

Tax Simplification for A Better Investment Climate

Global Tax Simplification Team
20-September, 2010
Istanbul



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IFC International
Finance Corporation
World Bank Group



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Shifting lenses to deal with tax

Traditional Revenue Goal

- Raise Revenue for government expenditure

Our program adds a new dimension:

Development/Growth Goals

- Create a “culture of taxation”
- Regularization of the rule of law
- To increase the size of the formal sector
- To promote growth*

✓ ***Good growth prospects for Developing countries**

- ✓ **WBG projects growth to reach 6% in 2010 for developing countries and about 5,9% in 2011, versus 2,2 % and 2,4% for the higher-income countries.**

Table of Contents

- 1. Background – Who are we ?**
- 2. Why is tax important in the current economic climate?**
- 3. Why Simplify Business Taxes?**
- 4. What is the tax simplification product?**
- 5. What knowledge management tools are available to you?**

Diverse Clients. Tailored Advisory Services

Pipeline:

- Balkans Program
- Bangladesh

Central Asia Regional Program

- Kyrgyz Republic
- Tajikistan
- Uzbekistan

Nepal

Vietnam

Pilot project
All workstreams

Lao PDR

Sierra Leone

Pilot project
All workstreams

Balkans Program

Armenia

Georgia

Burkina Faso

Nigeria

DRC

Madagascar

East African Community Initiative

India

Kenya

Rwanda

Tanzania

Yemen

Pilot project
All workstreams

Peru

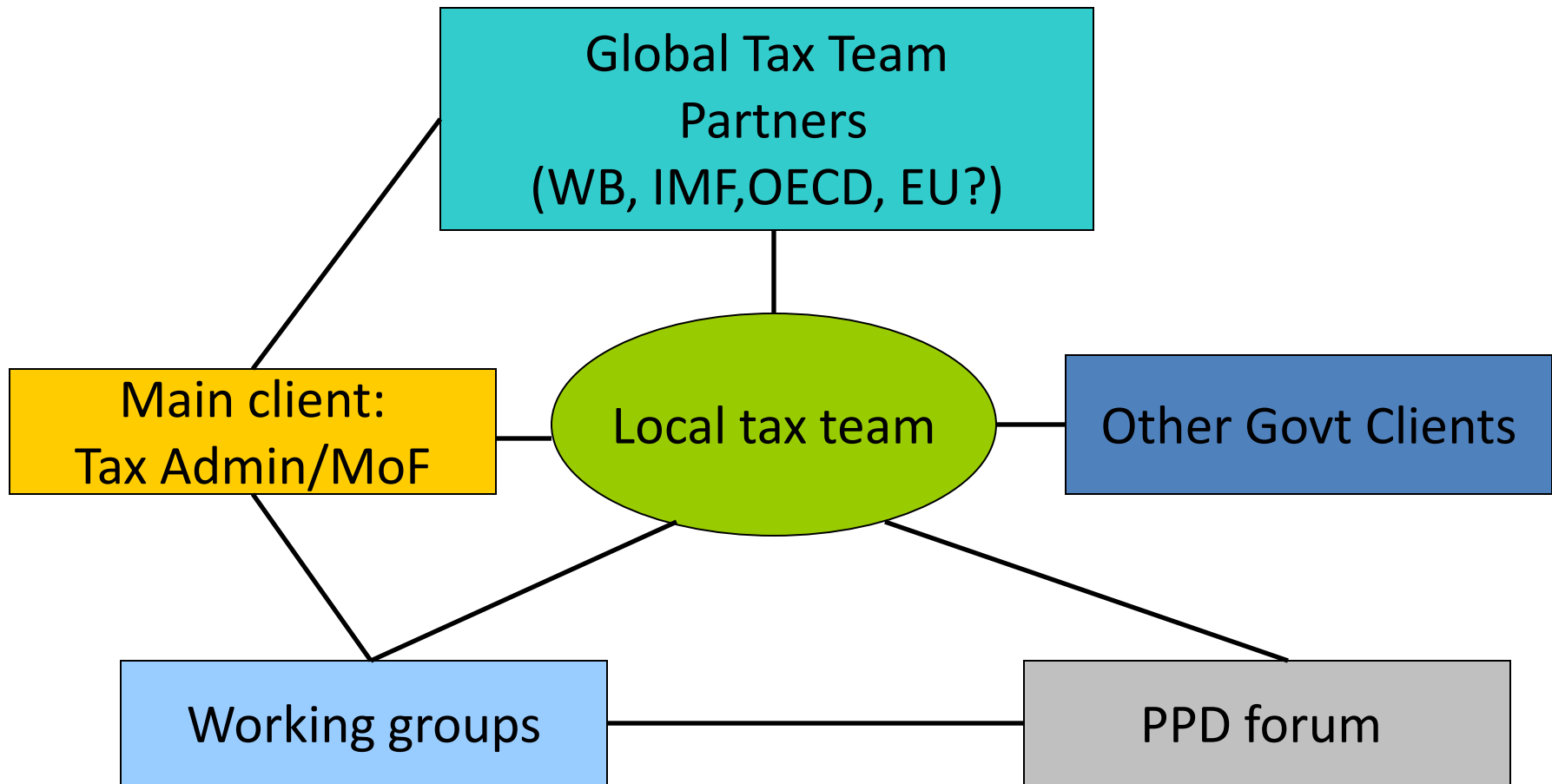


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Constellation of players on a Tax project



...not all are needed, depending on the workstreams

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Why is tax important in the current economic climate?

The current environment:

- **Sharp decline in growth in developing countries (7.9%, 2007 to projected 4.4% in 2009)**
- **Developing countries particularly vulnerable due to decline in remittances, reduced exports, reduced private portfolio and bank lending flows, currency depreciation and an anticipated decline in foreign direct investment flows**
- **Decline in growth means less tax revenues due to lower business profits, lower personal income and lower consumption**

Why is tax important in the current economic climate?

How to stimulate the economy?

- Complex debate at the international, national and local level – many areas of focus – financial systems, availability of credit, trade finance and insolvency regimes
 - Obviously no simple answer, but tax is an important issue because it is a big part of business recovery
-
- **Media and others focusing on credit recovery but in every previous crisis corporate output recovered first and then the credit markets followed (Michael Klein, Jan.26)**
 - **Tax can play a big role in assisting with this corporate recovery and output**
 - **Now the main emphasis is on reducing the fiscal deficit**
 - **Therefore - Good time to raise topic of taxes with our clients, particularly taxes directly connected to consumption (sales tax, payroll tax)**
 - **Also, more important than ever to demonstrate the link between tax simplification, increased investment and improved economic conditions.**



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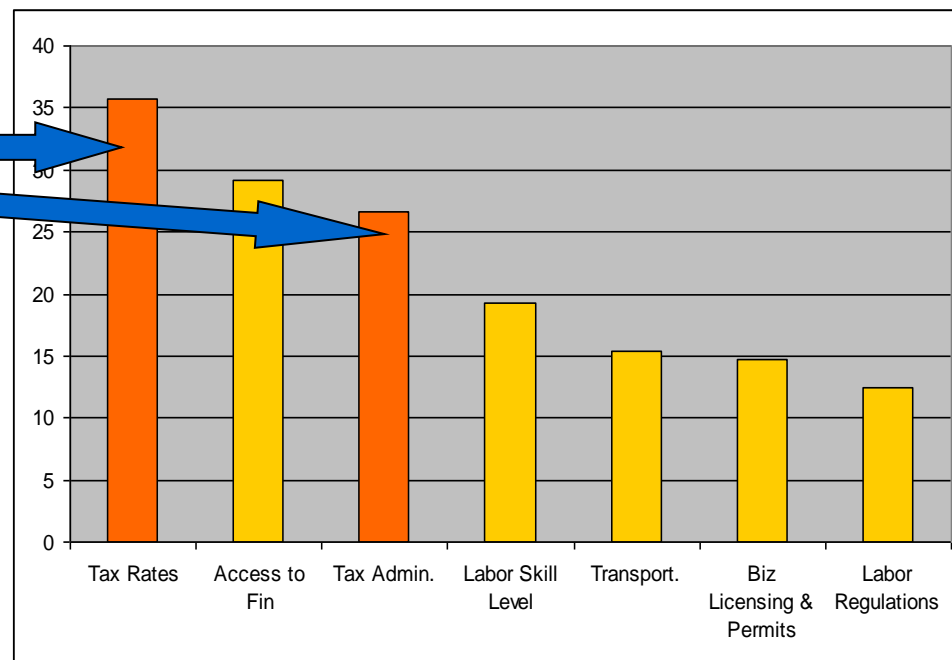
Why Simplify Business Taxation?

- **Our objective: Smart and simple tax administration and processes to lower the cost of doing business**

- **Tax rates and tax administration constantly ranked across regions among top 3 “major constraints” for businesses**

- **Filling the niche:**
 - We bring business perspective
 - Agenda setters on SME Taxation and Tax Compliance Costs
 - Collaboration with key players: IMF, PREM, PSD, OECD, ITD

Firms identifying issue as “major constraint” [%]



Source: Investment Climate Assessments data

- **Highly responsive to macro economic changes**
 - Crisis response work and post-crisis preparedness

Tax Burden—what are we talking about?

The Tax Burden =

Rates All the taxes you pay (income, VAT, etc.)-
incentives (depreciation, etc.)

+

Admin Costs (the time and financial cost of
complying with the tax requirement (time--
your time is lost wages + money--an
accountant or 2)

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What is the Tax Simplification?

“Smart and simple” tax policy and processes lower the cost of doing business

Short Term:

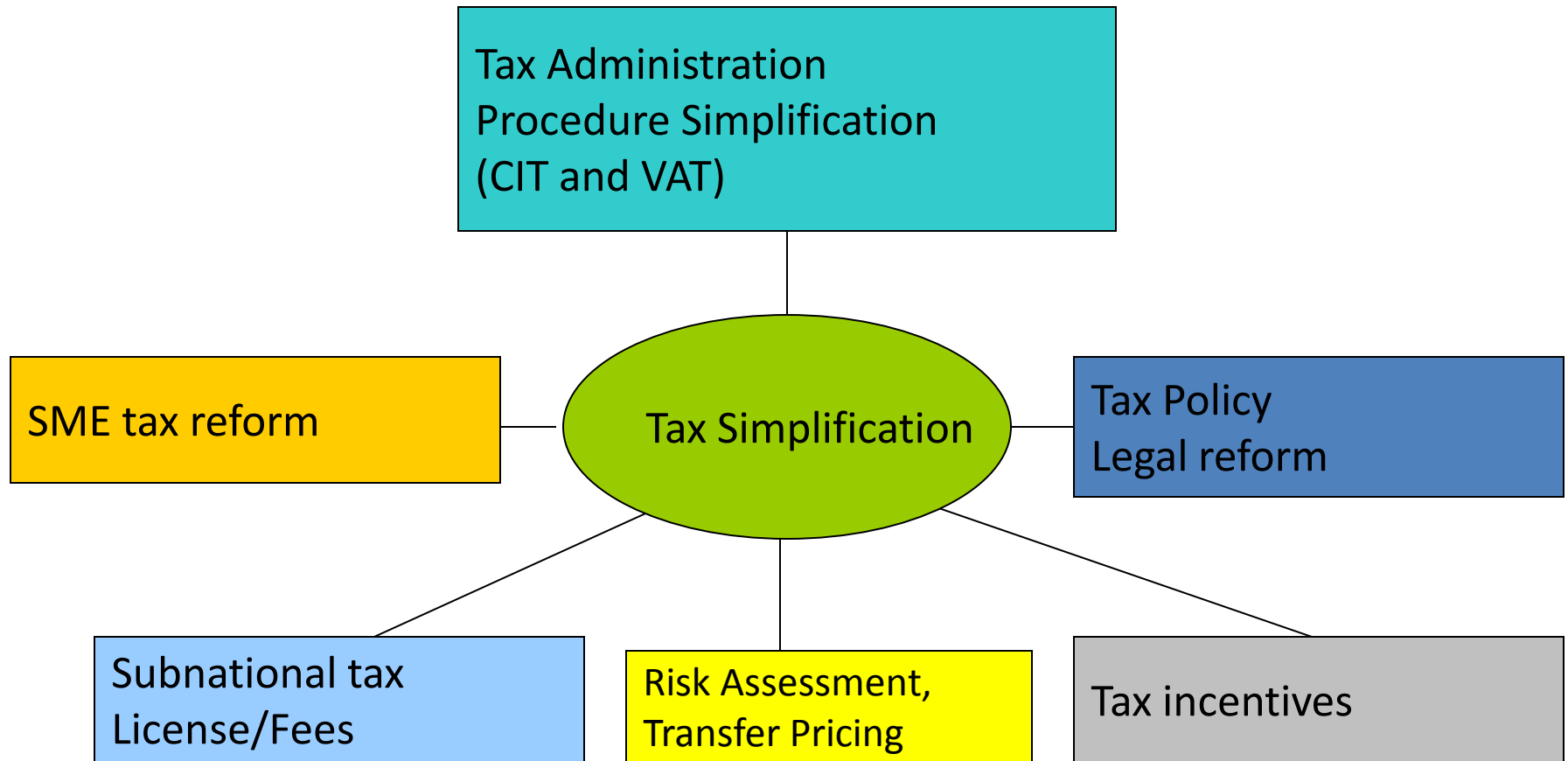
- **Reduction of compliance costs (time and financial)**
- **Reduction of tax-related barriers to formalization**
- **Reducing avenues for corruption**
- **Building capacity of taxpayers and tax administrators**

Long Term:

- **Facilitation of formalization and job creation**
- **Widening the tax net, spreading the tax burden**
- **Tax systems that foster good governance**



Specific work streams: A menu of options



...you can choose a la carte or the whole menu!

Meeting Client Demand with KM and Operations

Workstreams

Issues addressed

Tools

• Tax Administration Simplification	➔	Business tax administration is burdensome (CIT, VAT)
• Sub-national Taxes & Regulations	➔	Misuse of regulatory fees as revenue tools (esp. sub-national)
• Small Business Tax Reform	➔	Small business facing high compliance costs
• Tax Legal & Appeals Reform	➔	Overly complex, cluttered tax laws & appeals system
• Risk-based Audit System	➔	Excessive and discretionary tax audits
• Tax Incentives Reform	➔	Tax competition has led to sub-optimal tax incentive structure
• Crisis Response & Post-crisis Preparedness	➔	When “tax cuts” from stimulus packages generate large revenue gaps...

- METR Analysis
- Tax Admin Process Mapping
- Standard Cost Model (SCM)
- Compliance Costs Surveys
- Inventory of Fees & Charges
- Incentives Review
- Profit –Margin Analysis

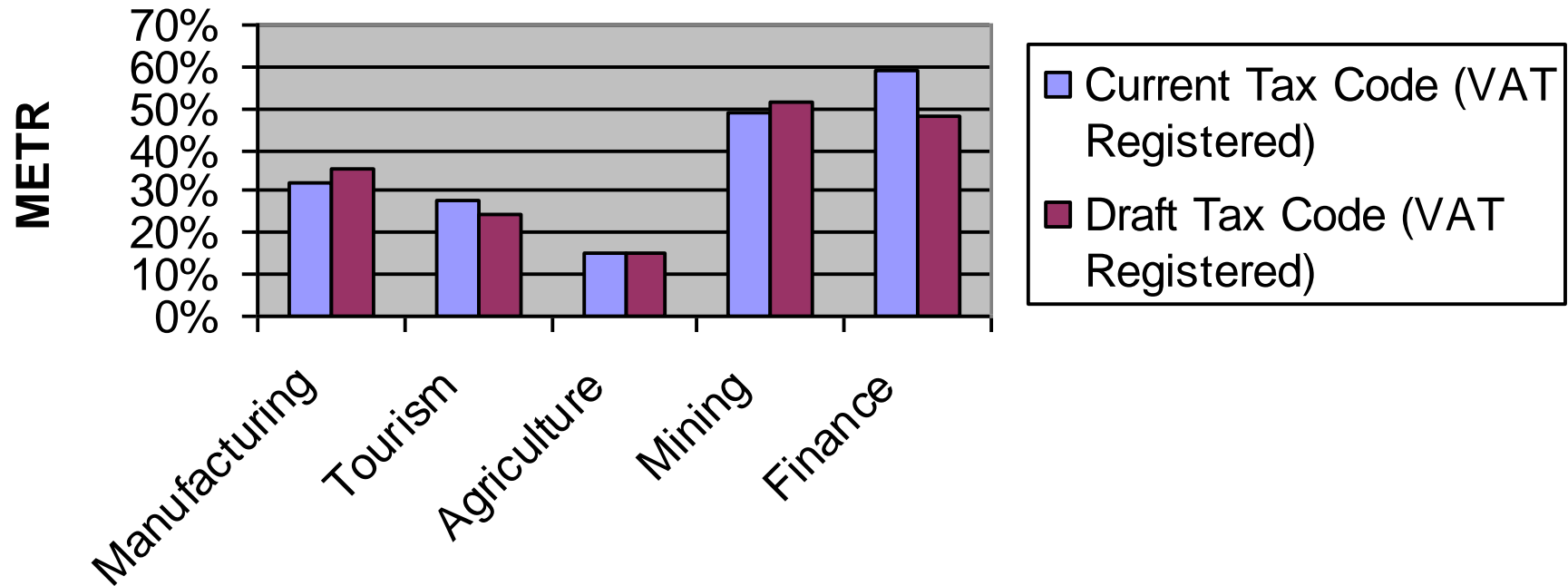


Diagnostic Tools on Tax Burden

- **METR/AETR tells us the impact of the statutory tax burden on business** by sector (including SME), it allows us to measure the impact of tax incentives on business, and it allows us to simulate the effects of statutory changes on the tax burden.
- **Process mapping gives us statutory cost of administration,**
- **Compliance cost survey tells us the actual cost of complying with the law,** the cost of **not-complying** (informality), where the main costs are, and gives us a benchmark M &E framework
- **Subnational tax/license/fee inventory tells us if subnational instruments are a problem**

Analysis of the Tax Burden on Business (METR and AETR)

Effective Tax Rate Changes



The Draft Tax Code reduces the tax rate burden on investment, but not by too much because of the Sales Tax.



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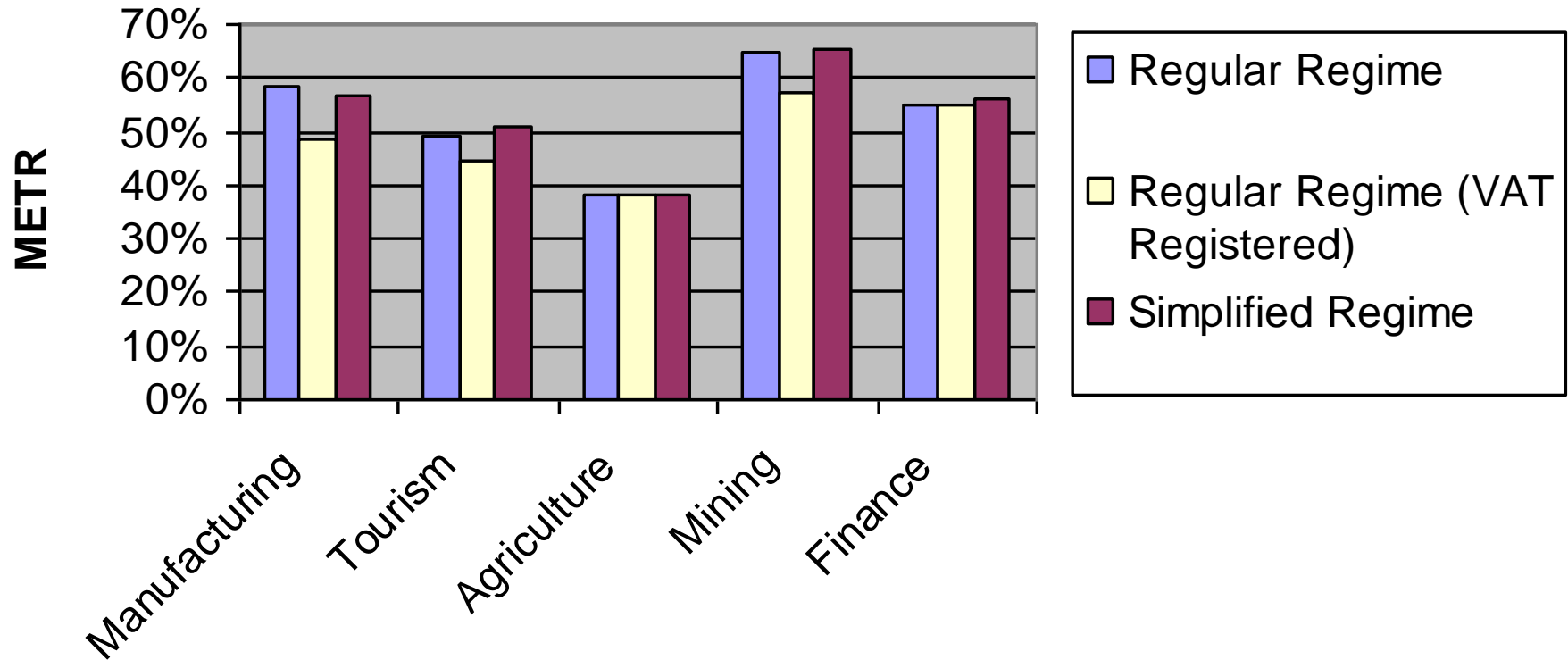
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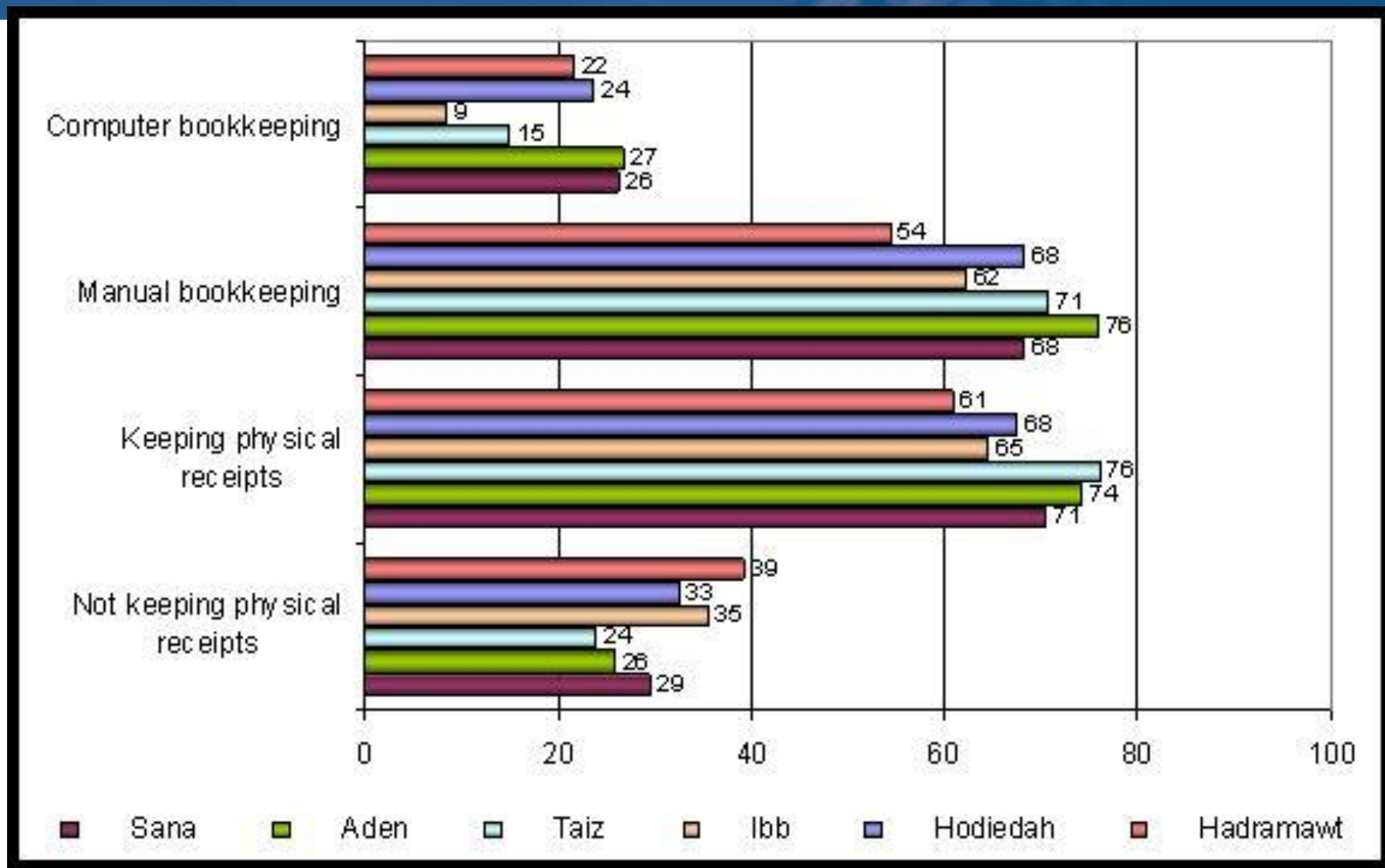
...and the tax burden on Small Businesses

Effective Tax Rate for Small Business



The Simplified Regime does not reduce rate burden on business

Compliance Cost Survey: example



Process Mapping: Example

Tax Simplification in Yemen

Process Map: Profit Tax - Issuing Taxpayer Identification Number

Process Code: 1.1.1.1.2a

Level of Detail: Detailed

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Status: As-Is

Last Updated: 11/05/2008

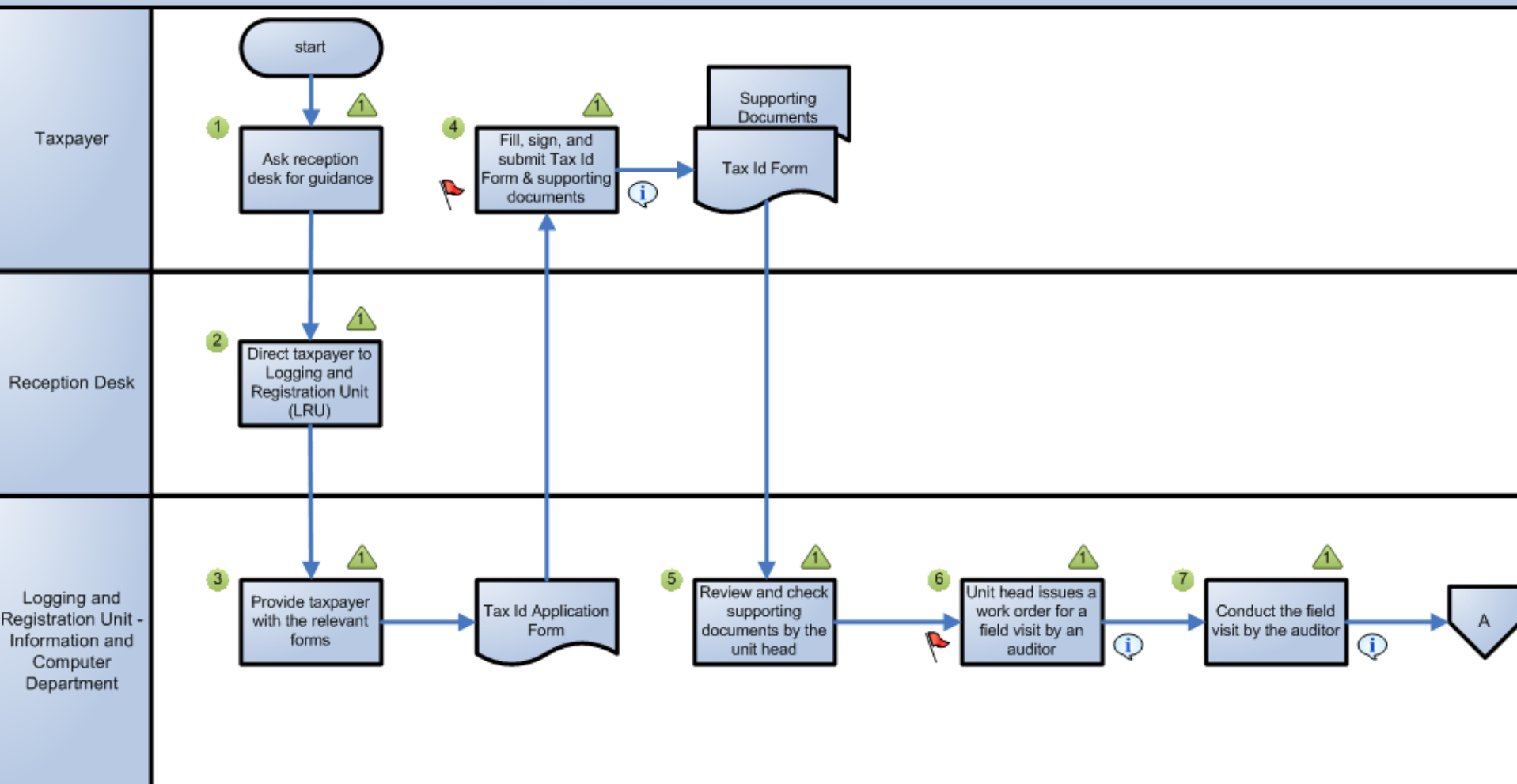
No. of Value Adding Activities (accumulative): 2

Elapsed Time (accumulative): 1 day(s)

Accumulative Cost: YR 0.00

Sana'a – Large Taxpayer Unit

اسم الإجراء: ضريبة أرباح – اصدار الرقم الضريبي (صنعاء – كبار المكلفين)



Sub-national Inventory: Example

Scenario (1) Construction: 1st grade Construction firm, located in the capital city

Item	Amount
Fees for opening construction corporation / Company	30000
Fees imposed on contractor's permits and classification certificate: first grade c	150000
Fees imposed on contractor's permits and classification certificate: Yemeni eng	15000
Fees of contractor's classification form	1000
Commercial Register Fees- first and second grades construction companies	5000
Chamber of commerce membership fee- first and second grades construction c	12050
Purgation and city improvement fees: per every first grade factory/ company (an	30000
The zaka	2.50%
Income Tax	35%
GST Tax	5%
Purgation and city improvement fees: of electricity consumption bill for all consu	5%
Local consul support - Monthly Percentage of electricity bill from all consumers	1%
Local consul support - Monthly Percentage of water bill from all consumers, cor	3%
Local consul support - Monthly Percentage of phone bills from all consumers, c	2%



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Doing Business Paying taxes indicators

- All taxes paid in the second year of operation
- **Tax payments**: The number of times the company pays taxes in a year is the number of taxes multiplied by the frequency of payment for each tax.
- **Time**: Number of hours per year it takes to prepare, file and pay three major types of taxes:
 - Corporate income tax
 - VAT or sales tax
 - Labor taxes
- **Total tax payable**: Total amount of taxes payable by the business except for consumption taxes as percentage of commercial profits

Tax Policy Simplification & Sub-National Tax Simplification

- Government sometimes use too many tax instruments to raise revenue with reduced impact
- Tax laws are too complicated and taxpayers have limited support on the intention of the law
- Government mandates special accounting for tax purposes which raise tax burden for taxpayers
- Tax Policy Reform includes
 - Government should limit the use of taxes as a regulatory instrument and vice-versa
 - Consolidating different taxes on the same or similar bases
 - Provide Tax Law guidelines and commentaries so that taxpayers and tax lawyers could interpret the law easily
 - Align Tax accounts as far as possible with book accounts

Tax Administration Simplification

- In many developing countries tax administration is a bigger burden than tax rates
- Taxpayers spend a lot of time,
 - Preparing tax returns
 - Making Tax payments
 - Filing tax returns
 - Answering queries in audit
 - Managing Tax Inspections
 - Dealing with Withholding Taxes
 - Handling Tax Appeals
- Tax Administration Simplification includes
 - **Mapping out the Processes in practice**
 - Using the Process Maps to consolidate some steps
 - In some cases eliminate some processes to limit direct contact with tax payers
 - **Introduce Risk Based Audits and limit audit to high risk tax payers**
 - **Provide easy options for taxpayers to file appeals**
 - Reduce burden of Withholding Tax without making it ineffective
 - Allow many options to file tax returns



Using the process maps to demonstrate the impact of reform

Name	Tax Type	Size	Old no. days	Old no. of steps	Total Cost YR	New no. of days	New no. of steps	Total new cost YR	% change	
Registration	GST	Large	1	12	0.00	1.00	12.00	0.00	nil	Reluctance to reduce these "first co
Filing	GST	Large	2	17	0.00	2.00	17.00		nil	Savings of 66% approximately if
Auditing	GST	Large	51	46	0.00	51.00	44.00		4%	
Field Audit	GST	Large	48	19	0.00	48.00	16.00		16%	
Assessment	GST	Large	1	15	0.00	1.00	13.00		13%	Proposed abolition of Assessment
Payment	GST	Large	8	28	0.00	8.00	24.00		14%	Monthly payments would contin
Refunds	GST	Large	17	35	0.00	17.00	32.00		9%	Scope for reductions is understand
Appeals	GST	Large	36	43	0.00	36.00	34.00		21%	
Systems to Tackle Corruption	GST	Large	6	11	0.00					Not directly re-examined. Selective
Registration	GST	Large	6	Differential	0.00					Aden procedures were not re exa
Filing	GST	Large	31	Differential	0.00					
Auditing	GST	Large	9	Differential	0.00					
Field Audit	GST	Large	31	Differential	0.00					
Assessment	GST	Large	2	Differential	0.00					
Payment	GST	Large	9	31	0.00					
Refunds	GST	Large	N/A	N/A	0.00					This process is not applicable In Ad
Appeals	GST	Large	N/A	Differential	0.00					The GST appeal process is still nev least give an estimate to that.
Systems to Tackle Corruption	GST	Large	N/A	N/A	0.00					This process is not applicable In Ad

SME Tax Reform

- SMEs are usually a small part of the tax revenue but their importance is understated
- A badly designed tax system could encourage SMEs to join the informal sector
- This in turn has implications for the formal sector
- Encouraging a culture of taxation among SMEs is an important goal
- SME Tax Reform includes
 - SME Tax Policy – Allow SMEs a simplified tax calculation even while aligning SME tax system with the overall tax system
 - Reducing tax administration burden by, reduced audits, simplified filing, simplified accounting, taxpayer service
 - Emphasis on taxpayer education and assistance

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Knowledge Management

Regional Tax Practitioners Networks & Conferences

- South-East Asia (Philippines, February 10)
- South Asia Tax Conference (India, October 09)
- Sub-Saharan Africa (Rwanda, April 09)

Trainings for Practitioners:

- Tax Deep Dive in Central Asia
- Tax Deep Dive in India
- Tax Deep Dive in Washington DC

Toolkits for Practitioners

- Designing a Tax System for Micro and Small Businesses
- Tax Simplification Toolkit

IN PRACTICE Notes

- Local Taxes and Regulations
- Small Business Taxation
- Business Taxation Reform with Governance
- Corruption and Tax Administration Reform
- Introducing VAT in Developing Countries
- Taxing Tourism in Developing countries
- Taxation in the Mining Sector
- Tax Compliance Costs Surveys note
- Communicating Tax Reforms
- Political Economy of Tax Reforms

Impact of Tax Incentives on Investment

- Policy note/guidance on incentives
- Incentives analysis and reform project

Thank You