

# Attribution of tax revenue to government subsectors

## Introduction

1. The aim of this GFS interpretation is to provide guidance on the subsector attribution of tax revenue in order to ensure a uniform application of the ESA 2010 rules in some borderline cases described below.

## References in ESA 2010 and GFSM14

### The subsectors of general government

2. ESA 2010 paragraph 20.56 informs that *“Depending on the administrative and legal arrangements there is generally more than one level of government within a country. In Chapter 2, three levels of government are specified: central, state (or regional) and local, with a subsector for each level. In addition to these levels of government, the existence and size of social security and its role in fiscal policy require that statistics for all social security units be compiled as a fourth separate subsector of general government. Not all countries have all levels [...]”*.

### Principal party recording

3. ESA 2010 paragraph 1.78 instructs that *“When a unit carries out a transaction on behalf of another unit (the principal) and is funded by that unit, the transaction is recorded exclusively in the accounts of the principal. As a rule, one should not go beyond this principle, by trying, for instance, to allocate taxes or subsidies to ultimate payers or ultimate beneficiaries under the adoption of assumptions.”*

*An example is the collection of taxes by one government unit on behalf of another. A tax is attributed to the government unit that exercises the authority to impose the tax (either as a principal or through the delegated authority of the principal) and has final discretion to set and vary the rate of the tax.”*

### Taxes on production and imports paid to EU institutions

4. ESA 2010 paragraph 4.25 instructs to include as revenue of the institutions and bodies of the European Union a list of taxes collected by national governments on their behalf : the (mainly) agricultural duties and import levies imposed at EU level rather than at national level – 1<sup>st</sup> and 2<sup>nd</sup> EU own resources. This is a necessary consequence of the EU being a customs union, so that no Member State can impose national levies that become payable as a consequence of goods or services entering its territory.
5. In contrast, ESA 2010 paragraph 4.25 instructs the recording of all value added type taxes (VAT) as national taxes, even if passed to the EU institutions. While the existence of national value added type taxes is imposed by EU legislation, VAT can only be imposed by national governments, and only national governments have the power to set and vary its rate. Therefore, *“The taxes on production and imports paid to the Institutions of the EU do not include the VAT-based third own resource which is included in other current transfers under the heading VAT and GNI – based EU resources”*. Accordingly, ESA 2010 paragraph 4.140 instructs that the 3<sup>rd</sup> EU own resource based on VAT is instead recorded as an other *“current transfer expenditure of government: in sub-category VAT-based EU own resource (D.761)”*.

**Automatic transfer of taxes from one government agent to another**

6. ESA 2010 paragraph 4.118 describes current transfers within general government and makes a reference to ESA 2010 paragraph 1.78: *"Current transfers within general government (D.73) do not include transactions on behalf of another unit; these are recorded only once in the accounts, in the resources of the beneficiary unit on whose behalf the transaction is made (see paragraph 1.78). This situation arises particularly when a government agency (e.g. a central government department) collects taxes which are automatically transferred, in total or in part, to another government agency (e.g. a local authority). In such cases, the tax receipts destined for the other government agency are shown as if they were collected directly by that agency and not as a current transfer within general government. The solution applies especially in the case of taxes destined for another government agency which take the form of additional rates superimposed on taxes levied by central government. Delays in remitting the taxes from the first to the second government unit give rise to entries under 'other accounts receivable/payable' in the financial account."*
7. 2008 SNA has the same principle in its paragraph 8.127: *"One government unit may act as an agent on behalf of a second government unit by, for example, collecting taxes that are due to the second unit, at the same time as it collects its own taxes. Taxes collected on behalf of the second unit in this way are to be recorded as accruing directly to the second unit and are not to be treated as a current transfer from the first to the second unit. Delays in remitting the taxes from the first to the second government unit give rise to entries under "other accounts receivable or payable" in the financial account."*

**Block transfers that include tax receipts from one government unit to another**

8. ESA 2010 paragraph 4.118 continues: *"Transfers of tax receipts which form part of a block transfer from central government to another government [...] are included in current transfers within general government. Such transfers do not correspond to any specific category of taxes and they are not made automatically but mainly through certain funds (county and local authority funds) in accordance with scales of apportionment laid down by central government."*

**IMF Government Finance Statistics Manual 2014 (GFSM2014)**

9. GFSM2014 provides further insight on the issue of which subsectors of general government taxes should be attributed. GFSM2014 starts discussing the attribution of tax revenue with paragraph 5.33, which sets up the different cases *"depending on the arrangements"* that are described in subsequent paragraphs: *"In some cases, one government unit collects taxes and then transfers some or all of them to another government unit or international organization. Depending on the arrangement, the taxes passed on to the second government unit may be reassigned as tax revenue of that unit or they can be recorded as tax revenue of the collecting unit and a grant from that unit to the second government unit."*
10. GFSM2014 paragraph 5.34 is identical to the *"A tax is attributed [...]"* sentence of ESA 2010 paragraph 1.78.
11. GFSM2014 paragraph 5.35 further elaborates on 'on behalf of': *"Where an amount is collected by one government for and on behalf of another government, and the latter government has the authority to impose the tax, and to set and vary its rate, then the former is acting as an agent for the latter. The full amount of tax raised is assigned as tax revenue to the government on whose behalf the collection was made. Any amounts retained by the collecting government as a collection charge should be recorded as a payment for a service, classified as the relevant category of sales of goods and services (142). The same amount is recorded as an expense for use of goods and services (22) by the counterparty. Any other amounts retained by the collecting government, such as under a tax-sharing arrangement, should be recorded as current grants (1331) receivable while the counterparty will record current grants (2631) payable. If the collecting government was delegated the authority to set and vary the rate, then the amount collected should be recorded as tax revenue of the collecting government."*

12. GFSM14 paragraph 5.36 guides on what to do in cases where the tax rates are jointly set by different levels of government: “Where different governments jointly and equally set the rate of a tax, with no individual government having ultimate overriding authority, then the tax revenues are attributed to each government according to its respective share of the proceeds. If an arrangement allows one government unit to exercise ultimate overriding authority, then all of the tax revenue is attributed to that unit.”

## Discussion of issue

### Taxes shared between different levels of government

13. Where one level (the agent) collects taxes on behalf of another (the principal party), ESA is reasonably clear – the tax is recorded as a revenue of the principal party. In deciding which party is the tax recipient, ESA guides that it is the subsector that exercises the authority to impose the tax (either directly or through delegated authority) **and** has the final discretion to set and vary the rate of tax.
14. ESA 2010 paragraph 4.118 covers the case where a tax collecting agent collects on behalf of another level of government and automatically passes over the proceeds. The wording used in ESA 2010 paragraph 4.118 might appear to follow a different terminology than paragraph 1.78. Paragraph 1.78 sets out a scenario where two parties are involved: the principal party and its agent (although it does not name the agent using that terminology). In paragraph 4.118 both of these parties are described as “government agencies” rather than government units. Paragraph 4.118 also adds a further piece of terminology: the beneficiary unit. It then uses two examples, the first where central government is the agent and the second where it is the principal, without further explaining them.
15. ESA paragraph 4.118 however provides two additional clarifying texts delineating the principal tax recipient:
- a. another government unit is the principal tax recipient when it superimposes additional rates and ultimately receives these additional taxes;
  - b. the central collecting government unit is the principal tax recipient when tax receipts are combined with other revenues as part of block transfers to another government unit. Such transfers do not correspond to any specific category of taxes and they are not made automatically but mainly through certain funds (county and local authority funds).
16. When amounts are not passed automatically to another government unit and when they are combined in a block payment, with other taxes or other items, according to rules decided by the government unit distributing the funds, ESA 2010 is clear that the tax collecting level of government is *de facto* the principal party and thereafter redistributes these as current transfers to other government units.
17. The sentence in ESA paragraph 4.118 describing how delays in remitting tax receipts from the collecting agent to the recipient party “give rise to entries under ‘other accounts receivable/payable’ in the financial account” could be judged as somewhat problematic. This (F.89) category of the financial account is defined to show timing differences between accrual time of recording and cash settlement between the parties to a transaction. The timing differences resulting from delays in the agent passing cash to the principal party are not covered by this definition since no non-financial transaction is recorded that they can be the counterpart of. The specific mention of using this category in ESA 2010 paragraph 4.118 can be viewed as a sign that ‘amounts in transit from agents as part of principal party transactions’ was an accidental omission from the definition of other accounts receivable/payable in ESA 2010 paragraphs 5.231 and 5.241 and hence they should be recorded there. A similar solution is adopted for the case where government acts as an agent in passing EU grants and subsidies to their beneficiaries (ESA 2010 paragraph 20.296).
18. The ESA guidance is sufficient to cover the classification of most taxes, particularly those where Member States’ governments collect taxes on behalf of the institutions of the European Union.

19. However, cases remain where the tax is not assigned to one specific level of government and instead shared between different levels of government. Such tax-sharing arrangements will deny any single level government sole control on tax rates and tax base but rather negotiations may need to take place with the other level of government<sup>1</sup>. A variety of arrangements exist, ranging from central level government setting the tax rates to approval of tax rates set by lower level governments, or from central level of government setting upper or lower limits to those sufficiently autonomous for no consultation to be needed.
20. A common example is where central government sets a tax rate and a lower level of government then adds its share onto it, creating a shared tax. This is covered in ESA paragraph 4.118 “*This solution [allocation of tax revenue] applies especially in the case of taxes destined for another government [unit] which take the form of additional rates superimposed on taxes levied by central government [for example].*” (brackets added)
21. Taking into account 1.78, the inference drawn from this is that each party that imposes and sets a tax rate should be considered the principal party for that amount. Therefore, for shared taxes there may be more than one principal party and one of the principal parties involved may also operate as the agent. In simple terms, the shared tax should be partitioned into different sub-taxes - one for each subsector recipient – and then the principal party approach applied to each sub-tax.
22. The following rules should be considered:
- a. When different government levels share the power to impose the tax and set and vary the tax rate but one level of government has the ultimate decision-making power, the tax should be attributed to that latter level. Any amounts received by other subsectors are distributed to them through a current transfer (D.73) from the principal.
  - b. When one government level imposes the tax but another level has the power to vary its features, it is considered that neither level(s) can be labelled as the sole principal party in the meaning of ESA paragraph 1.78 exact wording, which then requires interpretation. Typically, central government sets the framework and the sub-central level(s) can vary some features of the tax.<sup>2</sup> These arrangements are often motivated by administrative efficiency and legislative powers’ reasons. If the sub-central level of government (i.e., not imposing the tax) has the *de facto* power to vary the tax rate, even within (sufficiently large, proportionately) pre-defined bands, the tax revenue is attributed to this subsector.

## VAT

23. Within the European Union, Member States are required to adopt a value added tax (VAT) that complies with the EU VAT code. Member States set their own tax rates, with part of the proceeds transferred to the EU budget as the VAT-based third EU own resource. ESA instructs the recording of a national tax and a current transfer (D.76) of the EU resource. Given the national government responsibility here, it is agreed that the recording of VAT revenue at local government level (such as municipalities) should generally be avoided.
24. VAT should in most cases be attributed solely to central government. However, in some Member States with co-sharing arrangement with state governments, state government bodies have a statutory role to co-decide with other central and other state government bodies on imposing and setting and varying of VAT (rates). In these cases, the VAT is attributed to each co-deciding government body according to a predefined distribution key, unless the co-decision does not require unanimity.

<sup>1</sup> This will typically be central government but other cases exist.

<sup>2</sup> Central government is used here as an example of the typical scenario, the situation could also exist between state government and local government. The arguments apply between different levels of government and no hierarchical-level rules are implied. It is even conceivable that local government creates a tax and central government has the powers to vary it.

25. In some Member States, there are other government bodies statutorily deemed autonomous and provided with a jurisdiction to impose and set tax rates, including VAT. In these cases, the VAT collected on this basis is attributed to these other government bodies.

#### **Taxes collected by social security funds**

26. Social contributions and benefits are considered such an important role or function in the economy that they have their own main ESA category of transactions (D.6). The main economic transactions of social security funds cover collecting social contributions and paying social benefits. In many countries, social contributions are supplemented with transfers from central government, to a varying extent financed by central government taxes.
27. Whereas the social security funds subsector is exclusively related to the social security function, the other three general government subsectors are defined based on geographical territory covered.
28. As explained in ESA 2010 paragraph 4.88, social security schemes are funded by contributions paid (mostly) by employers and employees. This raises the question whether it logically follows that S.1314 resources must be classified as social contributions rather than taxation? Put in other words, can the S.1314 subsector record taxes? However, the distinction between taxes and social contributions for social security funds is not addressed in this GFS interpretation.
29. ESA 2010 paragraph 1.78 is equally relevant for attributing potential taxes received by social security funds, where this revenue is attributed solely to the government unit that (i) exercises the authority to impose the tax and, (ii) has final discretion to set and vary the rate of the tax. For a tax to be attributed to a social security fund, the prerogative to impose and set and vary a tax would have to be with the social security fund.
30. However, it may be difficult to decide which entity is imposing the tax, as it may be the case that the decision-making entity deciding on the imposition of a tax is common to two or more government entities, such as a national parliament deciding on the budgets of budgetary central government as well as social security funds. For example, when tax receipts are split between budgetary central government and extra-budgetary units of central government, it may be considered that the latter does not impose the tax on its own, but rather that the parliamentary control is in the first instance on budgetary central government. The principal might then be considered to be budgetary central government. As the partitioning between the territorially defined levels of government and social security funds is to a certain extent a convention used for statistical analysis, budgetary central government might be considered to be the principal, too, for taxes imposed by parliament, where the final beneficiary is a social security fund.

## **Conclusions on the recording in government finance statistics**

31. This GFS interpretation prescribes that where different government levels share the power to impose the tax and set and vary the tax rate, taxes should be attributed to the level of government that has the ultimate decision-making power.
32. In cases where one government level imposes a tax but other levels have the power to vary its features, neither levels satisfy the situation described in ESA paragraph 1.78. If the other level of government (i.e., not imposing the tax) has the *de facto* power to vary the tax rate, even within (sufficiently large) pre-defined bands, it is considered appropriate to attribute the tax revenue to this subsector and to view the imposition powers as an administrative arrangement for efficiency purposes.
33. In cases where the tax base as well as a basic rate is set by one level of government but other levels of government can receive tax revenue by adding a variable additional rate (usually within set limits), the revenue is attributed accordingly.
34. VAT should in most cases be attributed solely to central government. However, in some Member

States with co-sharing arrangement with state governments, state government bodies have a statutory role to co-decide with other central and other state government bodies on imposing and setting and varying of VAT (rates). In these cases, the VAT is attributed to each co-deciding government body according to a predefined distribution key unless the co-decision does not require unanimity. Also, in some Member States there are other government bodies statutorily deemed autonomous and provided with a jurisdiction to impose and set tax rates, including VAT. In these cases, the VAT collected on this basis is attributed to these other government bodies.

## Illustration/ T-accounts

### Example 1 (relating to paragraph 32)

Example 1 describes the case of a real estate tax (D.29), where a central legislation is imposed by central government determining the tax base. Local government (municipalities) determines the tax rate freely according to its financial needs. Central government collects all taxes (500) and passes them on to the respective municipalities with a one month delay. For simplification, the time of accrual of the tax is deemed here to be the time of cash paid.

Example 1: S.1311 imposes a central legislative basis for real estate taxes, municipalities set the tax rate, S.1311 collects the taxes and passes them on to S.1313 with a delay							
month 0		S.1311		S.1313		tax payers	
Assets/ Uses	Liabilities/ Resources	Assets/ Uses	Liabilities/ Resources	Assets/ Uses	Liabilities/ Resources	Assets/ Uses	Liabilities/ Resources
B.9/ B.9f	0	B.9/ B.9f	+500	D.29	+500	D.29	+500
F.2	+500	F.89	+500	F.89	+500	B.9/ B.9f	-500
	F.89 +500					F.2	-500
month 1		S.1311		S.1313		tax payers	
Assets/ Uses	Liabilities/ Resources	Assets/ Uses	Liabilities/ Resources	Assets/ Uses	Liabilities/ Resources	Assets/ Uses	Liabilities/ Resources
B.9/ B.9f	0	B.9/ B.9f	0	B.9/ B.9f	0	B.9/ B.9f	0
F.2	-500	F.2	+500	F.2	+500		
	F.89 -500	F.89	-500	F.89	-500		

### Example 2 (relating to paragraph 33)

Example 2 illustrates a case where central government imposes a personal income tax with a tax rate of 20%. State government can add a variable amount between set limits and adds a further 5%, making the tax rate 25%. Central government administers the tax collection. The tax raises 1000, of which 800 goes to central government and 200 is revenue of state government. There is a delay in central government passing on the amounts to state government.

Example 2: S.1311 imposes personal income tax and S.1312 adds additional rate						
S.1311		S.1312		tax payers		
Assets/ Uses	Liabilities/ Resources	Assets/ Uses	Liabilities/ Resources	Assets/ Uses	Liabilities/ Resources	
B.9/ B.9f	+800	B.9/ B.9f	+200	D.51a	+1000	
F.2	+1000	F.89	+200	B.9/ B.9f	-1000	
	D.51a +800		D.51a +200	F.2	-1000	
	F.89 +200					