



Investment Reform Index 2010: Results of the Access to Finance dimension

MONITORING POLICIES AND INSTITUTIONS FOR
DIRECT INVESTMENT IN SOUTH-EAST EUROPE

Sofia, 10 June 2010

The IRI 2010 measures reforms in 8 policy dimensions derived from the OECD's *Policy Framework for Investment*

IRI 2010 Dimensions

1. Investment policy and promotion
2. Human capital development
3. Trade policy and facilitation
4. Access to finance
5. Regulatory reform and parliamentary processes
6. Tax policy analysis
7. Infrastructure for investment
8. SME Policy *

...developed by OECD member and non-member participants as part of the OECD Initiative on Investment for Development (launched in 2003)

*Part of a separate process conducted in cooperation with the EC in the framework of the European Charter for Small Enterprises

IRI 2010 covers 10 economies

Albania

Bosnia and Herzegovina

Croatia

Kosovo under UNSCR 1244

Former Yugoslav Republic of Macedonia

Montenegro

Serbia

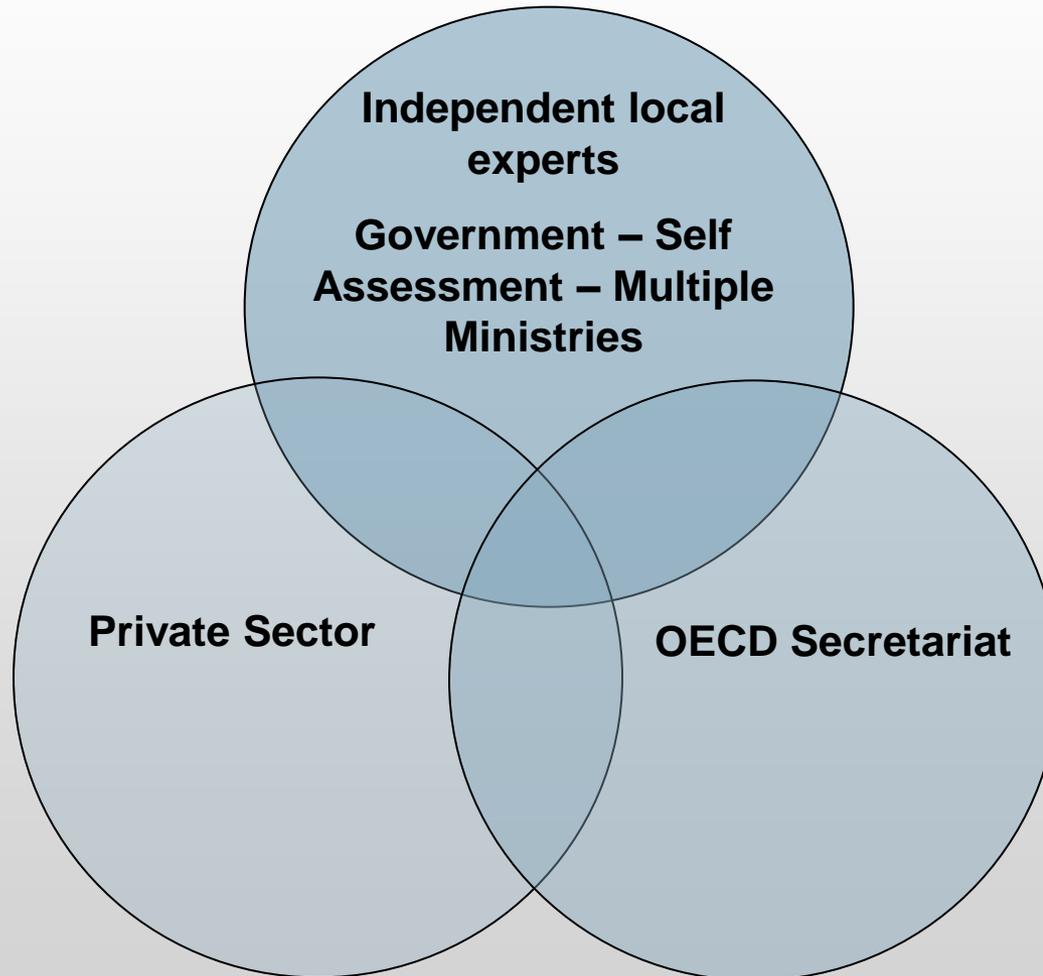
Moldova

Bulgaria

Romania

Process

Process – IRI 2010



Method

Tax Policy Analysis Assessment Framework

3 Sub-dimensions

Fiscal position
and planning

Taxation,
investment
and
employment

Taxation of
SMEs and
MNEs

Tax Policy Analysis Assessment Framework

3 Sub-dimensions

Fiscal position and planning

1.1 Forecasting aggregate tax revenues

1.2 Assessment of fiscal balance and policy feedback

Key Findings

Overview of tax systems

- **SEE economies have undergone significant tax reform in recent years**
 - **All countries have introduced low single-rate corporate taxes**
 - **Many countries have simplified all or parts of their tax regimes**
 - **Tax administration has improved**
 - **Combined with economic growth, this has led to increasing government revenues**

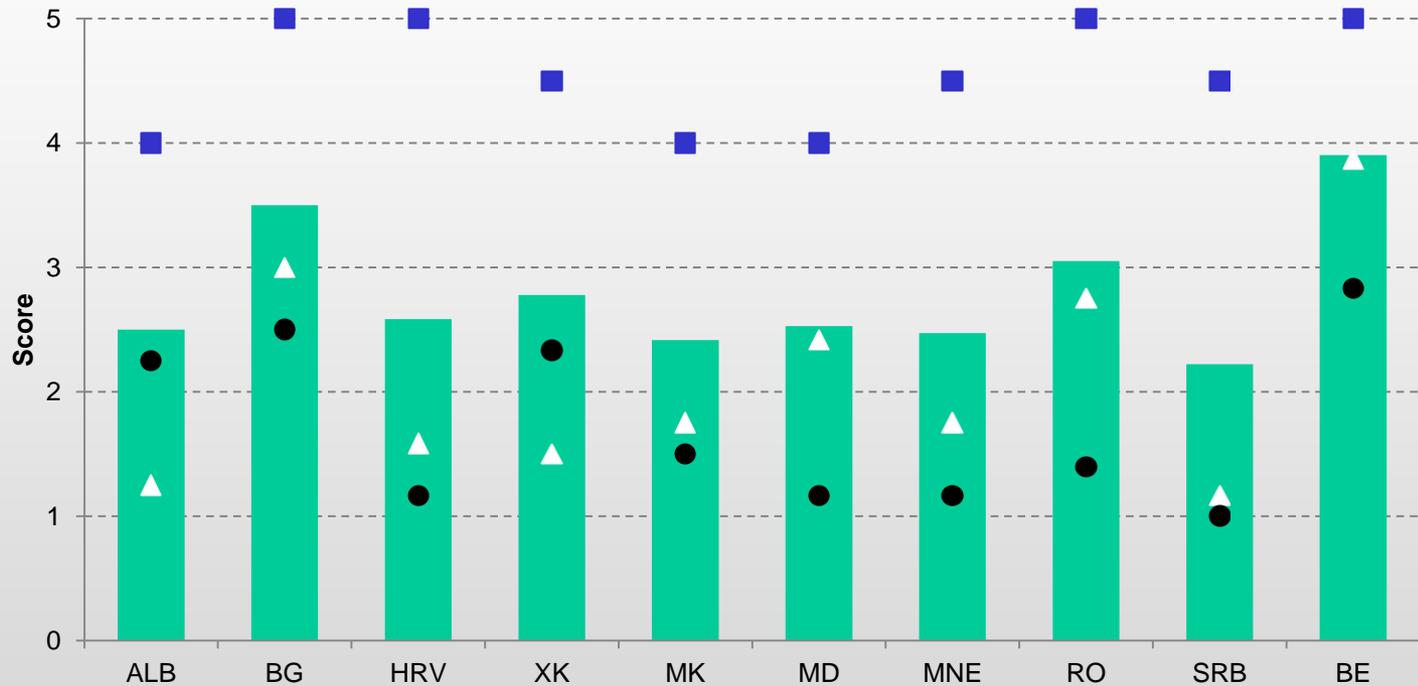
Tax policy analysis

Important progress in strengthening capacity to carry out tax policy development, regularly forecasting aggregate tax revenues and monitoring public revenues and expenditures

- But should develop a fuller array of models – will help to assess how tax reforms will affect different taxpayers
- Need more studies on the tax environment for SMEs and MNEs

Tax policy analysis

Overview of SEE Tax Scores



■ Dimension average (simple): tax policy analysis

▲ 2. Taxation, investment and employment

■ 1. Fiscal position and planning

● 3. Taxation of SMEs and MNEs

Sub-dimension 1: fiscal position and planning

- All SEE countries have an aggregate tax revenue forecasting model.
- All countries monitor tax revenue collection and public expenditures on a regular basis
 - Decisions on public expenditures consider total revenues and fiscal balance in quite a few countries
 - Bulgaria, Croatia and Romania rank expenditures on the basis of policy objectives.
 - Moldova recently improved its system of allocating resources based on policy objectives.

Sub-dimension 2: Taxation, Investment and Employment

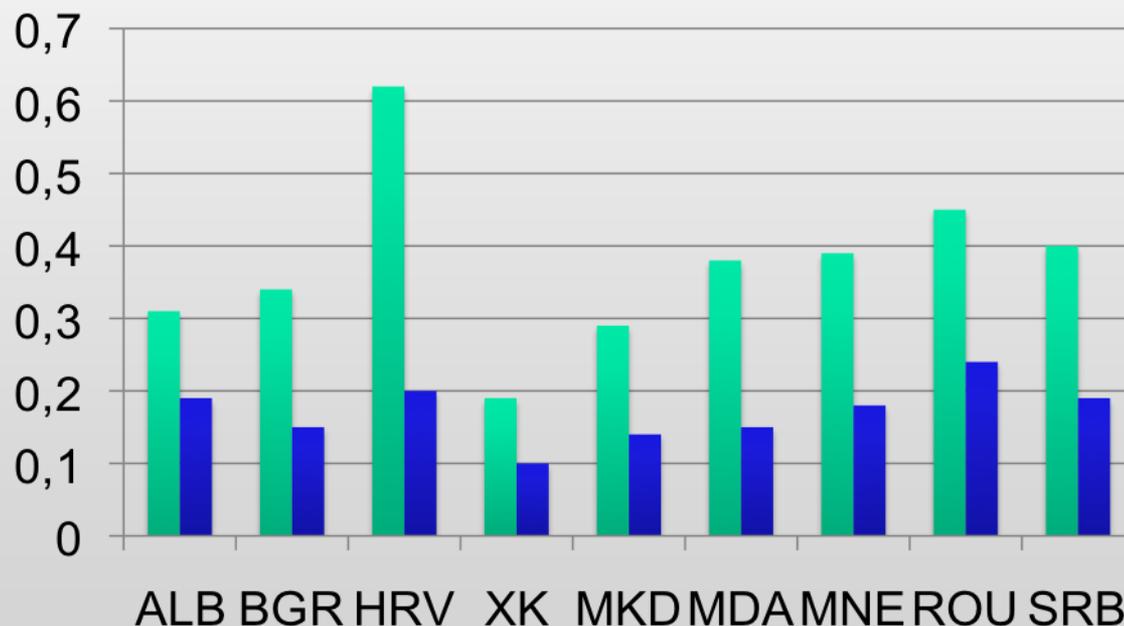
- No country has either a micro-simulation or marginal effective tax rate model in place, although many countries have expressed interest in implementing them.
- Some countries assess tax expenditure accounts
 - Bulgaria, Moldova and Romania periodically prepare tax expenditure estimates
 - Moldova prepares tax expenditure estimates. These estimates are used in preparing the annual budget law.
 - Other countries are looking to implement tax expenditure accounts
- A lot of effort has been put into labour income analysis
 - Bulgaria and Romania maintain a tax wedge model measuring marginal and average tax rates on labour income.
 - Other countries are taking steps toward implementing such a model

Sub-dimension 3: Taxation of SMEs and MNEs

- Analysis of tax impediments to equity financing of SMEs
 - Albania and Kosovo have conducted studies examining the implications for enterprise financing and investment of double taxation of distributed and retained profits.
 - Kosovo has supplemented its study with an analysis of the advantages and disadvantages of alternative integration systems.

Sub-dimension 3: Taxation of SMEs and MNEs

- Analysis of tax arbitrage by SME owners
 - A review of income tax rates on self-employed business income, dividends, interest and capital gains suggests that care has been taken to limit tax planning opportunities.
 - However, significant differences in tax rates across income types are still observed



■ Effective tax rate on wages
■ Effective tax rate on capital

Sub-dimension 3: Taxation of SMEs and MNEs

- Analysis of tax impediments to risky investment in SMEs
 - There is considerable diversity in loss offset provisions in SEE: FYR Macedonia and Croatia have relatively flexible loss offset provisions. Loss offset provisions in other countries are not quite so flexible.
 - Kosovo is the only county which has conducted studies on whether loss-offset rules impact investment in early stage, riskier companies

Sub-dimension 3: Taxation of SMEs and MNEs

- Assessment of tax compliance costs and remedial measures
 - Almost all countries have evaluated to some extent the tax compliance costs of their systems
 - Albania has even implemented a lump sum tax in response to high compliance costs.
 - Many SEE countries have also implemented initiatives to improve taxpayer understanding and compliance with the system.
 - SEE countries have documentation, websites and telephone services to respond to taxpayer questions
 - Many countries have electronic filing of taxes
 - FYR Macedonia and Montenegro have an educational outreach programmes
 - Montenegro meets and discusses tax changes with the Chamber of Commerce.

Sub-dimension 3: Taxation of SMEs and MNEs

- Analysis of non-resident withholding tax payments
 - Bulgaria has a framework in place for estimating and analysing non-resident withholding tax.
 - Other countries are looking to put one in place soon
- Analysis of thin capitalisation of the tax base
 - Serbia is an example of a country that has implemented base protection rules – interest rate deduction is limited to four times the taxpayer's equity. Excess interest can be carried forward.
 - Bulgaria has implemented a framework which identifies and analyses the degree of thin capitalisation of resident foreign-controlled companies.
 - Other countries are looking to put one in place

Summary and conclusions

- All SEE countries have made important progress in recent years in strengthening their capacity to carry out tax policy analysis.
- All SEE countries forecast all or most main tax revenues and can generate rough estimates of the total revenue effects of broad-based tax change.
- SEE countries have made significant progress in addressing tax compliance costs.
- No economy has yet to implement a CIT micro simulation model or a METR model. Only a few countries have a tax wedge model.
- To date, relatively limited attention has been given in the SEE region toward assessing the tax environment for MNEs and SMEs.

Discussion on the exercise

- Did you feel that the IRI exercise was worthwhile?
- Were you happy with the sub-dimension and indicator topics?
- Is there anything you would like to improve?