	2,949.7	23.8	150.7	424.2	127.7	5,571.8	0.0	2.4
Total	123,938.4	38,450.0	26,820.1	4,907.7	30,990.9	498.7	237,549.1	4.8	100.00

Source: Ministry of Finance

Notes: 1/ The general exemptions for individuals include VAT exemptions, schooling/education related expenses, exemption on 13th Salary (Christmas salary), exemptions to real estate taxes, among others. 2/ This corresponds to CIT tax credit, temporary exemption on tax on assets for new capital-intensive businesses, among others.

74. Forgone revenue from VAT exemptions is very large and regressive. As previously mentioned, VAT exemptions comprise for the most part rate reductions on specific food-items (including books, and educational materials) and medicines. A 2016 WB study found that 88 percent of total VAT expenditures in 2013 benefited non-poor households. The study also reported that if all VAT (ITBIS) exemptions were eliminated, revenue collection would increase around 2.2 percent of disposable income, while if only exemptions on education, health and electricity were removed, tax revenue would increase by 1.7 percent of disposable income. Even though, these scenarios would increase poverty, the higher revenue collection could be used for direct transfers to the most vulnerable. Thus, there is room for increasing tax revenue and enhancing the progressivity of the tax burden by reducing VAT exemptions.

75. The DR's CIT expenditures is expected to reach almost 1 percent of GDP in 2020. Tax incentives under the CIT target the tax rate as well as capital recovery of invested amounts. In the DR the CIT is subject to various generous exemptions and tax credits which can be claimed by long time periods. This

in conjunction with frequent changes on the corporate tax structure, including the tax incentives, increase the complexity of corporate taxation in the DR. Firms located in special economic zones (SEZs) are among the main recipients of corporate tax expenditures, accounting more than 50% of CIT expenditures. Box 1 summarizes the most common corporate tax incentives for investments.

76. SEZ-based firms declare on average, negative taxable incomes due to the generous exemptions and firm's ability to maximize their tax benefits. Special economic zones (SEZ) or Free trade zones (FTZ) provide an exemption from a variety of taxes – such as import duties, excises, VAT and municipal taxes, tariffs on imports and capital goods and often other taxes, including corporate income tax – to firms located in designated zones. The geographical boundaries of SEZs may be tightly defined (e.g., ring-fenced enclaves), or not. The WB 2017 analysis found that the introduction of new taxes on the domestic sales of SEZ-based firms in the DR do not appear to have negatively affected the sales revenue, assets or profitability of these type of firms as they continue to report taxable profits and liabilities close to zero. However, the contrary occurs to firms located outside of SEZs. In addition, the analysis shows that better performance in firms that receive tax incentives in compared to firms that do not can be attributed exclusively to the existence of tax exemptions.⁸²

77. The cost-benefit analysis on SEZs done by the DR's government showed a positive result at the aggregate level representing 3% of GDP in 2018, however there are SEZs firms in specific sectors with negative results. The total direct, indirect and induced effect contributions were estimated at an average of 3.7 percent of GDP during 2008-2018, while in 2018 they were estimated at 4.1 percent of GDP. The number of jobs generated by the sector increased 0.9% from 2017 to 2018.⁸³ Tax expenditures from SEZs increased steadily over the same period, reaching 1.1 percent of GDP in 2018.⁸⁴ Although the aggregated results are positive, when analyzed them at the micro level, not all SEZs companies obtained positive results. There is a group of firms whose tax expenditure exceed the benefit it generated to the economy for a particular year. An historic cost-benefit ratio showed that firms in "manufacturing of non-metallic mineral product, food industry, commerce and construction" activities generated a negative cost benefit each year. This means that on average 16% of firms in SEZs accounted for higher tax expenditures than benefits each year. Thus, there is room for eliminating company- or sector-specific tax incentives, where the foregone revenue is more costly for the government than the overall benefit. But more importantly, the DR should consider introducing rigorous cost-benefit analysis of all existing tax expenditures as a first step to reform them.

⁸² WB 2017

⁸³ However, the WB 2017 study reports that while SEZ-based firms generate a substantial number of jobs, each additional job created comes at a massive fiscal cost, that contributes to undermine the capacity of the government to finance much-needed social services and investment.

⁸⁴ The tax expenditure of the SEZs regimes includes tax expenditure from CIT, tax on assets, exemptions on excises and import taxes.

Table 11. Common Corporate Income Tax Incentives for investment⁸⁵

	Tax Holiday	Preferential Tax rate	Accelerated Depreciation	Investment Allowance	Investment Tax Credit
Revenue cost	Unbounded	Bounded	Bounded	Bounded	Bounded
Tax avoidance	Encourages transfer of profits from firms that are not exempted	Encourages transfer of profits from firms that are not exempted	Does not encourage tax avoidance	Encourages sale and purchase of assets to claim allowance	Encourages sale and purchase of assets to claim allowance
Transparency of revenue cost	Normally do not require tax filing	Requires tax filing	Requires tax filing	Requires tax filing	Requires tax filing
Resource Allocation	Tend to attract short-run projects	Tend to attract short-run projects	Does not affect life of assets. Tend to increase capital intensity	Tend to favor short term assets	Tend to favor short term assets
Administration Costs	Significant tax administration costs to monitor tax avoidance from related but non-exempted firms.	Significant tax administration costs to monitor tax avoidance from related but non-exempted firms.	Some. Usually associated with carry forwards.	Some	Some
Implementation Costs	Medium to ensure project complies with goals	Medium to ensure project complies with goals	Initially to ensure investment is made	Initially to ensure investment is made	Initially to ensure investment is made

Source: Promoting Growth in the Caribbean: Tax Incentives in theory and in practice, June 2013

⁸⁵ Common CIT incentives include: i) **Tax holidays** provide a full exemption from certain taxes, notably CIT. The exemption may be provided on a time-limited basis with 'sunset' clauses or have an indefinite duration. Partial profit tax exemptions could be used to provide partial relief from taxes on corporate profit (for example when reinvesting). In this case, taxpayers are normally required to file tax returns, and to report taxable profit and tax payable. ii) **Preferential tax rates** a reduced corporate tax rate (below the basic corporate tax rate) on profit on targeted investment, iii) **Accelerated depreciation** provides tax depreciation at rates and/or depreciation methods that allow for faster write-offs than would normally apply (increasing the present value of depreciation deductions), iv) **Investment tax allowances** provide a tax deduction for some percentage of qualifying investment expenditure, in addition to tax depreciation. The value to a firm of an investment tax allowance depends on the corporate tax rate applied to taxable income, v) **Investment tax credits** provide a tax credit for some percentage of qualifying investment expenditure. Tax relief from an investment tax credit is not a function of the CIT rate (the credit does not influence the calculation of taxable income). Specific carry-forward provisions may apply for tax allowances and unused credits.

C. Evaluation of the DR's tax incentives framework

78. An evaluation of the tax incentives framework of Dominican Republic concludes that the country does not meet some of the good practices for tax incentives. Table 12 shows the use of a benchmark to assess the tax incentive policy as well as how it is administered in the DR. The WB's Investment Climate Advisory used this assessment to provide governments with a summary of how its incentive system can be assessed against best practice. This assessment was based on the principles set out by the OECD's Task Force on Tax and Development aim at promoting transparency of tax incentives for investment.

79. The DR offers many different tax incentives with the aim of attracting investment spread among different legal instrument. While such incentives may increase investment decisions, their effectiveness is call into question as in many cases the overall benefits outweigh the costs. Many investments would very likely have materialized anyway, given a country's endowment of other investment determinants such as access to key resources or market size.⁸⁶ Tax incentives should be well-targeted⁸⁷ and based on clear eligibility criteria and require resources to control, monitor and evaluate their effectiveness. In addition, tax incentives in the DR are offered outside the tax laws, which is the best practice to reduce the temptation of discretion and misuse, instead they are spread among different laws.

80. Providing tax incentives outside the tax code gives substantial discretion to the investment agencies. Tax incentives should be automatically available through the filing of tax returns without the need for an additional pre-approval. While tax exemptions are established by law in the DR, they are regulated by different administrative agencies that exercise considerable discretion. There are many agencies (composed of public and private sector representatives) granting tax exemptions, which increase the complexity of the tax administration and create the potential for misjudgments as well as possible conflicts of interest. Moreover, these approval procedures, are costly for investors. These procedures could alternatively be cleared in advance by the tax administration and Customs without the need for a separate agency to pre-approve the exemption. Higher authorities could continue to do quality control by monitoring the tax and customs committees on the use and misuse of tax incentives.

⁸⁶ Economic Commission for Latin America and the Caribbean (ECLAC), Fiscal Panorama of Latin America and the Caribbean, 2019 (LC/PUB.2019/8-P), Santiago, 2019.

⁸⁷ Studies showed that tax incentives that lower the cost of investment (which involve specific allowances linked to investment expenses, such as accelerated depreciation schemes and special tax deductions and credits) are often preferred over profit-based tax incentives (which reduce the tax rate applicable to taxable income; examples include tax holidays, preferential tax rates or income exemptions), as they have proved to be more effective to increase/attract marginal investments. An efficient tax incentive is when (i) there is increased investment (net of displacement of other investments); (ii) the impact on (income from) jobs is positive; (iii) and there are spillover benefits (e.g., technology/skills transfer); and all that exceeds social costs from lost tax revenues and other costs (e.g., environmental degradation) and consequent distortion in rest of the economy (incentives lead to investments that have a lower pre-tax return than others). IMF (2015).

Table 12. Assessment of Tax incentives in Dominican Republic⁸⁸

Policy Criteria		Score	Comments
1	The tax incentives are used minimally and mainly to address market failures	No	There are many tax incentives provided through the tax laws as well as outside
2	Tax incentives are specified in the tax codes and not in other laws (except in the case of extractive industries)	No	Tax incentives are specified in the tax laws, however, discretionary tax incentives are provided outside the tax laws and managed by different regulatory entities
3	Tax incentives are not offered in a discretionary manner outside the law	No	Discretionary tax incentives are offered on a case by case basis
4	Tax incentives provided in the laws are available automatically to the taxpayer	No	Taxpayers must go through an approval process to benefit from certain tax incentives
5	The tax incentives should, as far as possible, be linked to investment and tax holidays should be used as sparingly as possible.	No	Tax holidays are one of the main tax incentives provided
6	The taxpayers who benefit from tax incentives should continue to file tax returns even if there are not liable to pay any taxes	Yes	Requirement to file taxes is enforced even when there is no taxable income
7	The tax administration is adequately trained to address issues of transfer pricing and misuse of tax incentives	Partially	No automatic audit of tax incentives cases.
8	The tax expenditure statements are prepared on a regular basis to measure the costs of the tax incentives	Yes	The cost of tax incentives is done as part of the regular budget reporting process.

Source: Framework provided in James (2020)

81. The government should shift tax expenditures from tax holiday model to an investment targeting model. Tax holidays provided either within the Free Zones or for specific sectors are inferior as compared to investment linked incentives and should ideally be replaced by the latter. This is the best practice because they also cause rent-seeking behavior. Moreover, harmful tax competition saps revenues in many developing countries, therefore efforts to potentially harmonize rates could place a lower bound on any potential race to the bottom.

82. The tax administration needs to strengthen its capacity to address issues of transfer pricing and misuse of tax incentives. It is necessary to address any misuse of tax incentives through their audit policy including compulsory audit of any taxpayers making claim of tax incentives of large amounts.

⁸⁸ James, Sebastian. Tax and Non-Tax Incentives and Investments: Evidence and Policy Implications, June 2014 (updated 2020). WB Investment Climate Advisory Services.

D. Overall tax incentives policy

83. DR's tax incentive policy leads to substantial monitoring cost for the government, as the process involves a large number of tax incentives and enterprise-specific procedures. Moreover, the efficacy of these tax incentives is in doubt because the increase in foreign direct investment, domestic investment, or business creation, may be outweighed by the foregone revenue.

84. Tax expenditures need to be reduced and substantially simplified. The reduction in tax expenditures will help reduce the inefficiencies produced by exemptions and incentives granted to individual companies. While motivated by good intentions, many of DR's tax expenditures do not make good industrial policy, as they favor large, inefficient, and long-established enterprises, for example in the tourism sector.

85. A rigorous evaluation of the effectiveness of tax incentives is necessary in order to minimize losses and opportunities for exploitation. The government needs to conduct a cost-benefit analysis of each of the tax incentives provided. The cost-benefit assessment of existing tax exemptions in terms of their policy objectives may offer guiding principles to prioritize reforms going forward. Cost-benefit analysis of the tax incentives needs to be done on a regular basis to assess whether the existing tax incentives have been impactful as well as cost-effective in fulfilling its intended goal. This will allow the government to remove any redundant or underperforming tax incentives and would create much needed fiscal space for the government. Transparency is also key, to which tax incentives should preferably be enacted within the tax code or consolidate in one single instrument.

V. Other taxes: Property Tax and Environmental Taxes

A. Property tax

86. Well-designed taxes on wealth (like property and estate taxes) contribute to increasing the sufficiency (collection), efficiency and equity of tax systems, although they may not represent a large part of government's resources like taxes on income and consumption. General taxes on wealth are more equitable and can generate more resources, although there are more difficult to control because some goods (such as jewelry) are easy to hide and others (such art works) are difficult to value. Therefore, most countries have established taxes on immovable property.

87. DR's taxes on wealth generated 0.6 of GDP in 2018, slightly below the LAC average but far below the OECD average of 1.9. Wealth taxes in the DR include taxes on immovable property and transfers, and inheritance and gift taxes. In addition, the tax on assets and the tax on checks are considered wealth taxes, although the former works as a minimum income tax, and an ad valorem excise tax is applied on the value of checks and wire transfers (Law 139-11). The property tax is levied annually on the cadastral value of urban property and land owned by individuals and trusts. The applicable tax rate is 1% on the total value exceeding DOP 7,710,158.2 (USD 131,910.3). In addition, a transfer tax of 3% is assessed on any transfer of ownership of real estate located in DR. Certain exemptions apply to both property tax and property transfer tax.⁸⁹ Lastly, inheritance tax for individuals is 3%, which is charged to the successors and beneficiaries. Gifts made to physical persons are subject to 27% withholding tax.

88. Taxes on immovable property have a significant revenue-generation potential but are little exploited in the LAC region. Property tax is suitable for decentralization due to its special attention to the localization principle, its tax base is immobile, and it does not run out over time.⁹⁰ According to recent estimates, based on information on the estimated values of land and properties from the World Bank, most Latin American countries are likely to greatly exceed the target collection of around 1% of GDP and approach 2%, if land and rural buildings were effectively included in the tax base. The current gap is also explained by the weak design of the property tax (i.e. level of rates applied, and number of exemptions offered) and the tax administration capacity⁹¹ due to inaccurate valuations of land and buildings and systematic lack of an adequate update of cadaster values. Property tax also suffers from a high level of informality: buildings are constructed without permits, properties are not registered and reported prices of some real estate transactions are falsified.⁹²

89. Property tax collection in the DR is significantly below regional and OECD averages. Between 2009 and 2018 the property tax on average generated 0.04 percent of GDP. Although, its contribution has doubled since 2009 to 2018 (i.e. from 0.03 to 0.06 of GDP), it is the second country with the lowest collection in LAC, it is substantially below the LAC average and OECD average 0.39 and 1.06, respectively.

⁸⁹ Exemptions include dwelling belonging to people over 65 years of age, pensioners, foreign source rentiers (50%), rural land, among others.

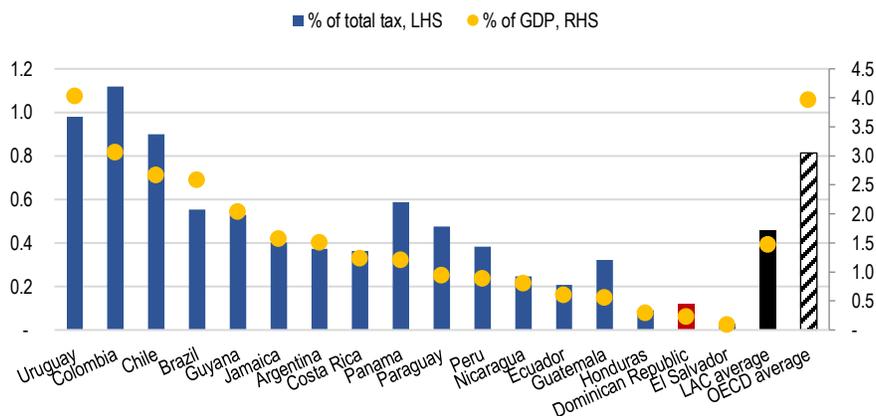
⁹⁰ ECLAC 2019.

⁹¹ Comisión Económica para América Latina y el Caribe (CEPAL), sobre la base de E. Ahmad, G. Brosio y J. P. Jiménez, "Options for retooling property taxation in Latin America", *serie Macroeconomía del Desarrollo*, N° 202, Santiago, Comisión Económica para América Latina y el Caribe (CEPAL), 2019.

⁹² OECD 2020.

If it were collected at the same level as the LAC countries (as a percentage of GDP), the collection would increase by 468.4%.⁹³ Property tax is relatively less difficult to control than other taxes, and a good indicator of the ability to pay. However, making it less difficult to tax does not imply that it is easy to manage, as they require sophisticated systems and information. Due to administrative and institutional issues, they generate little revenue in developing countries, including the DR. Tax base and rates should be adjusted regularly to reflect developments in the market value and the tax collection should be supported by modern administrative systems including an up-to-date land and property registration in central cadasters. As property tax is one of the most controversial taxes with citizens and has high political costs, local politicians are often unwilling to invest the appropriate resources to levy this revenue.⁹⁴

Figure 28. Property tax collection in LAC, % of total tax revenue and % GDP, 2018



Source: OECD Stats.

90. The DR faces several challenges to increase property tax collection. The low collection of this tax stems from a variety of factors, including differences between the appraised value and the market value of properties; significant gaps in registration; high threshold exemptions, weaknesses in the cadaster and the low capacity of tax administrations to collect taxes.⁹⁵ In the DR, the main hurdle to an effective property tax seems to be an outdated property cadaster, the high exemption threshold and exemptions to foreign property investments. In 2016, in Santo Domingo, the country’s capital and largest city, the average price of a two- or three-bedroom house in the city center stands at around US\$150,000,⁹⁶ which is covered almost by the exempted threshold. In 2019, based on independent studies on the new housing offer in the Ozama region, Oxfam calculated different possible scenarios to substantially increase the collection for this concept. By reducing the tax exemption threshold by about 46% and increasing the tax rate up to 2% the property tax collection could be increased up to four times the current amount.⁹⁷

⁹³ Calculation based on 2017 data. Oxfam 2019. Jovine, Rafael. “Autopsia Fiscal: Evaluación de los gastos e ingresos del gobierno dominicano para la garantía de derechos”.

⁹⁴ OECD 2020.

⁹⁵ Lafuente, M. (2009). *Public Management Reforms and Property Tax Revenue Improvements: Lessons from Buenos Aires*. WP 0209.

⁹⁶ <https://www.globalpropertyguide.com/Caribbean/Dominican-Republic/Price-History-Archive/tourism-boom-fuels-dominican-republics-property-market-127501>

⁹⁷ Oxfam 2019.

91. The DR should strengthen its property tax collection by updating the property cadaster and adapt the valuation method to match the administrative capacity. The valuation gap between the appraised value (which forms the tax base) and the market value should be small. Closing this gap would improve both collection and equity. Reduction of the current transfer tax rates could also be considered to prevent the underreporting of the value to pay less taxes.⁹⁸ Furthermore, the percentage of correctly registered properties in the cadaster should increase, alongside the formalization of property titles. In order to update and expand the registered tax base for property tax, existing tools can be used, for instance geographic information systems (GIS), digital maps, and aerial photographs to identify plots of land and the structures on these plots.⁹⁹ Any reform of property taxes must be accompanied by the strengthening of the institutional and managerial capacity of the municipal tax administrations. This process would involve coordination between the Property Registry, local tax administrations, and the DGII.

B. Environmentally related taxes

92. Environmental taxes are a critical tool to address the negative externalities on the environment imposed by carbon emissions and other pollution and encourage businesses and households to consider the environmental costs of their behavior. An environmentally related tax (ERT) is a tax whose base is a physical unit (or a proxy of a physical unit) of something that has a proven, specific harmful impact on the environment regardless of whether the tax is intended to change behaviors or is levied for another purpose.¹⁰⁰ Environmentally related taxes can be classified in four mutually exclusive tax-base categories for data purpose: energy, transport, pollution and resources.¹⁰¹ An OECD detailed examination of country-specific taxes for 23 LAC countries demonstrates that, on average, revenue from ERT amounted to 1.1% of GDP in 2018, a lower level than the OECD average of 2.3% of GDP. ERT revenue in 2018 varied from 0.02% of GDP in Belize to 2.3% in Honduras. In the DR it represented 1.81% of GDP, with taxes on energy (i.e. excise taxes on diesel and petrol) accounting for the largest share of environmentally related tax revenues, as in most LAC countries, followed by revenue from motor vehicles and transport services (i.e taxes on use and ownership of vehicles, departure tax, excises on vehicles (Figure 29).

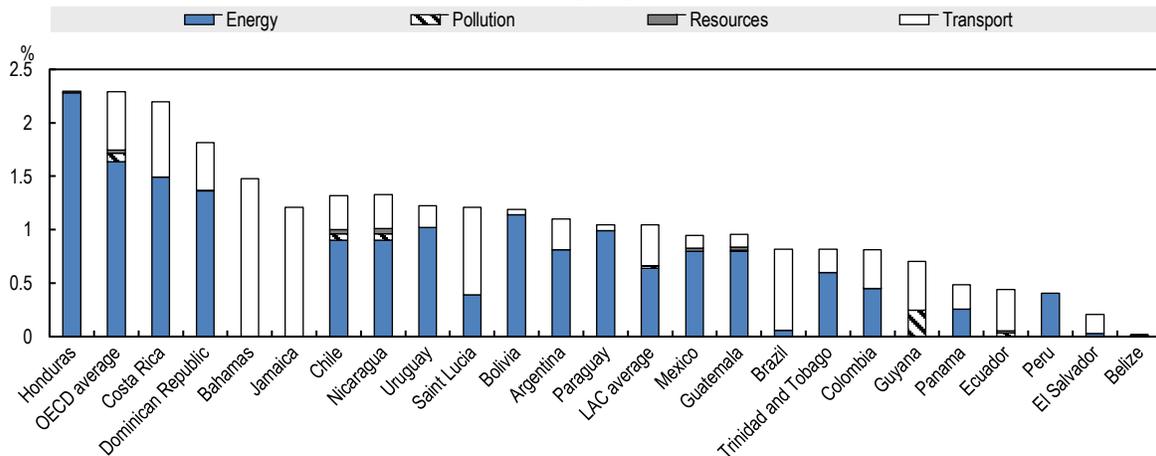
⁹⁸ Most countries apply a real estate tax rate below 3%. Peru and Jordania, are one of the few countries, which apply the same rate.

⁹⁹ See: <https://www.theigc.org/research-themes/cities/cities-that-work/policy-toolkit/land-property-taxes-exploiting-untapped-municipal-revenues/best-practice-land-property-tax-reform/>

¹⁰⁰ OECD 2020.

¹⁰¹ OECD comparative data is presented in these four categories: i) Energy: Energy products (e.g. fossil fuels and electricity) including those used in transportation (e.g. petrol and diesel), and all CO₂-related taxes, ii) Transport: One-off import or sales taxes on transport equipment, recurrent taxes on ownership, registration or road use of motor vehicles, and other transport-related taxes; iii) Pollution: SO_x and NO_x emission taxes, taxes on ozone-depleting substances, taxes on discharge of wastewater, taxes on packaging, on final disposal of solid waste and other waste-related taxes, and iv) Resources: Taxes on water extraction, forest products, hunting and fishing taxes, mining royalties, excavation taxes. Source: OECD 2020.

Figure 29. Environmentally related tax revenue in LAC countries by main tax base, 2018
Percentage of GDP



Source: OECD 2020.

93. The environmental tax on vehicle pollution (*Tax on CO2 emissions*) was introduced in 2013 in the DR, although its tax collection represents only 0.02 of GDP in 2018. Even though since its inception the tax collection of this tax has increased 63% in terms of GDP, it is still very low at 0.1% as a share of total tax revenues. This law was issued to incentivize fuel efficiency and reduce greenhouse gas emissions by incentivizing switching to cleaner fuels and renewable energy sources. However, it seems that more monitoring and control on the collection of this tax is needed to achieve the proposed goal.

Box 5. Environmentally related taxes in the DR, 2020

- Environmental tax on vehicle pollution (Impuesto a la emission CO2) is imposed on motor vehicles according to their CO2 emissions per kilometre with rates on the cost, insurance and freight (c.i.f.) value of the motor vehicle. Said tax is levied at the time of registration of the motor vehicle.
- Fuel taxes: i) Excise ad quantum, ii) Excise ad Valorem 16% and iii) additional fixed \$2 por gallon, as detailed above.
- Taxes on motor vehicles and transport services: taxes on use and ownership of vehicles, departure tax, excises on vehicles.
- Tax expenditures: renewable energy (0.5%) and non-conventional vehicles (0.04%)

Source: IBFD, and Ministerio de Hacienda

94. The authorities are committed to address the negative externalities on the environment. The DR made a significant step in this direction through the approval of the Action Plan under the Paris Agreement on Climate Change. In 2015, the Government of the Dominican Republic submitted its Nationally Determined Contribution (NDC) to the United Nations Framework Convention on Climate Change. In its NDC, the country describes its national commitments to global efforts against climate change. The Plan is an instrument to operationalize the NDC, identifying priorities for the 2019-2021 period in the areas of legislation, finance and budgeting, monitoring and evaluation, and capacity building to strengthen climate

action. The Dominican Republic is a highly vulnerable country to climate change impacts, which increases the urgency for adaptation actions and greenhouse gas emission reductions at a national level.¹⁰²

95. The DR should consider raising fuel prices above consumer expectations as it is below global oil prices and tax revenue has been falling in the last decade. Although it can be politically difficult, currently, global coal, gas and oil prices have all fallen so much that merely holding fuel prices stable at the past levels that consumers have become used to would raise significant revenues.¹⁰³ Eliminating fossil-fuel subsidies during low-price times is an attractive way to capture resources without hurting the most vulnerable (whose consumption can be boosted more efficiently by direct transfers).¹⁰⁴

96. Sustainable fiscal policy during the resilient phase of the crisis need to include environmental aspects and climate change. Recovering from the covid-19 crisis is a big challenge but also an opportunity to move to a more efficient, fairer and sustainable economy, including the tax system. Green investment spending is an important policy part of a green-growth strategy for recovery such as investing in energy efficiency or improving the grid to benefit from low-cost renewable energy. Across the LAC region, making this low-carbon transition will create about 15m more jobs than it displaces by 2030.¹⁰⁵ Tax policy measures to promote green growth and promote resilience should be discussed in any future tax reform.

¹⁰² <https://ndcpartnership.org/news/dominican-republic-launches-its-climate-action-plan-ndc-partnership>

¹⁰³ Estevão M. Climate-Smart Fiscal Policy Can Foster a Lasting Economic Recovery One Earth. 2020 Sep;3(3):273-276.

¹⁰⁴ Idem.

¹⁰⁵ ILO & IDB (2020). *Jobs in a Net-Zero Emissions Future in Latin America and the Caribbean*.

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Annex I. International Taxation

This annex provides an overview of the progress made by the Dominican Republic in adopting and implementing the minimum standards set in 4 of the 15 Actions that resulted from the OECD/G20 Base Erosion and Profit Shifting (BEPS) initiative. It also outlines, based on a high-level analysis of the Dominican CIT provisions, which of the non-minimum standard measures having resulted from the BEPS initiative could better help the country in its efforts to tackle base eroding practices and/or potentially increasing corporate income tax revenue. Finally, the last section identifies few internationally related aspects of the currently in force tax system not addressed by the BEPS Project that could nevertheless help the Dominican Republic increase tax revenues.

I. BEPS minimum standards

The OECD/G20 BEPS initiative developed 15 Actions pursuant to which some of the internationally accepted principles and provisions ruling the taxation of multinational enterprises (MNEs) and cross-border transactions were revisited and amended, with the aim of tackling the base erosion and profit shifting practices causing international tax evasion and avoidance. The BEPS project resulted in newly developed minimum standards, recommendations, and best practices, to be adopted in some cases by means of treaty provisions and in some others pursuant to domestic legislation.

Further, the BEPS project resulted in a new international instrument (commonly referred to as the Multilateral Instrument or MLI) aimed at facilitating the quick and wide implementation of the new treaty provisions resulting from the BEPS Actions.

Finally, the BEPS initiative also resulted in a new international forum, called the Inclusive Framework, which is opened to all jurisdictions willing to adopt and implement the newly developed international measures. While countries having joined the Inclusive Framework are free to choose which BEPS measures to adopt, depending on their specific needs and priorities, by becoming members of the Inclusive Framework they commit to at least implementing the 4 BEPS minimum standards and to be peer reviewed on such implementation.

In October 2018, the Dominican Republic joined the Inclusive Framework, henceforth it committed to implement the following 4 BEPS minimum standards:¹⁰⁶

- Standards on harmful tax practices (Action 5), which includes: (i) a commitment not to have preferential tax regimes that may influence the relocation of mobile financial and service activities in a distortionary manner; and (ii) a commitment to transparency through the mandatory spontaneous exchange of information on taxpayer-specific tax rulings (which include unilateral advanced-pricing agreements - APAs -).
- The inclusion of double tax treaty provisions aiming at preventing tax treaty abuse, especially through treaty-shopping (Action 6).
- The enactment of standardized rules for Country-by-Country (CbC) Reporting and for the regular exchange of the resulting reports (Action 13).

¹⁰⁶ Our understanding is that the Dominican Republic decided to prioritize the implementation of the BEPS minimum standards over any other BEPS measure.

- Standard related to the resolution of tax treaty-related disputes through the mutual agreement procedure (MAP) (Action 14), aimed at ensuring that: (i) MAP treaty obligations are implemented in good faith and that MAP cases are resolved in a timely manner; (ii) administrative processes are implemented to promote the prevention and timely resolution of treaty-related disputes; and (iii) taxpayers can access MAP when eligible.

Harmful Tax Practices (BEPS Action 5)

(i) Preferential tax regimes

Three of the Dominican Republic preferential tax regimes were selected to be reviewed by the OECD Forum on Harmful Tax Practices (FHTP)¹⁰⁷.

The FHTP review is carried out in three stages: (i) first, to establish whether a preferential tax regime is under the scope of work of the FHTP (only regimes applicable to income from geographically mobile financial and service activities, including intellectual property activities, are considered to be under scope); (ii) second, to determine whether the preferential tax regime is “potentially harmful” in light of at least 2 of the 12 factors set by the FHTP; and (iii) to establish whether the regime is “actually harmful”, given its economic effects. Should any of the reviewed preferential tax regimes be found potentially or actually harmful, the Dominican Republic will be requested to either amend the harmful features of the regimes or to abolish them.

The Dominican Republic preferential regimes selected to be reviewed by the FHTP are:

- The Free Trade Zones regime
- The Border Development regime
- The Logistics Center regime¹⁰⁸

The Free Trade Zones regime was scheduled to be reviewed by the FHTP at its October 2020 meeting. The decision reached by the FHTP on the regimes that were discussed during such meeting is yet to be published. However, given that on September 22, 2020, the National Council for Free Trade Zones (*Consejo Nacional de Zonas Francas de Exportaciones*), which is the Dominican competent authority for authorizing free trade zones users, issued *Resolución 6-20-A*, the Dominican Republic Free Trade Zone Regime may be found “out of scope of the work of the FHTP”. In effect, *Resolución 6-20A* clarifies that companies providing “*design, layout, telemarketing, telecommunications, printing, typing, translation, computing services and any other similar or related services*”¹⁰⁹ “*will not be allowed to include services that involve mobile activities of administration or provision of intangibles*”.¹¹⁰

Finally, the Border Development regime and the Logistics Center regime still are under review by the FHTP, because of their “ring-fencing” and “substantial activities” eventually harmful features.¹¹¹

¹⁰⁷ The technical work of the Inclusive Framework is carried out through several technical bodies and/or groups of the Center of Policy and Tax Administration (CTPA) of the OECD, in which all Inclusive Framework members are expected to participate. The FHTP is the technical body in charge of the technical work related to BEPS Action 5.

¹⁰⁸ Customs Regime - Decree 262-15

¹⁰⁹ These are the service activities which according to Law 8-90 benefit from the tax privileges and incentives of the Free Trade Zone regime.

¹¹⁰ Paragraph of Article First of *Resolución 6-20-A*.

¹¹¹ As mentioned before, the framework for determining whether a preferential tax regime is “potentially harmful” comprises 12 factors (4 key original factors, plus the substantial activities factor which was elevated to the

(ii) Mandatory spontaneous exchange of information on taxpayer-specific tax rulings

The review of the compliance with the transparency component of the BEPS Action 5 minimum standard is conducted by the FHTP on a yearly basis.

Dominican Republic's first review on the implementation of this part of the standard was carried on with respect to 2019.¹¹² The FHTP assessment may find that the Dominican Republic complies with all the elements of the standard that were set out in the corresponding Terms of Reference, except for following 2 elements:

- **Timeliness of the exchanges.** The exchanges of tax-specific tax rulings are required to take place quarterly during the year. The International Taxation Department is the unit within the *Dirección General de Impuestos Internos* (DGII) in charge of issuing the tax-specific tax rulings, identifying those under the scope of the standard (following a well-established information gathering process specifically designed for the purposes of complying with BEPS Action 5), and effectively exchanging them.
The International Taxation Department was created in December 2019. Prior to that date, tax-specific tax rulings were issued by the DGII Transfer Pricing Department. The late 2019 transition caused delays in the exchange of the rulings issued during 2019, not being remitted to the corresponding treaty partners.
- **Confidentiality.** The mandatory spontaneous exchange of information on taxpayer-specific tax rulings takes place by automatic means. Since the Dominican Republic has not been assessed by the Global Forum on Transparency and Exchange of Information (Global Forum) in connection with the standard on automatic exchange of information, the FHTP could not make any determination on the matter. Hence, the Dominican Republic should take any necessary steps to meet the confidentiality requirements.

Currently, the Dominican Republic can issue 5 types of taxpayer-specific tax rulings that are under the scope of the BEPS Action 5 transparency standard: (a) preferential regimes (as long as they are considered to be potentially or actually harmful); (b) cross-border unilateral APAs and other rulings covering transfer pricing issues;¹¹³ (c) rulings providing for unilateral downward adjustments; (d) rulings on permanent establishments; and (e) related party conduit rulings.

Preventing Tax Treaty Abuse (BEPS Action 6)

The BEPS Action 6 minimum standard mandates jurisdictions to include in their double tax treaties a new preamble combined with either (a) a so-called principal purpose test clause (PPT clause) alone, (b) a so-called detailed limitation of benefits clause (LOB clause) combined with domestic legislation for dealing with conduit situations, or (c) a combination of a PPT clause with a so-called simplified LOB provision. The

category of 'key factor' pursuant to the BEPS Project, and 8 'other factors'). At least 2 of the 'key factors' must be met for a regime to be considered to be "potentially harmful". The "ring-fencing" and the "substantive activities" are among the 'key factors'.

¹¹² The report has not been public yet as of the date of this review.

¹¹³ 21 out of the 23 taxpayer-specific rulings issued by Dominican Republic in 2019 corresponded to extensions of existing APAs.

combination a jurisdiction chooses to adopt should depend highly on the technical capacity of its tax administration to control the application of the abovementioned anti-abuse treaty provisions and the approach taken by their courts regarding treaty abuse. Due to the foregoing, many developing countries have chosen to adopt the new preamble, combined with a PPT clause and a simplified LOB (which will allow them to deny tax treaty benefits in the most impertinent cases of treaty shopping, without having to engage in the sometimes difficult process aiming at denying tax treaty benefits based in the PPT clause).

Currently, the Dominican Republic only has 2 double tax treaties in force (i.e. the 1978 treaty with Canada, and the 2011 treaty with Spain), none of which complies with the minimum standard regarding the prevention of tax treaty abuse.¹¹⁴

Given the very limited number of double tax treaties it currently has in force, the Dominican Republic decided to engage in bilateral renegotiations of such treaties in order to introduce the new preamble and one of the available options of anti-abuse provisions which resulted from the BEPS Action 6; instead of trying to introduce such changes by means of the MLI.

The renegotiation of the double tax treaties with Canada and Spain will provide a great opportunity for updating such treaties and trying to introduce tax treaty provisions that would benefit the Dominican Republic. Among those provisions there are both, BEPS resulting provisions (such as the one included in the new paragraph 3 of article 1 of the OECD Model - the so-called “savings clause” -, or the amendments introduced to the permanent establishment definition of Article 5 of the OECD Model), and non-BEPS resulting provisions (such as the Article 12A of the UN Model on technical services).

CbC reporting (BEPS Action 13)

The BEPS Action 13 minimum standard requires the provision by MNE groups, and the subsequent exchange (by jurisdictions), of the following CbC information:

- General information of MNE groups’ organizational structures, lines of business, and financial and tax positions (provided by means of the so-called “master file”, which has to be filed with the tax authorities of the jurisdiction where the head office of the MNE group is resident);
- Information on the revenue, profits before taxes, taxes paid and accrued in the corresponding year, stated capital and retained earnings, number of employees, and tangible property of MNEs in each of the countries where they operate (provided by means of a “country-by-country template” which has to be filed with the tax authorities of the jurisdiction where the head office of the MNE group is resident); and
- More detailed information to be provided by the local subsidiaries and branches of MNE groups on their transactions with related parties (i.e. transfer methods used, etc), by means of the so-called “local file”.

The purpose of the abovementioned information is to provide tax administrations with high level information on the global operations of MNE groups, the profits they obtain, and the taxes they pay. By having access to the “big picture” of MNEs’ global operations, a tax administration is in a better position

¹¹⁴ The double tax treaty with Spain has in its Protocol a narrowed PPT clause, which applies to the provisions on dividends, interest, royalties and independent personal services (as opposed to the PPT clause that resulted from the BEPS Project which applies to all the provisions in the tax treaty). In addition, the treaty with Spain lacks the new preamble on the prevention of treaty abuse.

to assess the appropriateness of the income reported in its jurisdiction by the MNE, in comparison with the MNE's overall income. CbC reporting was then conceived as a risk-assessment tool that would help tax administrations to identify MNEs' potential base-eroding practices, allowing them to do a better allocation of auditing resources. In that sense, the CbC reporting minimum standard has been regarded as one of the BEPS outcomes from which developing countries can benefit the most.

The implementation of the CbC reporting minimum standard requires, on the one hand the enactment of domestic legislation within the context of transfer pricing documentation requiring MNEs' entities to produce and file the aforementioned CbC information, and, on the other, appropriate international instruments allowing jurisdictions to exchange automatically CbC reports. In addition, since the information is to be exchanged upon international agreements that provide for the confidentiality of the information exchanged, jurisdictions must meet the confidentiality standards prior to receive CbC reporting information.

To date, the Dominican Republic has not enacted domestic tax legislation on CbC reporting (although it has been working on draft legislation since a while); nor it has signed the Multilateral Competent Authorities Agreement for exchanging CbC information that can be subscribed under the purview of the Convention on Mutual Administrative Assistance in Tax Matters (MAC) to which it is a party. Moreover, as mentioned before, the Dominican Republic has not yet been assessed by the Global Forum in connection with the confidentiality standard for automatic exchange of information purposes, which will prevent the country from getting CbC information on MNEs operating in the country. Thus, it is recommended that the DR implements a domestic legal and administrative framework to impose and enforce CbC reporting requirements. In connection with this, it is important that the DR take steps to put in place an exchange of information framework that allows automatic exchange of information.

Finally, the Dominican Republic has not been peer reviewed on its compliance with the BEPS Action 13 minimum standard. However, the Inclusive Framework is currently discussing a new methodology to conduct future peer reviews of the CbC reporting minimum standard. According to such methodology non-reviewed countries will start to be peer reviewed on a yearly basis, starting as of 2020.

Dispute resolution through MAP (BEPS Action 14)

The standard on dispute resolution through MAP was broken down in 21 elements, the implementation of which may require from the amendment of tax treaty provisions governing MAP, to the enactment of domestic law rules ensuring the timely and correct implementation of MAP agreements, as well as the issuance of guidance for guaranteeing access of taxpayers to MAP. In addition, jurisdictions having committed to the implementation of this minimum standard are requested to provide MAP statistics, in accordance with a common framework.

To date the Dominican Republic has not undertaken any action in order to implement this minimum standard. Given the small number of MAP cases handled by the Dominican Republic, the country requested and obtained a deferral of its BEPS Action 14 peer review.¹¹⁵ However, the Inclusive Framework is currently discussing a new methodology for conducting the Action 14 peer review. Such methodology may introduce changes to the treatment of jurisdictions who were granted a deferral of their peer review.

II. Other BEPS (non-minimum standard) measures

¹¹⁵ Approximately 55 jurisdictions obtained such a deferral.

Addressing the Challenges posed by a Digitalized Economy (BEPS Action 1)

Despite having been at the center of the BEPS project, to date there is still no consensus-based solution to the challenges posed in the field of direct taxation by the digitalized economy. In October 2020, the Inclusive Framework approved the release of 2 Blueprint Reports containing the technical proposals package on the matter. The Inclusive Framework requested public comments to the package of measures and expects to hold a public consultation on January 2021.¹¹⁶

Along with the Blueprints, the OECD made public general estimates of the economic impact of the measures proposed therein, suggesting that they could increase global corporate income tax by about USD 50-80 billion per year. The OECD has shared individually with each Inclusive Framework member estimates of the economic impact they may experience if implementing the proposed solution. It is still unclear the extent to which small market jurisdictions, such as the Dominican Republic, would experience a significant increase of their corporate income tax revenues as a consequence of implementing the solution.

The Dominican Republic has been participating in the Inclusive Framework discussions on the proposed solution, but, to our knowledge, it has not taken a decision on the matter. Moreover, as far as we understand, the Dominican Republic has not yet contemplated adopting any unilateral measure for taxing the income from digital services (such as a digital service tax, or DST). Some other members of the Inclusive Framework (developed and developing countries alike) have introduced, or are considering introducing some form of DST, in case either a consensus on the OECD proposed solution is not reached or the implementation costs of such solution outweighs the expected increase of revenue.

Permanent Establishment (PE) (BEPS Action 7)

The BEPS initiative developed updated treaty provisions intended to widen the definition of what constitutes a PE for tax treaty purposes.

It is very important that the definition of PE provided for in the domestic tax law is in line with, the PE definition provided for in double tax treaties. In general, double tax treaties do not create taxing rights, instead they assign taxing rights already existing in the domestic tax law of each of the contracting states in a treaty, among such states. Therefore, if the domestic tax law of a country provides for a PE definition that is narrower than the PE definition provided for in its double tax treaties, that country would be prevented from taxing a PE constituted under the tax treaty definition whenever a PE has not been constituted under the domestic tax law definition.

Should the Dominican Republic adopt the broader PE definition that resulted from the BEPS Action 7, it would need to amend the PE definition provided for in its domestic tax law, especially in connection with the case of dependent and independent agents. Furthermore, the wording of the current domestic tax law definition of PE does not seem to be completely aligned with the PE definitions currently included in the Dominican Republic double tax treaties, nor in the OECD and UN Model tax conventions. In particular, it is recommended that the definition regarding construction activities and consultancy services is revisited.

¹¹⁶ The Reports stress that consensus among the Inclusive Framework members has not been reached, as there are key political and technical issues that remain undecided.

III. Other aspects not specifically addressed by the BEPS project

VAT/GST on online sale of goods and services

Countries have increasingly started to impose VAT/GST on online sale of goods and services (including business-to-consumer or B2C supplies). Such measure is in line with the principle set in the OECD International VAT/GST Guidelines, according to which consumption taxes should be levied in the jurisdiction where the consumption occurs. There are key policy considerations behind the adoption of such measure, like (i) reducing the loss of revenue derived from the switch in consumers' patterns who prefer the online sale of goods and services that usually escape taxation, over locally supplied goods and services, or (ii) seeking a fairer treatment of the domestic suppliers over the foreign providers. Furthermore, a lot of work has been done in order to overcome the most common administrative barriers for implementing a VAT/GST on online- provided services and goods, with the OECD working towards issuing guidance on implementation of such a tax and numerous country-case experiences to build upon.

The key issue, though, is how to tax B2C imported services. It is not feasible to apply a reverse charge rule to B2C imported services as consumers are unlikely to comply and the costs of forcing them to comply would be very high. Instead, the foreign supplier of the imported services should be required to register for VAT if the level of their taxable transactions exceeds the registration threshold. The registration requirement should apply regardless of whether or not the foreign service provider has a place of business in the jurisdiction. A supply is taxable only if it is made within the jurisdiction. For this purpose, it is necessary to have place of supply rules (also referred to as place of taxation rules) to locate a supply of imported services in the jurisdiction.

During the last year, Ecuador, Mexico and Paraguay joined this trend and adopted changes in their laws to apply VAT on a wide range of services provided through the main digital entertainment and transportation platforms. Chile, with the recent approval of its tax modernization law, will also apply VAT on said digital services. In the Caribbean, the Bahamas (2019) and Barbados (2020) have also made progress with this type of reform. Thus, effectively taxing e-commerce and the digital economy should be prioritized in the Dominican Republic, it could contribute to raise revenues in the short-term and could compensate the extra expenses made by the government due to mitigate the covid-19 crisis.

Table A 13. LAC: Examples of taxation on the digital economy through VAT¹¹⁷

Country	Year of application	Scope of tax	Rate	Administration
Argentina	2018	The taxable base for VAT was expanded to cover digital services – including internet transactions- that are automated and require minimal intervention.	21%	Banking institutions are responsible for collection. If the buyer uses a credit card, the tax is collected when the balance is paid.
Bahamas	2019	VAT is applicable to all online providers of services relating to hotels and vacation rental properties.	12%	Service providers are required to register and to collect VAT from customers.
Barbados	2019	VAT is applied on goods and services for consumption in Barbados, which are purchased online by local or foreign customers from a vendor abroad or from local vendors when the transaction is processed outside Barbados.	17.5%	Foreign suppliers must register, and file digital VAT returns quarterly, and must issue invoices to the purchaser of the digital goods and services.
Chile	2020	VAT is applied to digital services consumed in the national market and provided by foreign entities not domiciled in the country (except in the case of transport companies).	19%	The internal revenue service (SII) will set up a platform that foreign companies can use to file returns and pay VAT electronically.
Colombia	2018	VAT has been levied in digital services provided by foreign suppliers since 2018. Virtual education services for the development of digital content are exempt.	19%	Service providers must register with the Unique Taxpayer Registry (RUT) to file returns and pay the tax, or they can opt for the withholding mechanism operated through commercial banks.
Costa Rica	2020	VAT is levied on cross-border digital services and is applicable one month after the tax authority establish the list of services to be taxed.	13%	Two options for collection are set out, directly by service providers, or through international credit or debit cards.
Ecuador	2020	The new tax reform extends VAT to digital services, which include all purchases of goods and services through digital platforms.	12%	The tax will be collected through credit cards used by consumers to make their respective purchases.
Mexico	2020	The tax will be applicable to services including multimedia downloads, online clubs, and dating, gambling and distance learning websites.	16%	The tax will be collected through the financial entity (credit card company) used by digital service consumers or users, resident in the country.
Paraguay	2020	The recent tax reform established that digital services provided by foreign suppliers will be subject to VAT,	10%	The tax will be collected through withholding mechanisms implemented

¹¹⁷ ECLAC 2020.

				by the operators of the credit/debit cards used to pay for the service.
Uruguay	2018	The taxable base for VAT includes services for the transmission of audiovisual content and intermediary services on foreign multi-sided platforms.	22%	Uruguay has opted to collect the tax directly from non-resident suppliers, without establishing withholding mechanisms for credit or debit cards.

Source: ECLAC 2020.

Sharing/gig economy

Another aspect worthwhile exploring for increasing revenue may be both the direct and indirect taxation of service activities carried out in the Dominican Republic (mainly accommodation and personal services, such as transportation and delivery services) which are contracted through on-line platforms operators who are resident abroad. The OECD has worked on Model Reporting Rules for platform operators in the sharing/gig economy, pursuant to which said operators could provide information to the tax authorities of the jurisdictions where the service is provided (i.e. the jurisdiction where the property is located, in the case of accommodation services, or the jurisdiction where the transportation service is carried out) for income tax purposes. Building on that work, the OECD is now working on recommendations to collect VAT/GST derived from the provision of sharing/gig economy services.

Offshore indirect transfers

Capital gains derived from the alienation of assets and rights located or used in the Dominican Republic are currently taxed with the general income tax at a general rate of 27%, pursuant to article 289 of the Tax Code. Capital gains can be offset against ordinary operational losses, while capital losses can only be offset against capital gains.

Law 495 of 2006 (article 14) added a new paragraph to article 289 of the Tax Code, pursuant to which assets and/or rights located or used in the DR owned by foreign companies shall be deemed as having been alienated whenever the shares of the foreign company owning such assets and/or rights are alienated. According to the provision, the capital gains derived from the indirect transfer of the assets/rights located/used in the DR shall be determined taking into account: (i) the transfer price of the shares of the foreign company (even though the article specifies that the tax liability will arise upon any transfer, regardless of whether it is gratuitous or for a value); and (ii) the weight the value of such assets/rights has in the total worth of the foreign company.

The abovementioned offshore indirect transfer (OIT) provision is relatively old and lacks important elements (e.g. it only refers to the alienation of shares of foreign entities, omitting similar interests -like participations in trusts and partnerships-; in addition, it does not provide any clarity as to whom the taxpayer is -i.e. the alienator of the shares or the company owning the local assets/rights). Moreover, the provision has not apparently been regulated, nor widely applied (the "doing business" publications of auditing and law firms of DR do not provide any information on the matter). The provision is mentioned in guidelines issued last year by the Tax Administration on the income tax imposed on capital gains, but such guidelines do not provide any clarity regarding the application of the OIT rule, so it is uncertain how the rule is enforced.

In light of the above, there would be room for, on the one hand, improving the current OIT rule provided for in paragraph 1 of article 289 of the Tax Code, and on the other, working on the regulation of such provision. However, it is uncertain whether, under the current circumstances, having an OIT rule would help raising revenue in DR significantly. As mentioned before, capital gains are taxed with the regular income tax. Therefore, companies/entities entitled to general income tax exemptions may not be taxed on their capital gains, regardless of whether such gains are derived from direct or indirect transfers.

Annex II. Fiscal Measures due to COVID-19, as of May 2020

Tax on Business	Tax on individuals	Health related
<ul style="list-style-type: none"> - The payment of the annual CIT due in April by all companies with a financial year ending in December 2019, may be paid in 4 equal installments. - The payment of advance payments of income tax (anticipos) may be paid in 3 installments immediately after the emergency period. - Taxpayers may request payment arrangements of up to 4 installments for the remittance of Tax on Transfers of Industrialized Goods and Services (ITBIS/VAT) relating to February 2020, without any surcharge. Similar arrangement established for March 2020. - The installments of all payment arrangements currently in force are reduced to 50% whilst extending the deadline. - Companies will be exempt from the payment of March 2020 monthly advance tax. Large taxpayers will not be granted under this measure except for taxpayers engaged in business such as travel agencies, hotels and entertainment services. - Payment extension for the VAT (ITBIS) second and first installments. - Extension of deadline for filing 2019 simplified tax regime return to 20 May 2020. - Contributions made by employers to employees under the temporary government-sponsored programme (FASE) will be deductible for CIT purposes. - Extension of deadlines for consumption tax on fossil fuels and petroleum derivatives (LH) and LPG contribution. 	<ul style="list-style-type: none"> - Individuals will be exempt from the payment of March 2020 monthly advance tax. - Extension for the filing and remittance deadlines for 2019 individual income tax return to 29 May 2020. 	<ul style="list-style-type: none"> - Exemption from VAT (ITBIS) for medical supplies.

Source: The Fiscal Impact and Policy Response to COVID-19, Fiscal Policy and Sustainable Development Unit (MTI GP), April 3, 2020.

Annex III. List of all existing legal instruments establishing tax expenditures in the DR¹¹⁸

Tax Expenditures defined by the general tax legislation:

- Law No. 11-92 and its amendments, which institute the Tax Code.
- Law No. 14-93 and its amendments, which establishes the Dominican Tariff.
- Law No. 3489 and its amendments, General Customs Law.
- Law No. 18-88 and its amendments, on Property Tax.
- Law No. 112-00 and its modifications on Hydrocarbons.
- Law No. 173-07 of Collection Efficiency: taxes on the transfer of real estate and vehicles.
- Law No. 25-69 and amendments, on inheritance and donation tax.
- Law No. 139-11 and its amendments that contains the tax regime of gambling, casinos and betting agencies.

Tax Expenses related to Special Regimes and Miscellaneous Legislation:

- Law No. 8-90 on Promotion of Free Export Zones.
- Law No. 28-01 creating a Special Border Development Zone
- Law No. 158-01 and its amendments, on Tourism Incentives.
- Law No. 122-05 on Regulation and Promotion of Non-Profit Associations.
- Law No. 56-07 on Textile Chain and Footwear.
- Law No. 57-07 on Incentives for the Development of Renewable Energy Sources.
- Law No. 392-07 and its amendment, on Industrial Competitiveness and Innovation.
- Law No. 171-07 on Special Incentives for Pensioners and Rentiers of foreign origin.
- Law No. 480-08 and its amendment, on International Financial Zones in the Dominican Republic (not in application).
- Law No. 502-08 on Book and Libraries.
- Law No. 108-10 and its modifications, of Promotion of the Cinematographic Activity.
- Law No. 5852-62 that establishes the National Institute of Hydraulic Resources.
- Law No. 96-88 Authorizing the Operation of Slot Machines in Gambling Casinos.
- Law No. 9-96, which frees from all types of import taxes all the merchandise/gifts that enter the country with foreign residents during the Christmas and New Year periods.
- Law No. 57-96, its amendments, which exempts from taxes the vehicles of Legislators.
- Law No. 204-97, which provides for exemption from salary No. 13 (Christmas salary).
- Law No. 125-01, Electricity Law.
- Law No. 183-02, Monetary and Financial Code.
- Law No. 78-03 on the Statute of the Public Prosecutor's Office.
- Tax Reform Law No. 557-05.
- Law No. 179-09 and its modification, on deduction of Educational Expenses from the Physical Income Tax Base.
- Law No. 146-71, General Law on Mines and Quarries.
- Law No. 92-04 on Systemic Risk.
- Law No. 189-11 on Trust and the Dominican Mortgage Market.
- Law No. 103-13 on Incentives for the Import of Non-Conventional Energy Vehicles.
- Law No. 126-15 for the transformation of the National Bank for Housing and Production (BNV) into the National Bank of Exports (BANDEX).
- Mining Concessions.

¹¹⁸ WB 2017

Special Contract that regulates the “Fideicomiso RD Vial”.

Concordat between the Holy See and the Dominican Republic, dated June 16, 1954.

Agreement between the Dominican State and the Social Service of Churches, dated January 19, 1964, as amended.