BUSINESS CLIMATE DEVELOPMENT STRATEGY

Phase 1 Policy Assessment

EGYPT

DIMENSION I-3

Tax Policy

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Partner: European Commission

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EXECUTIVE SUMMARY

Tax reform efforts, in particular the 2004-05 root-and-branch income tax reform carried out by the Egyptian government, have significantly contributed to improving the business climate in Egypt. However, there remains scope for strengthening the country's tax policy analysis and assessment capacity and for further modernising its tax administration.

Tax reform is an ongoing process, with tax policy makers and tax administrators continually adapting tax systems to changing economic, social, and political circumstances. In this process, tax reformers worldwide find themselves working towards competing goals. While tax revenues provide governments in most countries with essential funding to meet their social (education, health, social security) and infrastructure needs, they also affect economic decisions in areas like investment, production, labour supply and demand, and savings. Recognising these challenges, most structural tax reforms in recent decades have tried to foster a more competitive fiscal environment: one which encourages investment, risk-taking, and entrepreneurship, and provides increased incentives to work, while broadening the tax base by, for example, discouraging non-compliance (tax avoidance and evasion).

Challenges in Tax Policy and Administration

A clear focus for incremental reform

Egyptian tax reforms have focused mainly on improving tax legislation and modernising tax administration to make it more efficient and effective. However, there are currently plans to strengthen the Ministry of Finance's tax policy analysis capacity by creating a Higher Council for Taxes in 2010. The main tasks of this body are likely to involve developing and maintaining some of the analytical frameworks (models) discussed in this chapter.

A centralised tax authority has been created

The integration in 2006 of the Income and Sales Tax Departments into a single unified body, the Egyptian Tax Authority, contributed to making Egypt's revenue authorities more efficient and effective. In addition, the Egyptian tax authorities took their first steps towards a more "client-oriented" approach by establishing the Large Taxpayer Centre in 2005. Further steps in that direction are to be encouraged.

A taxpayer identification number has been introduced

The introduction of a taxpayer identification number (TIN) for income tax, general sales, and customs duty in 2005 improved taxpayer data collection. Further progress in centralised systems of collection (gathering, cleaning, recording, and updating) and assessment of taxpayer information are to be encouraged.

The use of self-assessment has increased trust in the system

The introduction of self-assessment and random audit systems have helped strengthen trust between taxpayers and revenue authorities, improve the Egyptian tax authorities' compliance strategy, and reduce administrative costs.

Access to information is much improved

There has been impressive progress in efforts to improve taxpayers' access to information and support documentation and to provide small businesses with assistance in understanding and complying with the tax system. The Large Taxpayer and the Sales Tax Authority in particular stand out. Further efforts in this direction are strongly encouraged.

More sophisticated analytical tools are being used

Egypt currently maintains aggregate tax revenue forecasting models for all main taxes, and systems are in place to monitor revenues and public expenditures on a regular basis. These analytical tools are essential for sound management of public finances and play a key role in the process of restructuring Egyptian public finances in support of fiscal consolidation.

Lowering and streamlining the income tax rates has led to higher revenue

Egypt's movement to a **broader base and lower rate corporate income tax** (20% rate and very limited use of tax incentives) has simplified the tax system and contributed to **increased investment**, tax compliance and tax revenues.

Challenges in Tax Policy and Administration

Fiscal position and planning needs to be strengthened

Egypt does not maintain a corporate income tax (CIT) micro-simulation model for analysing the revenue impact of alternative tax regimes or the disaggregate revenue effect of the current tax regime. Egypt does not currently prepare tax expenditure estimates of revenues foregone for each of the main corporate tax incentives for investment.

Tax evasion remains high

A large number of businesses in the small-and-medium sized sector continue to evade tax. Many SMEs are not registered and continue to operate in the informal sector, leading to a significant loss of potential revenue each year. This is particularly worrisome at a time when the budget deficit has been widening.

Tax treatments are not evenly applied

Although the Egyptian taxation system has been significantly improved in recent years, certain areas are still not as clear-cut as others. It appears that certain structures and entities are subject to varying tax treatments. Examples include: interest income earned by non-banks being taxable (but not taxable for banks), thus limiting the use of mezzanine financing from structuring transactions; and exemption of listed companies from capital gains tax. As such, obtaining a listing before exiting an investment becomes lucrative and hence possibly subject to speculation.[1]

A tax wedge model is needed to understand the effect of tax changes

A tax wedge model to analyse how tax distortions affect employment decisions is not currently maintained in Egypt. This basic (parameter-based) analytical tool could be particularly useful for assessing the impact of taxation on the labour market participation and work effort (number of hours worked) decisions of low-wage workers. Egypt is encouraged to incorporate the tax wedge model into its policy toolkit within 1-2 years.

Tax distortions may not be fully accounted for

Egypt does not maintain a marginal effective tax rate (METR) model for analysing tax distortions on investment and the implications of alternative tax reform proposals. Egypt is encouraged to assess how tax may distort the earnings payout decisions (business income, dividends, interest and capital gains) of closely held corporations. This assessment may help inform decisions about tax rates on different types of income.

More work on SME taxation is needed

Detailed analyses have not yet been carried out in Egypt to assess either how alternative loss treatment may affect investment in small firms with relatively high-risk business ventures or how it may affect the scope for tax avoidance (mischaracterisation of personal consumption expenses as business expenses).

There is no evidence that Egypt has conducted any detailed compliance cost assessments. Nevertheless, although it has apparently not considered the potential of alternative income regimes for reducing SME compliance costs, Egypt has recently implemented a simplified tax regime for SMEs.

Egypt introduced thin capitalisation rules for resident foreign-controlled companies in 2005. Egypt is encouraged to assess companies' debt-to-equity structures and strengthen thin capitalisation rules to protect the domestic tax base from aggressive tax planning.

Recommendations in Tax Policy and Administration

Improve tax collection

In order to address some of the budgetary shortcomings discussed in the macro-economic overview, Egypt needs to improve its tax collection. The new Tax Law from 2005 did broaden the tax base, but evasion remains widespread and more efforts and resources should be put into addressing this. Widespread tax-avoidance is linked to the following issue: the fact that many companies are not registered.

Encourage small-and-medium sized companies to register

The vast majority of Egypt's SMEs continue to escape tax collection as a result of their remaining in the informal economy. The administration should provide more incentives to SMEs to register, preferably using a carrot-and-stick approach. A first step has been taken through a new law which will impose the issuance of a receipt for any transaction, no matter how small. However, other incentives should be used, such as improved services for SMEs; the creation of local "tax booths" to help with filling in tax returns; and the possibility of a tax-amnesty for a certain period for early-bird registrations.

Improve simulation tools

A corporate income tax (CIT) micro-simulation model should be implemented. Local interest is high and some steps have been already taken towards implementing it. Egypt's work on implementing a CIT micro-simulation model will enable it to prepare tax expenditure estimates to guide tax incentive policy. Other analytical tools – *e.g.* METR analysis – could also be incorporated into Egypt's tax policy toolkit within 3-5 years.

A framework for non-resident tax payments should be considered

Egypt is encouraged to implement a framework for measuring and analysing non-resident withholding tax on interest, royalties, dividends, and other payments. Such a framework would be useful for assessing the possible consequences of reducing non-resident withholding tax rates, particularly with regard to related-party cross-border payments.

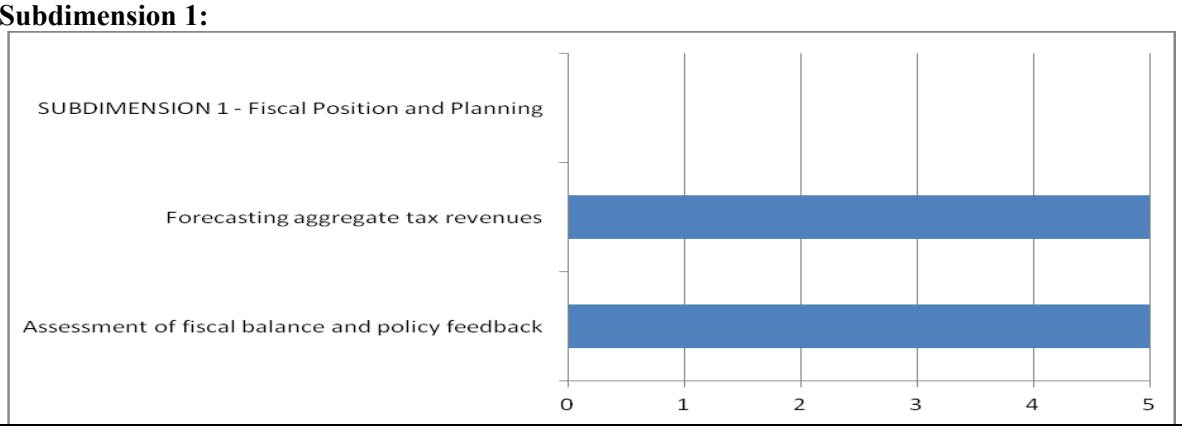
The way forward

Senior tax officials from the Egyptian Ministers of Finance have been actively engaged in a regional dialogue on tax matters under the MENA-OECD Investment Programme. Under the umbrella of the Working Group 3 (WG3) on Tax Policy Analysis, information and experience on the design and implementation of tax systems have been shared since 2004, when this group was created. The implementation of the analytical frameworks described in this chapter will allow Egyptian tax officials to guide tax policy by assessing alternative tax policies and implementation options and to build political support for tax reform by basing policy recommendations on international recognised framework for policy analysis. Moreover, these frameworks will strengthen the regional dialogue and enable cross-country comparisons by building tax measures based on international recognised methodologies. By request of the WG3 members and subject to availability of funding, tax administration issues will be also incorporated in this regional forum on taxation.

The Egyptian government is carrying out an in-depth revision of its tax administration in fiscal year 2009-10. The MENA-OECD Investment Programme will pursue its work on the BCDS for this dimension following the completion of the reform.

Scores by Subdimension: Egypt

Subdimension 1:



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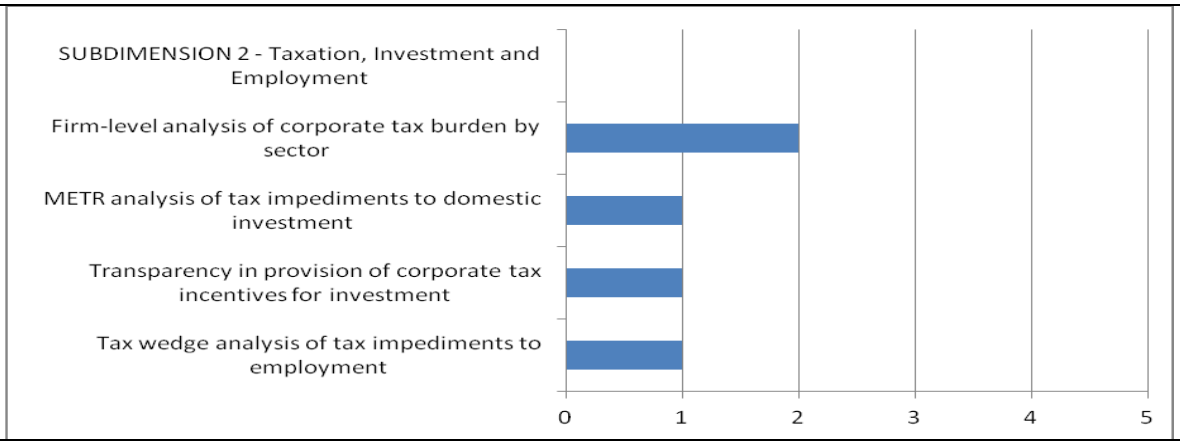

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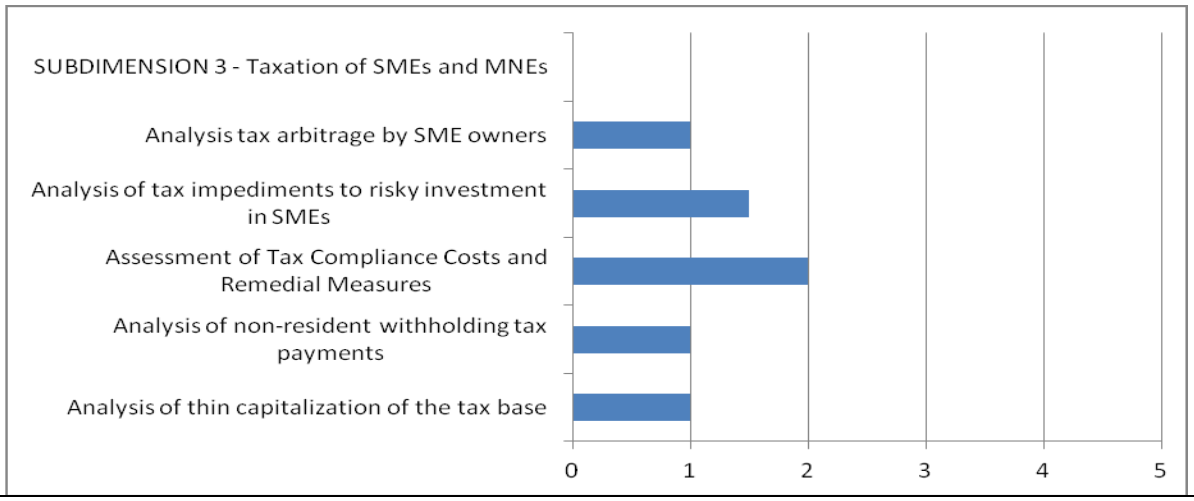

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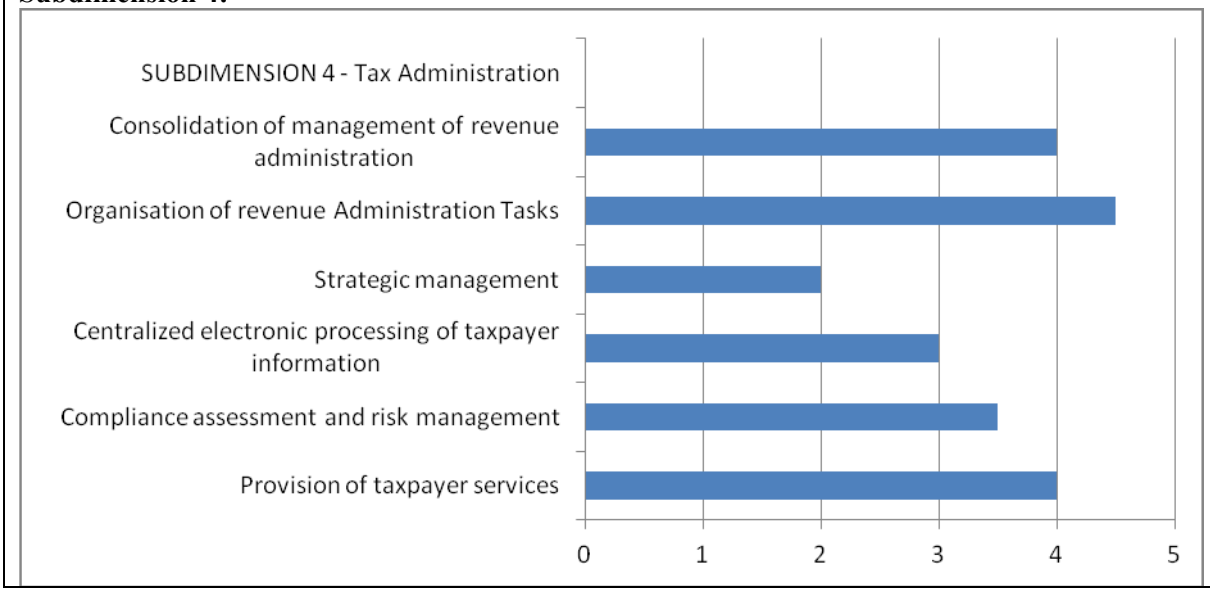


INTRODUCTION

Tax reform is an ongoing process, with tax policy makers and tax administrators continually adapting tax systems to changing economic, social, and political circumstances. In this process, tax reformers worldwide find themselves working towards competing goals. While tax revenues provide governments in most countries with essential funding to meet their social (education, health, social security) and infrastructure needs, they also affect economic decisions in areas like investment, production, labour supply and demand, and savings. Recognising these challenges, most structural tax reforms in recent decades have tried to foster a more competitive fiscal environment: one which encourages investment, risk-taking, and entrepreneurship, and provides increased incentives to work, while broadening the tax base by, for example, discouraging non-compliance (tax avoidance and evasion).

Tax Policy Reform Highlights

In the MENA region, Egypt leads the recent tax reform trend.[2] It actually began reforming its taxation system in the 1990s before making more far-reaching changes in 2004. Like other countries that have undertaken income tax reform over the last two decades,[3] it introduced a base-broadening cut of income tax rates in 2004 in order to improve efficiency while maintaining tax revenues. Soon after Minister of Finance Boutros-Ghali's new cabinet took office in July of that year, it began reforming income tax. In June 2005 Parliament approved Law 91/2005, which became effective in July 2005 for personal income tax and in January 2006 for corporate income taxation.

Income tax reform in Egypt in 2004-5 modernised the legislative framework governing corporate and personal income taxes.[4]

Main changes to corporate income tax:

- legislation simplified by consolidating all income tax legislation into one law;
- the basic statutory corporate income tax rate reduced from 32% (or 40%, depending on activity) to 20%;
- the corporate tax base broadened by eliminating numerous provisions for special tax treatment and introducing worldwide income taxation for residents;
- specific rules incorporated into the calculation of asset depreciation in the new law, thereby increasing transparency and reducing the discretionary powers of tax officials over allowable depreciation claims;
- withholding tax on interest and royalties reduced from 32% to 20%;
- the concept of permanent establishment introduced to improve the certainty of tax rules governing foreign companies;
- anti-avoidance regulations, including thin capitalisation and transfer pricing rules, were introduced.

Main changes in personal income tax:

- income tax brackets restructured into three categories;
- the top marginal tax rate reduced from 32% to 20%;
- a personal annual allowance independent of social status and/or gender was introduced to the tax system fairer;

- the personal tax base broadened by introducing residence-based taxation with foreign tax credits.

Tax Administration Achievements

Given that there can be no effective tax policy reform without also reforming tax administration, Egypt's 2004-5 reforms sought to make tax administration more modern, transparent, efficient, and fair. The most important improvements included:

- making the Egyptian revenue authorities more efficient and effective by integrating the Income and Sales Tax Departments into a single unified Egyptian Tax Authority;
- replacing administrative assessment with self-assessment, which helps to improve taxpayers' trust in the system and, by the same token, to build a taxpayer culture and reduce administrative costs;
- upgrading taxpayer services, *e.g.* by streamlining appeal procedures; establishing the Large Taxpayers Unit;[5] improving such Web-based services as electronic filing, tax returns, *and* guidelines; and strengthening other provisions, such as a toll-free call centre and taxpayers' education services (*e.g.* seminars organised jointly with chambers of commerce and awareness campaigns in the media);
- strengthening enforcement by: 1) random audit systems, which help reduce administrative costs *and* strengthen taxpayer trust in a system based on self-compliance; 2) stiffer penalties f*or non*-compliance and making accountants liable for tax information provided to the authorities;
- adopting Egyptian accounting standards a*nd training* tax inspectors in these accounting – and auditing – standards.

Egypt's tax reform efforts have, without doubt, helped to improve its economic performance. Its annual GDP growth rate increased by 2.3 percentage points (ppts) in 2005-6 relative to 2004-5. The investment ratio (expressed as a percentage of GDP) increased by 4.3 ppts between 2007-8 and 2004-5, and foreign direct investment (FDI) by 3.7 ppts over the same period. The increase in tax revenues of 1.7 ppts between 2005-6 and 2004-5,[6] coupled with a successfully implemented fiscal consolidation programme, also contributed to an improved fiscal position, reflected in the reduction of the overall (negative) fiscal balance from a peak of 9.6% in 2004-5 to 6.8% in 2007-8.

Table 1: Selected economic and fiscal indicators in Egypt[†]

	2003-4	2004-5	2005-6	2006-7	2007-8	*2008-9**	*2009-10**
Real GDP (annual % change)	4.1	4.5	6.8	7.1	7.2	*3.6*	*3.0*
Investment	16.9	18	18.7	20.9	22.3		
FDI	0.5	4.4	5.7	8.5	8.1		
Tax Revenues		14.1	15.8	15.3	15.3	*16.0*	*12.3*
Overall fiscal balance	-9.4	-9.6	-8.2	-7.3	-6.8	*-8.0*	*-8.4*
Primary balance	-3.1	-3.5	-2.2	-0.9	-1.2	*2.9*	*2.4*

Source: Egyptian Ministry of Finance, IMF World Economic Outlook (April 2009).

Tax Reform Challenges

Given the complexity of tax systems and their twin competing goals (an acceptable tax burden vs. maximum revenues and minimum administration and compliance costs),[7] policy makers are encouraged to

[†] Data as percentage of GDP unless indicated otherwise. Asterisks (*) denotes projections.

carefully weigh the pros and cons of alternative tax policy design and implementation reform options. Reflecting this need, many OECD and non-OECD countries have made considerable progress in recent years in strengthening their analysis capacity in order to design and implement more informed tax policies. They have modernised their tax administration systems and practices and implemented basic policy tools (models) which they view as central to guiding their tax policies.

In Egypt, Article 139 of Law 91/2005 also reflected an effort to move towards more informed tax policy making by stipulating that a higher council for taxes should be formed to study the tax capacity of corporations. The council is seen as a way of strengthening the analytical capacity of the Ministry of Finance, whose responsibilities include contributing to the analysis of alternative policy options. However, the immediate overriding priorities of the 2004 reform were to improve tax legislation and administration, leaving tax policy development for a second phase. Although this higher tax council has not yet been formed, Egyptian senior officials have confirmed that there are plans to create it by 2010.

The twin goal of developing an analytical capacity and continuing to modernise tax administration is a need that needs to be addressed to help overcome the current and future challenges of Egypt in the field of tax reform. Following the 2004-5 reform, the top priorities on the current Ministry of Finance's reform agenda (also contained in the 2008-9 budget) are to:

- reform the current system of sales tax by replacing it with VAT;
- introduce required adjustments to Income Tax Law 91/2005 in order to close loopholes and strengthen anti-avoidance provisions;
- incorporate adjustments to Law 139/2006 regarding government accounting;
- move forward in restructuring tax administration functions around "taxpayer segments" by establishing a medium and small taxpayers unit.

However, the global economic turbulence of recent years – particularly rises in world food and energy prices and the global financial turmoil that unfolded in 2008 – have increased the challenges ahead. The fiscal stimulus packages introduced by the Egyptian government in response to the financial and economic downturn place significant pressure on the budget by increasing expenditure programmes at the same time as tax receipts are declining.[8]

The OECD Business Climate Development Strategy

The tax component of the OECD *Business Climate Development Strategy* (BCDS)[9] aims to help identify areas where Egypt's capacity for tax policy analysis could be enhanced and where Egyptian tax administration could be further modernised. It recognises both the sovereignty of tax policy and the fact that sound tax policy development rests on information and its analysis – assessing data like revenue, economic efficiency, equity, and the compliance and administration cost implications of alternative tax policy options. Moreover, if tax policy reform is to be successful, it must be go hand-in-glove with administrative reform.[10]

The BCDS tax assessment framework examines the scope of tax analysis and assessment carried out by policy and administration officials in key areas, while also examining progress in tax administration reform. Specifically, this approach looks at the underlying data and tax models currently used and the steps being taken towards modernising tax administration. Upgraded tax data collection and management practices will help make revenue collection more efficient while easing taxpayer compliance costs and generally improving taxpayer services. Available tax data and models determine to a large extent a government's overall capacity to conduct economic analyses of tax policy options and may also contribute to the success of a particular tax reform. Such economic analysis includes, for example, the ability to

understand how different taxes contribute to total tax revenue (the tax mix) and to estimate how tax revenues are likely to change when rates, or other parameters, change. It also involves assessing possible "winners" and "losers" – in terms of tax paid – under changes being considered and considering whether a package of measures might be possible or desirable for delivering a balanced outcome (which would help to anticipate levels of taxpayer support, essential for a successful – politically popular – tax reform).

In addition, when certain findings produced by economic analysis are communicated properly and in a timely manner, they can help ease uncertainty over a given tax reform and thus facilitate its political and social support and implementation.

Tax Policy Unit

It is recognised that setting up and running a tax policy analysis unit requires substantial investment – for gathering, cleaning, monitoring, and updating data; developing frameworks for analysis; and training officials. However, such investment may well be worthwhile if it yields such benefits as achieving a fairer, simpler, more transparent tax system; minimising compliance and administrative costs; maximising tax revenues; and facilitating the implementation of tax reforms.

A tax policy unit would play an increasing role in guiding tax policy development to support medium- and long-term growth. In particular, it would enable Egypt to:

- expand frameworks to assess tax revenues; tax mixes and effective rates of taxation on labour, capital, and consumption; the effects of taxation on risk taking, financing, and growth;
- compare its domestic tax burden measures meaningfully with those in other MENA (and non-MENA) countries, using consistently applied methodologies;
- undertake tax policy analysis, draft reports for senior tax officials and ministers, and engage in dialogue on tax policy analysis, development and experience with analysts in other MENA countries (*e.g.* through MENA-OECD Working Group 3 meetings on tax policy analysis).

Modern, Efficient, Effective Tax Administration

Revenue authorities (both managerial and operational) require modern, flexible structures for more efficient, effective tax administration. An efficient, effective tax administration system is one that ensures compliance by minimising the use of resources through a balance of reliable taxpayer services and education, and targeted audit and enforcement activities. Ensuring compliance is important because non-compliance inhibits economic development by:

- constraining the amount of tax revenue for funding infrastructure projects, education and other programmes central to building attractive host country conditions;
- requiring increased tax rates on the income, property, and transactions of taxpayers in the formal economy, so leading to higher efficiency losses than would be observed under a broader tax base through increased compliance;
- limiting the growth prospects of "underground" firms, *e.g.* by restricting output (export) markets and the range of potential sources of finance.
- The significant efforts undertaken by Egypt to modern*ise and impr*ove the efficiency and effectiveness of its tax administration system are reflected in the relatively high BCDS scores achieved by Egypt in the Tax Administration Sub-Dimension (see Table 6).

A well integrated revenue administration management structure may reduce taxpayer compliance costs (*e.g.* by reducing the number of collection bodies that taxpayers have to deal with) and government administration costs (*e.g.* by effectively, efficiently co-ordinating compliance measures across taxpayers).

The first step in consolidating the management structure of the Egyptian revenue administration was to integrate the Income and Sales Tax Departments into a single unified Egyptian Tax Authority in 2006. The ultimate aim is to move Egyptian tax administration towards a more "client-oriented" approach in order to improve overall compliance levels by grouping key functional activities (*e.g.* registration, accounting, information processing, auditing, collection, appeal procedures) within a unified, dedicated management structure. This restructuring began by establishing a Large Taxpayer Centre in 2005. The next phase currently includes a plan for a Small and Medium Taxpayers Centre.[11]

The introduction of self-assessment and random audit systems as part of the 2004-5 tax reform contributed to strengthening trust between taxpayers and revenue authorities as well as to improving the compliance strategy of Egypt's tax administrators and reducing administrative costs. This compliance-based system of self-assessment was reinforced by an impressive improvement in taxpayer services, such as providing access to information and supporting documentation and offering assistance to help taxpayers understand and comply with the tax system. The webpages of the Large Taxpayer Centre and the Sales Tax Authority illustrate the progress made in taxpayer service provisions. The pages contain information on registration, legislation, and regulations and offer guides (including one on taxpayers' rights and duties), forms (*e.g.* registration forms, tax invoices, tax returns), an electronic filing option, and information on tax refunds and appeals.

Why the Tax Dimension is Relevant to Direct Investment

Taxation affects economic development because it influences investment decisions at many levels: it influences the size of the investment (whether or not to invest and how much) and location (where to invest), as well as those decisions involving expenditure in plant, property and equipment, employment, and skills (human capital).

It is widely agreed that a host country with a tax burden that is very high relative to its other advantages (political and macroeconomic stability, access to markets, and cost savings derived from public programmes in support of business) and higher than in competing locations may discourage investment,[12] particularly where location-specific profit opportunities are limited and profit margins are narrow.[13] While statutory tax provisions are clearly important, policy makers are also encouraged to consider the business compliance costs[14] associated with a tax system's levels of transparency, complexity, and stability. Although such costs are difficult to measure, they can nevertheless impede investment.

A poorly designed tax system[15] may discourage capital investment if its rules and the way in which they are applied are not transparent, or if they are overly complex, or unpredictable, so adding to project costs and uncertainty over net profitability. Systems that leave the assignment of tax relief to the discretion of officials tend to invite corruption and undermine good governance objectives fundamental to securing an attractive investment environment. Policy makers are therefore encouraged to ensure that their tax system delivers a tax burden that is acceptable to businesses and can be easily determined, keeps tax compliance and tax administration costs in check, and help to diminish rather than add to project risk.

Taxation also affects investment indirectly in that it determines the tax revenues (an important, if not main, source of funding for government expenditure)[16] available for funding a country's infrastructure (*e.g.* roads, airports, seaports), the skills profile and strength of the workforce, public governance, and other aspects of the investment environment identified by investors as key considerations in choosing a host country.

A central challenge for policy makers endeavouring to encourage domestic and foreign direct investment with limited financial resources is to assess the tax policy that best provides an attractive system while raising revenues to support the development of infrastructure and other factors that make an environment attractive to direct investment. In achieving these goals, sound tax policy and clearly drafted legislation are not enough to ensure an attractive investment environment. Governments must ensure consistent, transparent implementation of tax policy and legislation through efficient, effective tax administration.

Box 1. Tax policy and economic development

Some of the key linkages between tax policy and development may be highlighted as follows:

- *Employment.* Tax policy affects labour supply and labour demand decisions. Labour supply (that is, the decision by households or individuals to join the labour market) is influenced by aspects of the personal income tax (PIT) system such as marginal PIT rates, thresholds, and earned income tax credits. Also affecting labour supply is the way a social security contribution (SSC) system (employee SSC rates, thresholds, etc.) bears on wages and salaries. The demand for labour is also affected by the impact of SSC systems on labour costs and by the effect of tax on investment.
- *Investment in education and training* (post-secondary education, skills upgrading, etc.). Tax is relevant by influencing the benefits of (returns on) investment in education and training, with PIT and SSC contributions rising or falling with employment tax credits and the magnitude of wage income. Tax also influences the costs of investment incurred by firms (*e.g.* where they are provided with special tax breaks to help defray the cost of training) and/or individuals (*e.g.* tax relief for education expenses).
- *Investment by firms in tangible and intangible assets.* Taxation alters the after-tax rate of return on investment by influencing after-tax revenues, net acquisition costs of assets, and costs of equity and debt finance – all of which can directly affect investment.
- *Access to intangible assets through purchase or license agreements*. Rather than investing in R&D to develop intangible assets, influenced by the availability (or not) of special tax deductions and/or tax credits for R&D, a firm may purchase intangible assets from others, or acquire the rights to use such assets. Taxation influences the optimal amount of intangible capital that may be held, as well as the relative attractiveness of and reliance on alternative means of acquiring such capital (with possible implications for the scale of "spillover" effects on the domestic economy).

Tax policy also plays a role in determining whether economic development is sustainable:

- *Income distribution effects*. Income distribution is affected by tax policy, *e.g.* progressive versus flat PIT rates, basic allowances, and some forms of tax credits. As sustainable economic development places constraints on inequality in income distribution, tax policy may hinder or help underpin support for a growth agenda.
- *Environmental effects*. Tax policy may be used as a market-based instrument to address issues of environmental degradation (*e.g.* so-called "green" taxes). Market-based instruments (environmental taxes, tradable permits) are now widely recognised as more efficient than regulatory approaches in addressing such certain environmental concerns as global warming.
- *Budget effects*. Tax policy – which encompasses the tax treatment of investment, employment, transactions, assets, etc. – also has budgetary consequences because it influences the amount of tax revenue available to fund public expenditure on infrastructure and other programmes identified by investors as of critical importance in shaping the investment environment.

THE TAX POLICY AND ADMINISTRATION ASSESSMENT FRAMEWORK

At the heart of the BCDS tax assessment framework lies the recognition that tax policy is sovereign. At the same time, however, there is also the recognition that sound tax policy development rests on information and the analysis of such parameters as revenue, economic efficiency, equity, and the compliance and administration cost implications of alternative policy options. Moreover, successful reform requires improvements to both tax policy and administration.

The aim of the tax component of the BCDS is to roughly measure the progress the Egyptian Ministry of Finance has made to date in developing a tax policy and modernising tax administration. This section focuses on progress made in two areas:

- the implementation of analytical frameworks for assessing the impact of reforms on tax revenues and the tax treatment of investment and labour;
- revenue collection efficiency, together with lower taxpayer compliance costs and a general improvement in taxpayer services.

Given the complexities of taxation, tax policy development requires certain key items of information, data, and analyses as a basis for assessment. Informed policy making requires, at a basic level, information on the contribution of different taxes to total tax revenue, and estimates of how total revenues are likely to change when tax rates or other parameters in the tax system change. Moreover, a given tax reform will affect different taxpayers in different ways. To determine whether a proposed tax reform is politically feasible, policy makers need to be able to identify the taxpayer groups that will be worse off (*i.e.* bear a higher tax burden) under a given tax reform and those who are likely to benefit (pay less taxes). Distributional assessments of different packages of reform proposals allow ministers to consider whether it they could incorporate sets of measures to create a more balanced and acceptable outcome.

Other key questions are how tax policy affects the cost of funds, risk-taking, and labour supply and demand, given the interest in adopting a pro-growth tax strategy. It is also important to assess the degree to which the costs of complying with a tax system (*i.e.* completing and filing tax returns) add to the overall tax burden and thereby discourage entrepreneurs from starting up businesses and firms from operating in the formal tax-paying economy. At the same time, policy makers are encouraged to consider whether the tax system encourages aggressive tax planning that may threaten the tax base (*e.g.* allocating profits to low-tax jurisdictions using tax-motivated holding and financing structures and non-arm's length pricing in related party transactions).

In addition to examining the scope of analysis carried out by tax policy officials in key areas, the BCDS tax assessment framework probes underlying data and tax models currently used and which, to a large extent, determine a government's overall economic analysis capacity. Assessments of capacity in the tax policy area recognise the advantages of transparent modelling approaches and the use of macro- and taxpayer level micro-data that are subject to quality checks. Positive recognition is given to efforts by countries to develop micro-data bases (which requires a significant allocation of resources) where none are in place or operational. The centralised electronic processing of taxpayer information plays an important role in developing micro-data bases.

Centralised systems of taxpayer data collection and collection assessment are also key to efficient tax administration. Such systems allow information to be matched and exchanged, which considerably decreases administrative costs. They also reduce compliance costs and the discretionary powers of tax officials in implementing tax systems, so reducing corruption and enhancing good governance.

Another aspect of tax administration considered in the tax component of the BCDS is compliance risk management. The main role of a country's tax administrators is to ensure compliance efficiently and effectively. Managing compliance risk solely through an enforcement strategy has proved neither effective nor efficient. Efficient tax administration should optimise collection while sustaining taxpayers' confidence in the authorities and a properly functioning tax system. Self-assessment regimes combined with compliance risk management are an example of the kind of strategy that helps to build taxpayer's trust.

The main findings from the areas of inquiry outlined above, based on questionnaire responses provided by Egypt and follow-up interviews with policy officials, will be used to help identify areas where analytics and capacity could be enhanced through technical training. One avenue of progress could be for Egyptian tax officials to be invited to participate in tax policy seminars, tax modelling workshops, auditing workshops, and other technical assistance events organised by the OECD Centre for Tax Policy and Administration through its outreach programme within and outside the MENA region.

The range of topics addressed under the BCDS tax component is broad, given the need to balance competing considerations when establishing policy and administrative measures in support of investment, employment, and economic development. The assessment framework has four sub-dimensions:

- 1. Fiscal Position and Planning

  Examines Egyptian practices in preparing short- and medium-term forecasts of tax revenues and drawing up fiscal policy plans.

- 2. Taxation, Investment, and Employment

  Addresses Egyptian practices in assessing the corporate tax burden of firms across the main sectors of the economy and the labour tax burden across different household structures. It also considers the extent to which Egypt has implemented tax expenditure reporting in order to shed light on tax incentive programmes.

- 3. Taxation of SMEs and MNEs

  Evaluates Egyptian practices in assessing issues relevant to SMEs and MNEs, such as how tax policy impacts the cost of funds for investment, incentives for tax-arbitrage behaviour, and compliance costs, and the extent to which the tax system encourages aggressive tax planning.

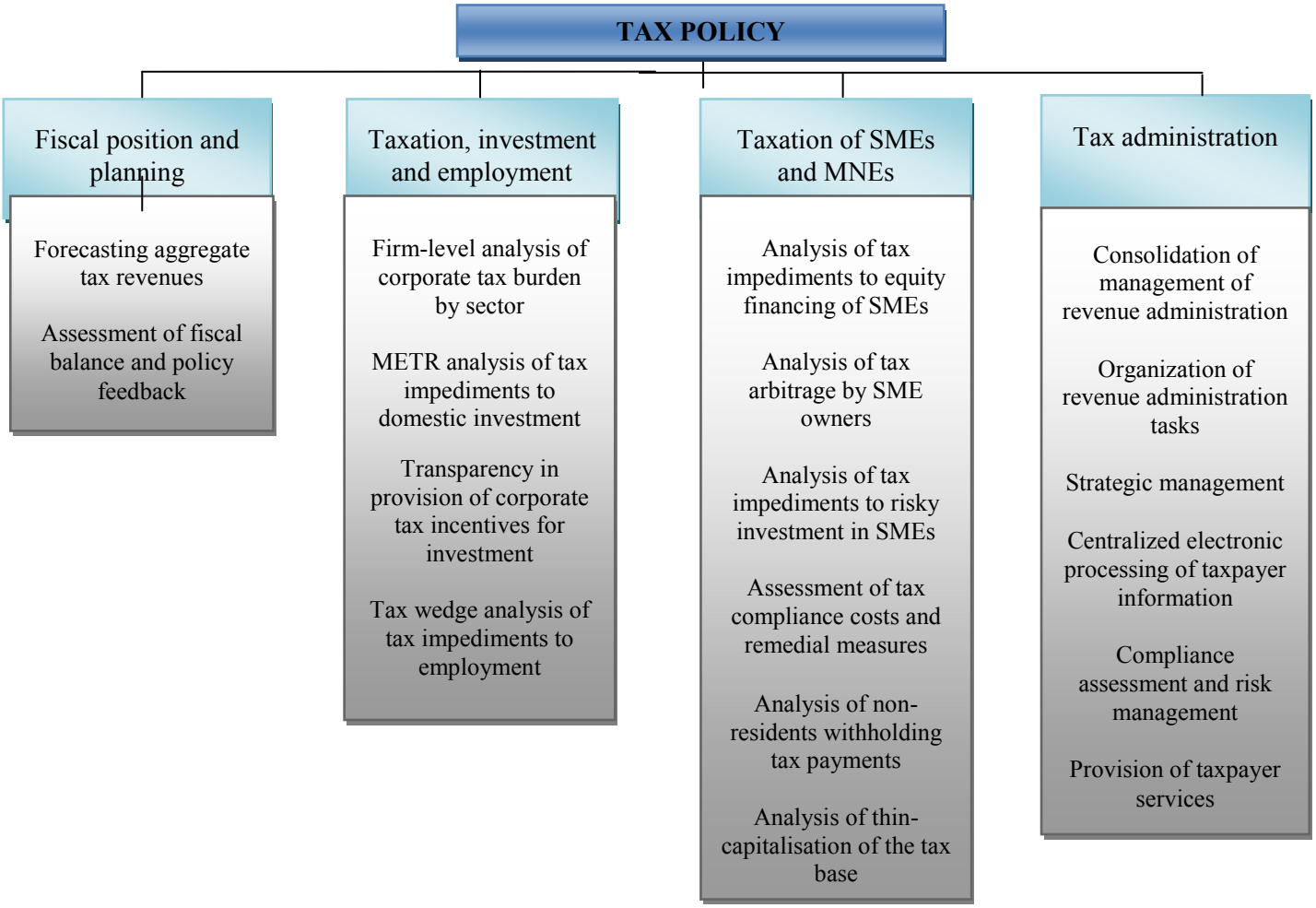
- 4. Tax Administration

  Assesses Egypt's efforts to modernise, simplify, and make its tax administration system efficient, effective, stable, and transparent.

This section discusses in detail the areas of taxation covered by the BCDS tax component (see below, Figure 1). Through guidance in these areas, the tax component of the BCDS provides a framework to support policy development and the modernisation of tax administration with regard to OECD and non-OECD country practices. The tax component is made up of three sub-dimensions, which in turn comprise indicators. Each indicator is assessed against the benchmark of OECD and non-OECD "good practices" and the country is given a score. Brief policy recommendations are then made.

It should be noted that this tax assessment framework has been developed for both developed and developing countries and that not even the most advanced economies will score the top mark of five in all indicators, particularly those relating to tax policy.

Figure 1. Structure of the tax component of the BCDS



Sub-Dimension 3.1.: Fiscal Position and Planning

Indicators under Sub-Dimension 3.1, "Fiscal Position and Planning", address Egyptian practices in preparing short- and medium-term forecasts of tax (and non-tax) revenues and in drawing up fiscal policy plans. These plans may be subject to revision as tax bases and corresponding revenue estimates and expenditure plans are reconsidered and reconciled.

Table 2. Sub-Dimension Fiscal Position and Planning indicators and scores

3.1. Fiscal position and planning	
3.1.1. Forecasting aggregate tax revenues	5
3.1.2. Assessment of fiscal balance and policy feedback	5

3.1.1. Forecasting Aggregate Tax Revenues

Aggregate (GDP-based) tax revenue forecasting models are important for estimating future tax revenues and, therefore, for informed tax and non-tax revenue and public expenditure policy making.[17] The "forecasting aggregate tax revenues indicator" considers whether the Ministry of Finance maintains an aggregate (GDP-based) tax revenue forecasting model for each main tax – defined as a tax that contributes 5% or more of total tax revenues.

Since fiscal year 2005-6, the Egyptian Ministry of Finance (MoF) has maintained aggregate tax revenue forecasting models for each main tax. Since 2005, the development and updating of forecasting models has been the responsibility of the Macro-Fiscal Policy Unit.

Annual government finance statistics are consistent with international standards (based on IMF GFSM 2001) and reported for publication in the *Government Finance Statistics* (GFS) yearbook. Quarterly data on the budgetary central government are reported for publication in *International Financial Statistics*. Under this system, the budget is guided in the medium term by macroeconomic and financial objectives and constraints.

In 2009 the Egyptian MoF received technical assistance from the IMF in managing its budget, debt, statistics, and public expenditure. However, according to the IMF, Egypt's economic and financial statistics continue to be weak in their timeliness, coverage, and reporting. In particular, the consolidation of general government operations (its budget sector, the National Investment Bank, and social insurance funds) under this GFS classification is incomplete for "below-the-line" transactions. Problems related to national accounts data have also been identified. Annual and quarterly national accounts data are based on the 1993 System of National Accounts (SNA 1993). However, there are still inconsistencies within data sets (between quarterly and annual GDP estimates), over time (changes in the base year which do not overlap with the previous year), and with balance-of-payment statistics.

As stated above, statistics are a key analytical tool, and in the case of Egypt they are particularly important for restructuring the country's public finances to support fiscal consolidation. Additional revenues (*e.g.* from VAT) are needed to improve Egypt's public finances and to finance its longer-term structural fiscal reforms.

3.1.2. Assessment of Fiscal Balance and Policy Feedback

Prudent fiscal policy management involves not only forecasting tax revenues, but also maintaining short- and medium-term fiscal policy plans that identify current and future anticipated revenues and public expenditures. "Assessment of fiscal balance and policy feedback" is an indicator that looks into whether

countries regularly estimate revenue collection and public expenditures, and whether planned public expenditures consider these estimates and overall fiscal balance. A top score is achieved when: (a) expenditure items are classified by type and prioritised on the basis of policy objectives, with budget allocations addressing priority expenditures; and (b) the formal or informal rules in place require the government to adjust expenditure and/or tax design where the fiscal balance is negative and exceeds some fixed percentage of GDP.

The Egyptian Ministry of Finance regularly (at least every quarter) monitors tax revenue collection and public expenditures. Estimates of planned public expenditure are routinely considered and decided alongside estimates of total tax revenues, aggregate non-tax revenues, overall fiscal balance (current and forecast years), primary balance, and debt as percentage of GDP.[18]

The draft law to amend some articles in the Governmental Accounting Law No. 127 of 1981 is currently under revision. It will create a single treasury account that will unify all government account resources in a single account at the Central Bank of Egypt and enable the MoF to manage public funds effectively and lessen the burden on servicing the public debt.

Law No. 87 of 2005 was issued to amend some articles in the State Budget Law No. 53 of 1973 so as to guarantee that new chapters in the state budget are prepared in accordance with international standards of transparency and clarity.

Box 2. Relevant models and data for monitoring revenue collection and public expenditures

Relevant models and data for developing short- and medium-term fiscal policy plans include the following:[19]

- GDP-based tax revenue estimation models (for each main tax);[20]
- historical tax revenue data;
- national accounts income, expenditure, and balance of payments data (historical data);[21]
- non-tax revenue data (current year, forecast years);
- public expenditure data, grouped by function (current year, forecast years).

The classification used in the 2008-9 budget distinguishes between economic, administrative, and functional classifications. There is a clear distinction between revenues, expenditures and financing transactions, as well as between transfers and exchange transactions. Regarding expenditures, the main policy objective of the government is social justice, defined as improving citizens' standard of living, providing them with basic needs, and ensuring that all benefit from economic development. Expenditures in health, education, housing, utilities and public transport consistent with international standards are therefore prioritised, particularly education and health. The fiscal policy stance is monitored on the basis of the country's cash surplus/deficit and overall fiscal balance.

Since July 2004, Egypt has undertaken public expenditure reviews in four sectors: education, health, water, and transport. This move was closely related to work designed to improve budget classifications, budget execution, accounting and reporting, banking and payment arrangements, and the legal framework for budgeting. In 2005 Egypt took steps to establish a framework for developing performance-based management and budgeting in education and health (as a starting point), and for piloting the development of indicators and other performance data used in selected countries.

There is no evidence as to whether formal rather than informal rules are used to adjust government expenditure and/or tax design where the fiscal balance is negative and exceeds some fixed percentage of GDP. However, the 2008-9 budget stated that Egypt had delivered a stable environment for economic activity in the previous three years by controlling the budget deficit and reducing its ratio to GDP. In addition, the government announced a voluntary commitment to gradually reducing the budget deficit to around 3% of GDP over the medium term as part of its fiscal and debt consolidation strategy. The budget law also includes the following two general rules:

- during budget preparation contingency reserves should not exceed 5% of "total uses excluding interest payments";
- during budget execution: (a) expenditure appropriations may exceed budget provisions in special circumstances subject to parliamentary approval, (b) expenditure may exceed budget provisions if equivalent revenues can be raised in order to maintain the debt-to-GDP ratio.

However, the IMF reported high levels of fiscal deficit and public debt in January 2009, short-maturity debt, and the need for a back-loaded adjustment effort to meet the revised fiscal deficit targets. Until recently, these challenges were manageable given the authorities' good record on reform and fiscal consolidation – the overall fiscal deficit was on a downward trend from a peak of 9.6% in 2004-5 to 6.8% in 2007-8. However, the current global economic crisis has reversed the downward trend of the overall fiscal deficit.

Where fiscal balance is negative, as in Egypt, special consideration should be given to adjusting the tax mix and taxation levels and to restricting low-ranked public expenditures.[22] This requires assessing actual and target levels as well as rates of company taxation, which includes corporate tax and personal tax on the business income of the self-employed. These assessments should be made alongside assessments of actual and targeted reliance on other taxes.[23]

Estimates of actual and target tax revenues from business income and their effective corresponding tax rates may be based on aggregate data, on company-level micro-data, or on both. As considered in indicator 3.2.1 ("firm-level analysis of corporate tax burden by sector"), Egypt is encouraged to develop company-level micro-data databases, due to difficulties of estimation and interpretation when aggregate data alone is used.

Sub-Dimension 3.2.: Taxation, Investment and Employment

The revenue estimation models described above in Sub-Dimension 3.1 can deliver estimates of the aggregate revenue impact of certain broad-based tax reforms. However, they are generally not capable of yielding information on how a given tax reform will affect different taxpayers (distributional impact). Indicators under the "taxation, investment and employment" sub-dimension address Egyptian practices in assessing the corporate tax burden of firms across the main economic sectors and the tax burden on labour across different household structures. The indicators explore models used by OECD and non-OECD countries. They include micro-simulation models that draw on taxpayer-level data and models for assessing effective tax rates on investment and employment. The indicators also consider the extent to which Egypt has implemented tax expenditure reporting to throw light on tax incentive programmes and revenues forgone.

Table 3. Sub-Dimension Taxation, Investment and Employment indicators and scores

3.2. Taxation, investment, and employment	
3.2.1. Firm-level analysis of corporate tax burden by sector	2
3.2.2. METR analysis of tax impediments to domestic investment	1
3.2.3. Transparency in provision of corporate tax incentives	1
3.2.4. Tax wedge analysis of tax impediments to employment	1

3.2.1. Firm-Level Analysis of Corporate Tax Burden by Sector

Policy makers often need to be able to identify the taxpayer groups that a proposed reform penalises and those that it benefits in order to determine whether the reform is politically feasible. Many OECD and transition countries implement micro-simulation models, so called because they rely on taxpayer-level micro-data.[24] They enable tax policy officials to:[25]

- Estimate the distributional effects of tax reform. By assessing which taxpayer groups are negatively or positively affected by a tax reform, policy makers may consider how to address the distributional effects, *e.g.* by introducing or adjusting other tax parameters that may provide a more balanced outcome across taxpayers.[26]
- Generate forecasts and estimates of current and future tax revenues which can be considered alongside public expenditure forecasts. Such comparisons are important for managing the government's fisc*al positi*on, and particularly for effectively monitoring corporate income tax (CIT) revenues foregone by tax incentives for investment.[27]
- Improve the accuracy of revenue forecasts, thus limiting the need for subsequent policy adjustments when tax and/or other policy reforms have larger (or smaller) than anticipated impacts on government revenue.

"Firm-level analysis of corporate tax burden by sector" is an indicator that measures the extent to which Egypt has implemented and maintains a CIT micro-simulation model, with input data drawn from a *stratifie*d sample of CIT returns.[28] The indicator also considers whether the model is used regularly to analyse total and sector-based CIT revenues, CIT revenues forgone by tax incentives, and average corporate tax rates by industry and location, and to evaluate the revenue impact of alternative proposals for reforming the corporate income tax system.

Egypt's Ministry of Finance probably maintains a model based on aggregate revenue data. It is also taking steps to implement a CIT micro-simulation model, although it has defined no framework. Developing and implementing such models can be complicated and requires specific technical skills and data collection, capacities that the MoF is currently trying to develop. Indeed, Article 139 of Income Tax

Law No. 91, passed in 2008, stipulate the formation of the Higher Council for Taxes to study the tax capacity of corporations. The council is seen as the Ministry of Finance's analytical capacity unit, developing, maintaining, and contributing to the analysis of well informed alternative policy options. Nevertheless, the council has not yet been formed, although government official have confirmed that there are currently plans to create it in 2010.

Key steps in establishing a micro-data base include: working with tax administration officials responsible for the design of tax returns to ensure that the basic data required for tax calculations and simulations are reported by taxpayers; application of sampling[29] procedures to obtain a representative stratified sample of taxpayers that can be used to estimate tax revenues and study the implications of tax policy reforms; and transcription of tax return data into electronic databases.[30]

3.2.2. METR Analysis of Tax Impediments to Domestic Investment

Micro-simulation models are often supplemented by marginal effective tax rate (METR) analyses.[31] As opposed to micro-simulation models, which rely on historical data (taxes actually paid) to estimate the impact of tax reforms, METR analyses are forward-looking. Using only tax parameters (*e.g.* statutory tax rates, tax depreciation rates, investment tax credit rate) and capital and finance weight data,[32] they help policy makers to assess whether the tax system encourages or discourages business investment and whether tax reform increases or eases tax distortion. METR models facilitate policy analysis and assessment of tax reform options by providing summary indicators of the likely net impact of corporate and personal taxation on investment, which is often not easy to determine when a reform includes provisions that both encourage investment (*e.g.* reduction in the tax rate on profits) and discourage it (*e.g.* reduced capital cost allowances).

METR analyses are vital for identifying investments which might benefit from a particularly low or high effective tax rate and, more generally, for delivering broad qualitative findings on the consequent long-term distorting effects of taxation on investment behaviour.[33] Micro-simulation models are often incapable of picking up such distortions – high effective tax rates in particular can often distort economic activity to the extent that a certain type of investment is not actually represented in the economy and thus not identifiable from taxpayer level data. METR models, however, are not limited by the types of firms already represented in the economy – they can simulate the impact of various reforms across an entire range of investment types.

As METR frameworks provide limited scope for accurate revenue forecasting, they are often most effective as a complement to micro-simulation modelling. When used together, they produce a powerful tool for predicting the net impact of tax reform on revenues and investment decisions of firms.

Box 3. Effective tax rate (METR) analysis of investment (tax distortions, impediments)

In virtually all market-based countries, the integration of national economies forces policy makers to critically re-examine their tax systems and assess likely impacts on investment. Arguably, the framework most widely used by tax policy economists to assess the net effect of tax systems on investment behaviour is the forward-looking marginal effective tax rate (METR) model. A METR model calculates "wedges" that tax systems drive between pre-tax rates and after-tax rates of return on investment at the margin – *i.e.* on the last currency unit of capital invested, where the marginal benefit just covers the marginal cost. METR statistics may be generated for various capital asset types (machinery, equipment, buildings and inventories), investor types, sources of finance, and at various levels of disaggregation.

The METR framework is highly attractive in that it provides a summary indicator of the net effect of taxation on a given investment type, factoring in (often numerous) key tax parameters – some tending to discourage investment, others to encourage it – such as statutory corporate tax rate(s). METR models also incorporates factors that influencing the tax base, like depreciation allowances, as well as investment tax credits, capital tax (if applicable) and sales tax (including non-recoverable VAT) on capital inputs. They may also factor in personal taxes where relevant

(investment in micro-enterprises which relies on local financing), and where shareholder dividend tax rates and capital gains tax rates (if applicable) may influence minimum required "hurdle" rates of return on investment. Indeed, a main attractive feature of the METR modelling framework is its ability to produce summary indicators that incorporate the net effect of a variety of (complex) tax parameters and their interactions. Moreover, METR analysis may be extended to consider cross-border as well as domestic investment.[34] When used together with elasticity estimates of the sensitivity of investment to taxation, the framework can be used to estimate the percentage change in domestic investment and FDI in response to one or more tax policy adjustments.

To those not familiar with the neo-classical model of firm behaviour from which METR statistics are developed, the interpretation and use of such statistics may not be readily apparent. Indeed, too often studies using this form of tax rate analysis tend to obscure rather than clarify the underlying assumptions and model structure. However materials have been developed by the OECD to explain METR analysis in a step-by-step, user-friendly fashion in order to shed light on the basic concepts and address the "black box" reputation of such measures. The technical analysis is supplemented by a review of key underlying assumptions and data limitations, to be kept in mind when interpreting METR results.

The METR analysis indicator assesses Egypt on its implementation of a METR model that would enable summary analysis of the effect of tax on the scale of investment. A top score is achieved where the model is disaggregated across asset types and where METR results are explained in summary reports for consideration by ministers for more informed policy making. Currently the Ministry of Finance does not use the METR model, although it probably maintains a model based on aggregate revenue data to calculate effective rates. However, it is likely that steps towards the implementation of a METR model will be taken under the umbrella of the Higher Council for Taxes once it is in place.

3.2.3. Transparency in Provision of Corporate Tax Incentives for Investment

Investors generally prefer host countries that apply tax rates to a broadly defined profit base, rather than a high-rate, narrow-base approach to levying corporate tax. At the same time, special incentives may play an important role in certain cases. Where tax incentives for investment are used, care must be taken to choose incentive types and design features that are less likely than others to result in non-targeted activities unintentionally losing excessive revenue.

Balancing revenue losses from additional tax relief against limited additional investment resulting from that relief is an important consideration where taxation is an important, but not decisive, factor in investment location decisions, and where companies can manage a modest host country tax burden. This recognises that tax relief may be too generous – more than necessary for offering an investment-friendly environment.

Tax expenditure[35] (TE) accounts may significantly contribute to the assessment of tax relief, enabling both improved transparency in the delivery of special tax incentives and stronger policy assessment, evaluation, and reform, which in turn includes better monitoring of fiscal balance targets. TE accounts estimate the tax revenue foregone by the main corporate tax incentives. Specifically, they can:

- help set in motion measures to evaluate[36] and contain tax expenditure costs by accurately quantifying tax expenditures;[37]
- avoid duplication, overlap, and conflict of expenditures by clearly identifying and classifying both tax expenditures and direct expenditures by function;
- improve revenue forecasts (when based on micro-data) and support fiscal planning by taking into account both direct public expenditures public expenditures delivered through the tax system; [38]

- allow the distributional assessment of tax relief by assessing its allocation across different taxpayer groups (and the impact of adjusting or removing it);

- reduce the scope for corruption of and rent-seeking by tax administrators, so helping to foster taxpayer compliance, support the broad objective of good governance across government operations, and ease investor uncertainty over the tax treatment of other (rival) firms.

By making the delivery of special tax incentives more transparent, tax expenditure frameworks can foster good governance and help build taxpayer trust and confidence in the tax system, so furthering economic development. The implementation of a CIT micro-simulation model is often useful in preparing tax expenditure estimates and enhances their accuracy.

"Transparency in the provision of corporate tax incentives for investment" is an indicator that considers whether tax expenditure accounts have been properly prepared and used to support fiscal planning, whether estimates have been considered alongside direct expenditures in the drawing up of government expenditure and tax policies, and how often tax expenditure reports are published.

Preparing TE accounts and identifying and estimating public expenditures that result from special (targeted) tax relief provisions and are financed through the tax system requires TE frameworks. They are typically differentiated according to the type of tax (*e.g.* PIT, CIT, VAT). In principle, tax expenditures should be properly authorised and managed with the aim of ensuring transparency and accountability.

The Ministry of Finance does not currently produce expenditure estimates of tax revenues forgone as a result of the main corporate tax incentives. The only country in the MENA region producing a TE report is Morocco, which has been doing so since 2005. Egypt's main argument for not doing so is that its 2004 income tax reform did away with corporate tax incentives. However, it still offers some tax incentives, such as its tax preferential zones and the non-requirement for US companies operating in Egypt under an USAID contract to pay taxes. Furthermore, some investments in the stock market, dividends paid to shareholders, and many forms of bonds and interest income paid out by banks are all exempt from tax. There are also a number of PIT tax relief arrangements.

3.2.4. Tax Wedge Analysis of Tax Impediments to Employment

Another critical issue for policy analysis and development is the impact of tax systems on employment (labour markets). The personal tax system and income-related social security contributions paid by employees and employers are expected to have a direct impact on the labour market by influencing both job market participation (whether to work or not) and decisions to work "at the margin" (whether to work longer hours). Taxes increase the cost of employing workers, particularly low-wage workers, while benefit systems are alleged to leave little incentive to work, especially among low-wage families.

The OECD *Taxing Wages*[39] methodology allows policy makers to assess the impact of the current tax system and alternative tax reforms on the average and marginal rates of wage income taxation for households differentiated by income level and family composition.[40] Average tax rates, which show the percentage of gross wage earnings taken in tax (before and after cash benefits) and social security contributions, are used to analyse the impact of taxes on decisions to participate in the labour market. Marginal tax rates, which show the share of an increase in gross earnings or total labour costs that is levied, are used to assess the impact of taxes on work efforts at the margin.

Although Box 4 provides a more detailed list, three main policy options may be assessed using the *Taxing Wages* framework:

1. the effects of tax on the labour market participation of low-income workers;
2. the effects of tax on work effort (*e.g.* number of hours worked) among high-wage, low-wage and part-time workers;
3. incentives for spousal (second earner) and part-time work.

"Tax wedge analysis of tax impediments to employment" is an indicator that considers such issues by evaluating whether Egypt maintains models that measure tax wedges and corresponding marginal and average rates of tax on labour income in accordance with the OECD *Taxing Wages* methodology. The indicator considers whether models cover a certain number of possible household structures, wage levels, part-time and spousal work, and whether the results may be compared with other countries and used systematically to inform policy making.

Currently, Egypt's Ministry of Finance (MoF) does not maintain a tax wedge model measuring marginal and average tax rates on labour income for assessing how tax distorts employment, nor does it have any plans to implement one. This simple forward-looking parameter-based model could contribute to tax policy analysis in general, particularly in the context of current personal income tax reform and pension reform. It would provide understanding of the distributional impacts of these reforms and their impact on employment decisions.

Box 4. Effective tax rate (*Taxing Wages*) analysis of employment (tax distortions, impediments)

Comparative analysis of international trends in personal income tax reforms can be useful for policy makers. However, modelling effective tax rates on labour income and the analysis of labour market effects are important because policy recommendations on personal income tax reform must be tailored to a country's specific situation. Labour market issues, such as the magnitude of youth and women in the work force, part-time employment, and long-term and seasonal unemployment, may differ markedly. Tax levels and structures also vary. Furthermore, reforms tend to build on current systems, targeting problem areas without necessarily disrupting reasonable expectations of links between social security contributions and benefits. They also must be compatible with other policies designed to reduce unemployment.

The OECD *Taxing Wages* methodology considers the detailed structure of a country's tax system as it impacts labour income. It offers tools for assessing the impact of alternative tax reforms on different types of households, from which it infers the reforms' effect on employment (labour demand and supply). In particular, *Taxing Wages* calculates the personal income tax and social security contributions paid by employees and their employers (factoring in standard tax allowances), and examines how these levies and family cash benefits impact on net household incomes.[41] This framework is used to derive average and marginal rates of labour income taxation.

Examples of different policy options that may be assessed using the *Taxing Wages* framework include:[42]

- *Tax effects on work effort.* Reductions of marginal tax rates at the top and bottom of the income scale may have a positive effect on the work effort (*e.g.* number of hours worked) of high-wage, low-wage, and part-time workers. Micro-simulation models allow policy makers to identify revenue-neutral packages of reforms involving income tax adjustments to finance reductions in marginal rates (*e.g.* by reducing personal allowances or child tax credits, or increasing social security contribution ceilings). This analysis may be complemented by a *Taxing Wages* approach to assessing the net effects of tax reform adjustments on incentives to increase work effort among workers differentiated by income and household composition.
- *Tax effects on labour market participation of low-income workers*. A decrease in the average effective tax rate at the bottom of the income scale may increase the incentives of low-skilled individuals and part-time workers to enter or participate in the labour market. Lower tax rates may also encourage companies to employ low-income workers. Using the *Taxing Wages* framework, policy makers may assess which alternative tax reforms are appropriate (*e.g.* restructuring social security contributions either by introducing thresholds or reducing contribution rates for low income earners), while taking into account considerations of efficiency and equity.
- *Incentives for spousal (second earner) and part-time work*. One way of lowering the cost to an individual of entering the labour market and encouraging the development of part-time work may be to change the taxpayer unit used for tax purposes – in particular to move from a household/couple as the income taxpayer unit to the

individual, while possibly taking additional measures to adjust tax allowances when a second worker enters the labour market. This issue is important where policy makers seek, for example, to encourage women to participate in the labour market.

- *Assessment of possible tax distortions on the decision whether to remain in dependent employment or start a business*. This involves comparing the effective tax rate on labour and capital income when employed with tax liabilities, against when working for oneself and ploughing savings into a business. The *Taxing Wages* framework is used to establish the tax burden on labour income (in employment), and the tax burden on business income of the self-employed

- *Assessment of possible tax distortions on the decision whether to operate an unincorporated or incorporated business***.** The *Taxing Wages* framework is used to ensure that the tax system does not discourage (or encourage) incorporation. Efficiency considerations arise when different business structures offer taxpayers certain non-tax advantages and disadvantages.

Sub-Dimension 3.3.: Taxation of SMEs and MNEs

Indicators under Sub-Dimension 3.3, "Taxation of SMEs and MNEs", address Egyptian practices in assessing the number of issues relevant to small- and medium-sized enterprises (SMEs) and multinational enterprises (MNEs). Such issues include how tax policy impacts the cost of funds, incentives for risk-taking, and employment activity (labour supply and demand). "Taxation of SMEs and MNEs" also addresses the costs of tax compliance, which can be a disincentive for businesses operating in formal, tax-paying economy. At the same time, it encourages policy makers to consider whether the tax system encourages aggressive tax planning.

In 2006 the Egyptian Ministry of Finance, working with the Canadian International Development Agency (CIDA), created its dedicated SME Development Unit. Its purpose is to develop fiscal policies that will enable SMEs to join the formal sector. However, there is no evidence that the unit has analytical capacity.

Table 4. Sub-Dimension Taxation of SMEs and MNEs indicators and scores

3.3. Taxation of SMEs and MNEs	
3.3.1. Analysis of tax impediments to equity financing of SMEs	n.a.
3.3.2 . Analysis of tax arbitrage by SME owners	1
3.3.3. Analysis of tax impediments to risky investment in SMEs	1-2
3.3.4. Assessment of tax compliance costs and remedial measures	2
3.3.5. Analysis of non-resident withholding tax payments	1
3.3.6. Analysis of thin-capitalisation of the tax base	1

3.3.1. Analysis of Tax Impediments to the Equity Financing of SMEs

A central consideration as regards the tax treatment of incorporated small businesses is the scope for the double taxation of profits arising from shareholder taxation of dividends and/or capital gains. Double taxation arises where business profits are taxed first at the corporate level (without integration relief) and after-corporate tax profits are taxed in full at personal tax rates on dividends and/or capital gains.[43]

The double taxation of corporate profit may limit business creation and growth in several ways:

- Dividend taxation may discourage the creation of an incorporated business.
- While it is common for entrepreneurs to wish to establish a business in unincorporated form, it is not always true. They may wish to enjoy the advantages (*e.g.* limited liability) that incorporation provides, before deciding to create a small business. However, injecting capital into a new incorporated business may not be attractive on account of the double taxation of dividend returns.[44] Similarly, for growth-oriented firms that start up as unincorporated businesses, continued growth beyond a certain size may require incorporation to efficiently reach capital markets. Double taxation of returns on capital that is withdrawn from an unincorporated business and injected into a newly-created incorporated enterprise may discourage incorporation and thereby growth.[45]
- Double taxation of returns on capital may distort firms' financing ch*o*ices.
- For more mature firms, dividend taxation may increase the hurdle rate of return on new share capital, and thereby discourage business expansion funded by new equity. Furthermore, capital gains taxation may inc*rease* the hurdle rate of return on reinvested profits, and thereby discourage investment financed by internal funds. In addition, classic tax treatment of corporate profits may impede the financing of small businesses (unincorporated and incorporated alike) by, for example,

limiting the amount of capital available to start-ups and small businesses requiring external capital (capital gains lock-in and corporate lock-in incentives).

- The taxation of returns on capital at PIT rates may *b*e a competiti*ve d*isadvantage for domestic firms.
- To the extent that required rates of return on multinationals' shares are not grossed up to cover personal tax on returns, *big* corporations e*njoy* a cost of capital advantage over small businesses that relying on local investors. The result is that small companies find themselves at a competitive disadvantage that may seriously hamper their growth prospects.

"Analysis of tax impediments to the equity financing of SMEs" is *a*n indicator t*hat* evaluates countries according to the degree of double taxation in their tax systems, and the impact that double taxation may have on the availabil*ity a*nd cost of equity financin*g to* small businesses. This indicator does not apply to Egypt, since dividends are not taxed at personal rates and capital gains on listed shares are exempted.[46]

3.3.2. Analysis of Tax Arbitrage by SME owners

Where different types of income – from self-employment, (dependent) employment income, dividends, capital gains, interest, etc. – are taxed at significantly different tax rates, owners of small businesses (particularly closely held ones) may decide to change their business and capital structure, earnings distribution, and other financial policies in order to reduce their overall tax liability.[47] It is important that policy makers consider tax avoidance opportunities and incentives under alternative tax rate structures so that they can factor in the potential revenue losses caused by tax arbitrage behaviour when making an overall assessment of the advantages and disadvantages of a given tax structure.

An example: in a given country the corporate income tax rate is low and distributed profits are not liable to shareholder tax (or are taxed at a low final withholding rate). Wages, however, are subject to relatively high personal income tax and employee and employer social security contribution rates. The owner-employee of an incorporated small business may well decide to pay himself or herself an artificially low wage in order to receive not only capital income, but a portion of the returns on labour as dividend income. To take another example: if capital gains on shares are tax exempt while wages and dividends are subject to personal income tax, there may be incentives for small business owner-workers to retain earnings in their company (and earn tax-preferred capital gains on SME shares) rather than receive them as wages or dividends. They would then invest the funds actively in productive capital or passively in portfolio assets. Such outcomes raise concerns over revenue, efficiency and equity. Moreover, public awareness of tax relief obtained in this way may contribute to a general sense that the tax system is unevenly applied and unfair, so eroding voluntary compliance.

"Analysis of tax arbitrage by SME owners" is an indicator that rates countries on the extent to which they have assessed the potential consequences of differences in tax rates across different types of income within their tax system to allow for tax arbitrage (tax avoidance being the exploitation of tax rate differences). The indicator also considers whether measures have been adopted to address the most common forms of tax arbitrage. Egypt is examined according to its assessment of effective rates of taxation levied on different forms of income earned by the owner-employees of closely-held corporations. It particularly scrutinises the possible distortions caused by different payout policies. While a review of the rates of income tax levied on self-employed business income, dividends, interest and capital gains suggests that Egypt has taken care to limit tax planning opportunities, studies have not been yet conducted on the potential of tax arbitrage by small business owners.

Table 5. Simplified example of potential tax arbitrage

Egypt (2009)	Statutory rates	Wages	Dividends	Interest	Capital gains
CIT	20.0%	0.0%	20.0%	0.0%	20.0%
PIT (top marginal rate)	20.0%	20.0%	0.0%	0.0%	2.5%
SSC employer	24.0%	19.2%	0.0%	0.0%	0.0%
SSC employee	14.0%	14.0%	0.0%	0.0%	0.0%
Combined*		42.3%	20.0%	0.0%	22.0%

Source: Ministry of Finance, Egypt.

* The combined rate (tax wedge) on a wage income takes into account the deductibility of employee's social security contributions. This rate is calculated as: [(1-SSCee)*PIT+SSCee+SSCer]/(1+SSCer). The combined rate for dividends and capital gains is calculated as: CIT+(1-CIT)*withholding tax.

Very simple calculations show that in Egypt (see Table 5 above)[48] there are significant rate differences across income types, in particular when social security contributions levied on wage income are taken into account. These differences seem to suggest that the current tax system in Egypt gives incentives to owner-workers of incorporated small businesses to:

- pay themselves artificially low wages and complement them with dividends, which are exempted from personal income tax; and/or
- retain earnings in their companies and earn tax-exempted capital gains on shares, rather than receive their earnings as wages.[49]

3.3.3. Analysis of Tax Impediments to Risky Investment in SMEs

Tax systems, and in particular the treatment of losses, may have an effect on risk taking – *i.e.* investing in a business or other asset with an uncertain return. Risk taking may be discouraged if the tax treatment of profits and losses is asymmetric.[50] In general, symmetrical treatment requires that losses are deductible at the same effective tax rate as profits and gains, for only then is the government an equal partner in the investment, sharing equally in profits and losses.

However, policy makers may be reluctant to ensure fully symmetric treatment of income and losses, because of the implied revenue loss. Lengthy carry-forward (and possibly carry-back) provisions may be viewed as providing sufficient scope for claiming capital losses, albeit typically without interest adjustment. Furthermore, as owners of small businesses generally have some scope for mischaracterising personal consumption expenses as business expenses, limits may be expected on personal business and corporate loss claims. Restrictions on capital loss claims generally follow the same policy concerns, notably revenue loss and the subsidisation of private consumption (reflected both in corporate losses and capital losses on corporate shares).

At the same time, however, the possible effects of treating taxable gains and losses asymmetrically may prompt policy makers to consider adjusting the trade-off through a more liberal treatment of losses, with revenue losses covered by more restrictive rules governing allowable business deductions (*e.g.* denying deductions that are related more to consumption than to pure business expenses).

Egypt provides considerable flexibility for obtaining relief to offset business losses. There is no distinction between ordinary and capital losses, so losses realised in one category of income may be deducted against other categories of income in the same year. At the same time, a five-year carry-over is

allowed for excess capital losses, with few restrictions for joint-stock companies and partnerships limited by shares not listed on the Egyptian stock exchange. In addition, losses may be carried back when incurred on long-term contracts in order to offset profits gained from the same projects. This flexibility probably means the government giving up tax revenue on taxable income offset by increased loss-offset claims (which include non-targeted claims related to consumption as opposed to business activities, where there is some mischaracterisation of personal expenses as business expenses). However, some additional (future) tax revenue may factor in should flexibility achieve its intended effect of encouraging new business creation.

"Analysis of tax impediments to risky investment in SMEs" is an indicator that considers whether Egypt has assessed the impact which its loss-offset rules have had on investment in early-stage, high-risk companies and whether it has incorporated any findings into its tax policy. In Egypt there has been no analysis to date into how alternative approaches to the treatment of business and capital losses may affect incentives for tax-avoidance and relatively high-risk investment – *e.g.* in software development or investment in other intangibles.

3.3.4. Assessment of Tax Compliance Costs and Remedial Measures

Besides actual tax liability, firms must also contend with often heavy compliance costs.[51] In addressing today's complex business structures and transactions, a certain degree of complexity in the tax system is to be expected. However, where investors view a tax system (laws, regulations, and administration) as excessively complex relative to other tax systems or to an alternative approach, the added costs incurred in understanding and complying with the tax system may well discourage business creation, investment, and full compliance.[52]

By reducing tax compliance costs, and thereby lowering the overall tax burden on small businesses, simplification provisions help achieve more neutral tax treatment of firms of varying sizes. Neutral treatment may yield efficiency gains (see Box 5) and encourage compliance with a country's tax laws, encouraging business to operate in the formal rather than informal, or underground, economy. Nevertheless, simplification measures should be carefully designed so that they do not offer some taxpayers greater opportunity to avoid or evade tax, so raising concerns over the integrity of the tax system and horizontal equity. Such concerns would need to be weighed against the net efficiency gains from greater neutrality and increased tax compliance amongst targeted groups. [53]

"Assessment of tax compliance costs and remedial measures" is an indicator that considers Egypt's efforts to assess the average cost to small businesses of complying with taxes and the advantages and disadvantages of simplifying certain current tax administration practices. A top score is achieved when studies have been conducted into establishing threshold levels that determine the application of alternative regimes and the possible distortions those threshold levels could introduce.

Egypt has assessed the average cost to small businesses only in terms of the time needed to comply with all main taxes (income tax, social security, payroll, and sales taxes). This study was prepared in cooperation with the International Finance Corporate (IFC) in the context of its report, *Doing Business*. However, the accuracy and reliability of this indicator is questionable for two main reasons: 1) the only taxes it considers are VAT, CIT, and SSC, whereas it should also include, at the very least, employees' personal tax withholdings, which represent a significant cost, particularly for medium-sized enterprises; 2) estimations of time required to comply with taxes are subjective and not consistent across countries.

Although there is no evidence that Egypt has prepared studies assessing the implications of alternative simplified tax policy regimes, it has recently carried out some reforms to reduce compliance costs, particularly for SMEs. Egypt has implemented a simplified income tax regime for SMEs and is also

granting incentives to taxpayers to encourage e-filing and e-payment. It has also (as discussed in Sub-Dimension 3.4, "Tax Administration") made considerable progress in implementing initiatives to improve taxpayer understanding of and compliance with the tax system and to facilitate access to information.

Box 5. Rationale for tax simplification for small businesses

Tax compliance costs tend to increase with the number of taxes entrepreneurs are subject to, the frequency at which they must file returns, the levels of government involved, and the complexity of tax rules. With a substantial fixed cost component, tax compliance costs as a percentage of sales are relatively high for small firms. By reducing tax compliance costs and thus lowering the overall tax burden on small businesses, simplification provisions and taxpayer education and assistance programs may help achieve more neutral tax treatment for firms of varying sizes. This in turn brings potential efficiency gains and encourages compliance with tax laws, which includes operating in the formal rather than informal (underground) economy and full reporting of all amounts required to determine the true tax base.

A main efficiency concern associated with significant tax compliance costs incurred by firms of all sizes is that the smaller a business (measured by capital), the higher its pre-tax rates of return on capital must be to absorb compliance costs. This effect, where small businesses find themselves at a competitive disadvantage relative to larger firms, points to inefficient allocation of capital, with underinvestment in small businesses. A second efficiency consideration is that when increased compliance results in increased tax revenues, it may be possible to reduce tax rates in one or more elastic tax bases, with possible efficiency gains. Increased compliance may also be seen as desirable when considered from the perspective of the benefits to society of having all citizens involved in financing programmes to support economic and social development ("nation-building").

Simplification provisions of various types can be expected to impact small businesses differently, given the heterogeneity of the small business population. Some measures may directly encourage business creation and tax compliance while others may not, which points to the need to consider a range of measures. For example, simplified accounting or less frequent filing of tax returns may be of little practical consequence to small businesses with very low turnover like street vendors. They may regard the tax compliance burden of even a simple, regular tax system as excessive and a disincentive for joining the formal economy. Yet these same measures may actually encourage larger scale SMEs to establish and comply.

Very low-turnover businesses are generally unaffected by simplified accounting and filing measures. A simple replacement tax, like a turnover-based presumptive tax, could be introduced in place of regular income tax and/or VAT for firms with a turnover below a given micro-business threshold. Replacement taxes raise key design considerations. They include setting a turnover level for the VAT threshold, determining the tax burden under a presumptive (replacement) tax system, and, in particular, avoiding any large upward adjustments in tax liabilities when a business's exceeds its turnover threshold and has to migrate from a replacement regime to the regular regime.

3.3.5. Analysis of Non-Resident Withholding Tax Payments

Governments are often under significant pressure from the business community to reduce non-resident withholding tax rates in line with international trends towards reduced rates so as to improve their international competitiveness position. There is additional pressure to reduce rates under the terms of tax treaty negotiations. The efficiency effects of adjusting non-resident withholding tax rates depend on whether transactions are between unrelated or related parties. The main implications of reducing rates when transactions take place between unrelated parties are:

- Domestic investors may access different goods and assets at a lower cost when withholding tax rates are incorporated into the final price. This can reduce, among other things, borrowing costs for resident firms.
- In cases where withholding tax rates are not fully incorporated into the final price and a foreign supplier is able to claim a foreign tax credit, reduced non-resident withholding tax rates may only

serve to increase the tax revenues of a foreign country. This is particularly important in the case of royalties for intangible goods in a competitive market.

In related-party transactions, the efficiency effects of non-resident withholding tax rate adjustments are more complex. There may be a number of outcomes:

- When foreign tax credit is available, reductions in the withholding tax rate could result in windfalls for foreign treasuries.
- When foreign tax credit is not available, a reduction in the withholding tax rate reduction benefits an entire corporate group. Although the operating subsidiary in the host country does not gain, the reduction may encourage FDI and thus benefit the entire parent company.
- In related-party transactions, interest and royalty withholding taxes are deductible against the corporate tax base. Rate reductions can further encourage the repatriation of earnings by way of inter-affiliate interest and royalty charges rather than dividends. Such tax planning affects the way in which the tax base is shared between host and home countries. It may result in a tax burden in the host country that is not consistent with efficient allocation of capital.

Given the problems and limitations of tax relief targeted at FDI, policy makers may be well advised to consider broad-based tax relief that benefits foreign and domestic investment. This approach avoids the distortions and compliance problems associated with FDI-targeted corporate income tax relief, although it generally costs more in revenue losses for a given percentage change in the effective tax rate. Revenue losses from a reduction in the basic statutory corporate tax rate tend to be significant, particularly where the existing domestic capital stock and corporate tax base is large.

"Analysis of non-resident withholding tax payments" is an indicator that considers whether a country has maintained a framework for measuring non-resident withholding tax on cross-border payments. A top score is given when the underlying cross-border payments data are drawn from returns that taxpayers are required to file, with information on payment type, amount paid, currency, amount of tax withheld, and recipient country.

Egypt's international balance of payments data reports, on its current account, investment income payments to non-residents that include:

- direct investment income (income on equity, interest income on debt);
- portfolio investment income (income on equity, interest income on debt);
- other investment income (including interest on loans and other capital).

Direct investment income on equity includes dividends, branch profits and reinvested earnings. If Egypt's national statistic agency can produce data on interest income and the components of equity income, rough estimates may be made of the impact on revenue of adjustments to statutory non-resident withholding tax rates on interest and dividends (and to adjustments in a branch profits tax.) However, given differences between statutory and tax treaty withholding tax rates, there is a need for more detailed individual payment amounts that show the countries of residence of non-resident recipients in order to produce rough estimates. Similarly, estimates of the impact on revenue of adjusting a given tax treaty rate require data on payments to the relevant treaty country.

In some countries (although not in Egypt), taxpayers and agents (banks, trust companies, etc.) who make payments to non-residents on behalf of taxpayers are required to complete and submit forms that provide the government with information on income (interest, dividends, royalties, rents, etc.) paid to non-residents, the amounts paid, the recipient country, and the amount of tax withheld. A non-resident withholding tax model compiled from such data would be ideal.

3.3.6. Analysis of Thin Capitalisation of the Tax Base

Treatment of the cost of providing debt finance is a key business tax issue, especially in the context of cross-border finance within a multinational group of related companies. Problems arise because finance can broadly take two legal forms: debt and equity, with debt generally being tax favoured. For investors, the advantages of cross-border debt rather than equity finance are often clear:

a) Interest payments are normally fully deductible from the corporate income tax base, while dividend payments are not.

b) Interest deduction can often be claimed on an accrual basis in recognition of the fact that interest is not generally a contingent payment.

c) Tax treaties often provide for lower withholding tax rates for interest than for dividends. Some countries even maintain a zero rate of withholding tax on interest, which is usually not the case for dividends.

While a) and b) apply to Egypt, there is no withholding tax on dividends and the withholding tax for interest is 20% (unless a lower treaty rate applies – 32% for interest on government bonds). Under these rules, an MNE group is provided with a clear incentive to fund its investment in subsidiaries largely with debt, in many cases wholly eliminating profits made by the subsidiary. Because of this, Egypt, like many other countries, has acted to protect its tax bases by developing thin capitalisation rules that limit the tax deductibility of interest, especially where the debt is provided by related parties.[54] Thin capitalisation rules follow the fixed debt-to-equity ratio approach (4:1 for fiscal year 2009) in Egypt. In other words, interest on debt and debentures is not deductible when the debt exceeds four times the owner's equity. If it does exceed that ceiling, a deduction is allowed for the interest on loans up to a certain limit.[55]

"Analysis of thin capitalisation of the tax base" is an indicator that considers whether steps have been taken to assess, and possibly address, excessive leveraging of the domestic corporate income tax base of resident foreign-controlled companies. There is no evidence that Egypt has this type of framework or any plans to implement one. However, the introduction of thin capitalisation rules with the 2004 tax reform suggests that some kind of analysis was conducted to support their implementation (although formal analysis and quantification of this excessive leveraging has probably not been undertaken).

Sub-Dimension 3.4.: Tax Administration

As the previous section on Sub-Dimension 3.3, "Taxation of SMEs and MNEs", underlines, the costs of tax compliance (understanding tax rules and complying with administrative procedures and regulations) account for a sizeable share of the taxpayer's total tax burden. When these costs are not kept to acceptable levels, they discourage the creation of businesses and jobs, investment, and full tax compliance.

At the same time, tax systems' design and implementation framework also have a considerable impact on revenue authorities' administration costs. Efficient tax administration is key to compliance strategies that maximise the collection of revenues (used to finance infrastructure, education, governance, etc.) while optimising the use of public resources through a balance of reliable taxpayer services and education and targeted audit and enforcement activities.

If reform aimed at improving investment and business is to be successful, it must reform both tax policy and tax administration. The main objective of administrative reform should be to modernise the revenue authorities' management and operational structures in order to make administration more efficient and effective.

The Tax Administration Sub-Dimension assesses Egypt on its efforts to modernise and improve tax administration. It does so by analysing factors that may affect the efficiency, effectiveness, transparency, and accountability of the revenue authorities.

Table 6. Sub-Dimension Tax Administration indicators and scores[1]

3.4. Tax Administration	
3.4.1. Consolidation of management of revenue administration	4
3.4.2. Organization of revenue administration tasks	4-5
3.4.3. Strategic management	2
3.4.4. Centralized electronic processing of taxpayer information	3
3.4.5. Compliance assessment and risk management	3-4
3.4.6. Provision of taxpayer services	4

3.4.1. Consolidation of Management of Revenue Administration

From an investment climate point of view, institutional arrangements for revenue administration are important because they affect taxpayer compliance and government administrative costs. In particular, the multiplicity of revenue administration entities operating separate tax and SSC collection arrangements obviously raises questions about their ability to co-ordinate compliance activities across taxpayer populations. In addition, dealing with several separate revenue collection bodies places an extra compliance burden on businesses.

More generally, institutional arrangements for revenue administration play a key role in a properly functioning tax administration. Given the wide range and nature of the laws they must apply, the systems of assessment and self-assessment they must rely upon, and the large number of clients they administer, revenue bodies need adequate powers and autonomy to perform efficiently and effectively. On the other hand, they must operate, and be seen to operate, fairly and impartially. They undergo a range of checks and

[1] Scores for the Tax Administration section are only indicative. The Ministry of Finance is currently undertaking a set of reforms of the tax administration. The outcome of the reforms may have altered and improved the effectiveness and performance of Egypt's tax administration by the time this report is published.

balances to ensure the transparency of their operations and proper accountability for their overall management of the tax system.[56]

There has been a trend[57] towards integrated management of all taxes (direct and indirect, social security contributions, and, in some cases, customs tariffs) in a unified department or agency.[58] However, the unified body's degree of autonomy and responsibility for collecting social security contributions and/or customs duty varies widely from country to country.[59] To a large extent, the varied institutional arrangements observed reflect underlying differences in the political structures and systems of public sector administration in different countries, as well as longstanding historical practice. In general, as pointed out in IMF working paper WP06/240: "[in developing countries] problems related to low capacity and the need for massive administrative reforms, combined with corruption and long periods of non-performance, have made the case for a different form of government structure, compelling both to decision makers as well as to the donor agencies interested in funding the needed reforms".

Figure 2. Organisational charts of Egypt's Ministry of Finance and Revenue Authorities

Source: Egyptian Ministry of Finance webpage.

"Consolidation of management of revenue administration" is an indicator that assesses how integrated Egypt's revenue administration management structure is. A top score is awarded when all main taxes are administered by a unified management structure within a single department or agency, which co-operates closely with customs administration. Egypt took its first steps towards an integrated structure in September 2005 when it set up a Large Taxpayer Centre (LTC). Then, in 2006, it incorporated the Income and Sales Departments into a single unified Egyptian Tax Authority with 60 000 employees (see Figure 2) Egypt is also considering establishing medium and small taxpayer offices in all governorates. There is, however, no evidence of advanced integration or cooperation between the Tax Authority and the Customs Authority.

Nevertheless, it should be recognised that the degree of integration so far achieved was a considerable challenge, given the limited resources, tight budget, and increasing demands placed on the tax authorities as a result of the 2004 fundamental tax reform and the globalisation of business activities.[60]

3.4.2. Organisation of Revenue Administration Tasks

The organisational structure of revenues bodies is another important factor affecting the operational efficiency and effectiveness of tax administration and the delivery of services to taxpayers. Many revenue bodies are undertaking major reforms in this field by switching from structural arrangements based largely on types of tax (separate, largely self-sufficient multifunctional departments each responsible for a kind of tax and independent of each other) to one based principally on functions – *e.g.* registration, accounting,

information processing, audit, collection, appeals – and/or taxpayer segment criteria. In practice, however, the majority of revenue bodies have an organisational structure based on a mix of criteria.

The primarily functional model may help to substantially improve overall operational performance by standardising more work processes across taxes (*e.g.* effective specialisation, economies of scale, simpler and consistent treatment of taxpayers), thereby simplifying computerisation and dealings with taxpayers (*e.g.* by reducing the number of taxpayers addressing different departments on similar issues) and generally improving operational efficiency (*e.g.* by improving management, control, and the use of infrastructure and facilities). The adoption of the functional model has led to many developments aimed at improving tax administration performance. Examples include single points of access for tax inquiries, the development of a unified system of taxpayer registration, common approaches to tax payment and accounting, and more effective management of tax audit and debt collection functions.

In addition, there is an emerging trend for revenue bodies to create specialised operational units that organise service and enforcement functions principally around taxpayer segments – *e.g.* large businesses, small and medium-sized businesses, individuals. The rationale is that each group of taxpayers has different characteristics and tax compliance behaviours and, as a result, constitute different risks for revenue. In order to manage risks effectively and so improve compliance levels, the revenue body needs to develop and implement strategies (*e.g.* law clarification, taxpayer education, improved services, more targeted audits) that are appropriate to the unique characteristics and compliance issues presented by each group of taxpayers. Revenue bodies also need a structured approach to researching and understanding what these compliance issues are. While application of the taxpayer segment model is still in its early stages of use, many countries have partially applied it by creating dedicated large taxpayer divisions and units.

"Organisation of the revenue administration" is an indicator that assesses the organisational structure of the Egyptian revenue authorities. A top score is obtained when a tax-type structure has switched to structural arrangements based on functions and/or clients (taxpayer segments) in order to improve the efficiency and effectiveness of tax administration. The Large Taxpayer Centre (LTC) created in 2005 under the terms of the 2005 Income Tax Law replaced the Model Customs and Tax Centre created in June 2003. It was designed as a one-stop shop (receiving and filing tax returns, making tax payments, dealing with auditors and examiners, etc.) for large taxpayers that opted to participate in the new system.[61]

The LTC serves 2 000 taxpayers (80% of total tax revenue). Its main objective (stated in its webpage) is to reduce large taxpayers' tax burden and costs and provide them with integrated electronic services. In fact, the LTC and the Sales Tax Department are the only websites that provide taxpayers services in English.[62]

3.4.3. Strategic Management

Another important factor contributing to the efficiency, transparency, and accountability of revenue administration bodies is that they adopt and publish formal mission statements and performance objectives within the government management process. Such formalisation can help revenue authorities to:

1. manage the efficiency and effectiveness of agencies and ministries and/or internal control and accountability within individual ministries;
2. improve decision making in the budget process and/or in resource allocation and the accountability of ministries to the Ministry of Finance;
3. improve external transparency and accountability to parliament and the public, and clarify the roles and responsibilities of politicians and civil servants;
4. achieve savings.

Formalisation is a mark of the trend towards a results-based approach to both management and budgeting. Under this approach, as opposed to an input-based one (number of auditors, local offices, etc.), results are measured in the form of outputs (numbers of returns filed, inquiries handled, audits completed, etc.) and/or outcomes (*e.g.* improvements in standards of service to clients and their satisfaction with the treatment received).[63] Managers thus enjoy greater autonomy, discretionary powers, and flexibility, but with the requirement and expectation of greater accountability for their performance. [64]

The "strategic management" indicator assesses the transparency of revenue bodies' practices against their formal mission statements and objectives. It also considers whether reports and result-oriented performance are intended to increase revenue authorities' accountability, essential to building a taxpaying culture. In order to achieve a top score, a revenue administration needs to have announced a formal mission statement and performance objectives based on output and/or outcomes. In addition, information on the total budget and on the number, composition, and distribution across offices of its staff has to be gathered on an annual basis.

The Egyptian Ministry of Finance's website features a statement on activities and achievements. While the statement set outs the main performance-based objectives, it does not include any performance reports. The Egyptian Sales Tax Authority is arguably the most modern of the tax departments. One main reason is the relatively recent introduction of the goods and services tax (GST) in 1993. The department's webpage contains mission statements from both ministry and commissioner. However, there is no evidence of any report on performance objectives.

It should be noted that in 2005 there was ongoing work on performance-based budgeting in order to establish a framework for developing management and budgeting for public expenditures (starting with education and health), and piloting the development of indicators and other performance data. A standard, widespread practice that helps improve the transparency and accountability of tax administration bodies is that they should prepare and publish business and strategy plans and performance reports.[65]

3.4.4. Centralised Electronic Processing of Taxpayer Information

Centralised systems of taxpayer information collection and assessment of collection are key to efficient, effective tax administration. Such systems can enhance administration of the tax system and, therefore, management of the revenue body's workload (*e.g.* facilitating audits and enforcement by matching and exchanging information). They also have a significant effect on taxpayers' compliance burden (*e.g.* by facilitating taxpayers' use of electronic services, pre-filing tax returns) and may also reduce corruption in tax administration (*e.g.* by reducing direct contact between taxpayers and tax officials). In addition, centralised systems may facilitate data gathering and analysis that could feed the tax policy models discussed in previous indicators (see Sub-Dimension 3.2, "Taxation, Investment and Employment").

A critical feature of these systems and, in general, of tax administration arrangements, is the comprehensive systems of taxpayer registration and numbering, an example of which is the unique taxpayer identification number (TIN).[66] Such systems can support most tax administration processes and underpin all return filing, collection, and assessment activities.

Other important elements of the tax administration framework enabling taxpayer information processing are: withholding regimes, self-assessment regimes, advance and instalment payments of taxes, and third-party information reporting. In practice, information on individual payees (name, identification number, amount paid, and amount of taxes withheld) is reported to revenue bodies under withholding and self-assessment regimes and advance/instalment payment of taxes. In the absence of a withholding requirement, third party information reporting is an important compliance tool for tax administration.[67]

(Third-party information reporting is mandatory for certain third parties, *e.g.* businesses, financial institutions, and government agencies. They are required to report payments and payee details, complete with their TINs, to the revenue body.)

Over the last 10 to 15 years, revenue bodies in many countries have been transforming tax collection and assessment so as to take full advantage of the significant benefits of modern technology, in particular for the electronic transmission of critical taxpayer data.[68] Benefits include faster collection of government revenue, more accurate data, the end of reverse workflows, and faster access to taxpayer data for use in a range of administrative (and potential policy) purposes. Taxpayers, too, benefit – they have less paperwork and tax refunds are credited faster.

"Centralised electronic processing of taxpayer information" is an indicator that assesses access to and management of taxpayer information and revenue authorities' capacity to adopt and adapt to new technologies. A top score is awarded when TINs are systematically assigned to taxpayers and centralised systems of gathering, cleaning, recording and updating taxpayer data are in place.

Although Egypt has implemented a single TIN for income tax, general sales tax, and customs duty, there is no evidence of centralised systems of taxpayer data collection and assessment. However, it may be that the LTC and Sales Tax Authority collect and assess taxpayer collection routinely, since they seem to be more IT-advanced.

3.4.5. Compliance Assessment and Risk Management

A hallmark of effective tax administration is optimised collection under the tax laws in ways that sustain community confidence in the tax authority (by reducing or circumventing tax officials' discretionary powers in the interpretation of tax law) and demonstrate that the system is operating correctly (*e.g.* minimising tax avoidance, incentives to operate in the informal sector, and loops for tax planning opportunities). Systems for identifying critical compliance risks and the capacity to develop and implement effective compliance strategies are, therefore, significant matters of concern – particularly for most transition economies and developing countries.

Historically, many revenue authorities have addressed compliance risks only in terms of enforcement programmes. However, several factors have substantially increased revenue risks and the complexity and volume of service, audit, and other compliance interventions by revenue authorities. These include growth in international trade supported by e-commerce developments, changes in employment patterns and growth in numbers of contractors, innovations in business structures and financial products, and the commoditisation of tax schemes. Furthermore, greater accountability is required from revenue bodies, and with it come higher community expectations of administrative agencies and of governments.

In order to address tax compliance risks[69] more effectively, more advanced revenue authorities have recently adopted a more strategic approach by applying modern risk management techniques.[70] This development, which is in line with the adoption of modern corporate governance practices, gives recognition to the fact that the more serious tax compliance risks require a range of treatment strategies. It has also been found to be a useful way of communicating to staff what the revenue body is trying to do and what is expected of them.

In an environment in which resources are limited, operating in accordance with a process framework of this kind helps revenue authorities to:[71]

- respond quickly to changing circumstances;

- ensure that treatment strategies are applied to the highest priority activities, and that those strategies have a high probability of success;
- leverage the impact of interventions; and thus, ultimately,
- meet their business objective (*i.e.* to optimise collections under the law while maintaining *com*munity confidence in the system).

In order for risk identification and *asse*ssment systems to be effective, they must have sufficien*t da*ta with which to assess compliance risk. These data may be derived from many sources, including operational programme data (*e.g.* feedback from audits), tax return entries (including financial statement information), and external data (*e.g.* bank interest details, company registration data, or publications).[72] As an adjunct to electronic analysis of data, case-based systems can be used to help determine which cases deserve further examination. Experienced auditors generally access these systems. They use their local knowledge in deciding whether further compliance actions, such as audit, are warranted.

The "compliance assessment and risk management" indicator considers whether the Egyptian tax administration system has an explicit "proactive", systematic management approach towards compliance. A top score is achieved when – in addition to integrated case management, internal compliance assessment tests, and systems for detecting non-filing, stop-filing, and non-payment of taxes – revenue authorities have implemented industry-specific risk analysis assessments and advanced audit techniques based on indirect compliance measures.

Egypt's 2004 tax reform introduced self-assessment for taxpayers and a new random audit system. This approach shifted the burden of proof for tax evasion from taxpayers to the tax authorities. The reform limits revenue authorities' inquiry to a sample of some 5-10% percent of all taxpayers. (Prior to the 2004 reform the tax authority examined tax returns on a discretionary basis when they were submitted.) This move, aimed at regaining the lack of trust between taxpayers and the tax authority was well received by taxpayers. However, there is no evidence of the techniques used in compliance risk assessment.

3.4.6. Provision of Taxpayer Services

An effective programme of taxpayer service activities is a critical objective of all revenue authorities. The general complexity of tax laws, coupled with the relatively large populations of taxpayers being administered, means that, fundamentally, all revenue authorities must rely heavily on taxpayers' voluntary compliance in order to achieve the outcomes expected of them. It is axiomatic that to achieve high levels of voluntary compliance, revenue authorities must offer taxpayers and their representatives services of a high standard to help them determine and meet their obligations under the law. Revenue authorities can facilitate voluntary compliance by:

- providing clear explanations of the law, in a form and manner and at a time suitable to taxpayers;
- establishing arrangements that assist taxpayers in meeting their obligations at minimal cost and inconvenience;
- giving accurate responses to taxpayers' questions within reasonable periods of time;
- refunding overpaid taxes in reasonable periods of time;
- quickly resolving taxpayers' complaints; and
- dealing with non-compliance in a firm, timely, and effective manner.

Box 6. A strategic approach to taxpayer services provision

Over the last decade or so many revenue authorities have adopted a more strategic approach to the provision of services to taxpayers as a way of facilitating voluntary compliance. Examples of this strategic approach include:

- Differentiating service delivery actions and activities across various taxpayer segments and groupings (*e.g.* website information groupings, dedicated portals and account managers for large taxpayers, specialist inquiry and consultative services for tax professionals) in recognition of the fact that taxpayer populations are not homogeneous.
- Treating taxpayers as persons and entities with rights that are codified and published. These formal statements are designed to summarise and explain taxpayer's rights and obligations in plain language, so making such information more widely accessible and understandable.[73]
- Consulting widely with taxpayers and/or their representatives prior to the implementation of changes; designing products more from the perspective of the taxpayer as a client entitled to high standards of service.
- Taking advantage of modern technology offerings. While there is a wide range of channels for delivering services to taxpayers, (*e.g.* walk-in counters, telephones, written correspondence, Internet, e-mail, mobile phone text messages, digital television), governments worldwide have, over the last 5-10 years, been demanding that substantially more effective use should be made of modern technology systems to deliver services to citizens and businesses. This can be explained by revenue administrators' extensive information provision and processing responsibilities (*i.e.* the timely provision of information to taxpayers and tax professionals to help them comply with tax laws, and the operation of modern electronic facilities for capturing taxpayers' liability and payment information).
- Establishing and monitoring service delivery performance according to prescribed service performance standards. Many revenue authorities have established time-bound service performance standards for certain aspects of taxpayer service delivery, *e.g.* 95% of electronically filed income tax returns will be processed in two weeks. However, few revenue authorities have a comprehensive set of such standards for a broad range of taxpayer services or publicise the results achieved.
- Measuring client satisfaction with the level and quality of services offered.
- Demonstrating accountability by publishing the levels of performance achieved against the service standards set.
- Ensuring that there is an appropriate balancing of resources between service and enforcement activities to achieve the outcomes sought.
- Systematically identifying weaknesses in service delivery and developing organisational action plans (including many of the strategies identified above) to address those weaknesses.
- Recognising that it is often more cost-effective to leverage service actions through taxpayers' representatives (*e.g.* tax professionals, industry/business groups, other third parties).

The "provision of taxpayer services" indicator considers whether revenue bodies are adopting a more strategic approach to the provision of services to taxpayers. Services include taxpayer information and assistance, the handling of appeals, and the provision of information and certainty of procedures for taxpayers' interviews and appeals. A top score is achieved when taxpayer's rights and obligations and service performance standards are formalised and published on a revenue administration website.

Egypt's 2005 income tax law (Law No. 91/2005) marked an important turning point in services to taxpayers. Prior to the law, the Egyptian tax authorities organised tax seminars, workshops, and roundtables with chambers of commerce, syndicates, and accountants in order to explain tax rules and receive feedback. In the wake of the new law, they drew up a plan to inform and educate taxpayers about the newly implemented tax law and to encourage them to take part in the reform. The plan included media campaigns directed at all classes of society.

The taxpayers services currently provided in Egypt include:

- tax returns and associated guidelines, which can be easily downloaded from tax authorities' and some tax societies' websites, as well as from the government portal site;
- e-filing and e-payment;
- training sessions for taxpayers and tax professionals organised on demand by the tax authority;
- a toll-free call centre;
- publications issued by MoF, which include the tax law, executive regulations, and all related tax bulletins;
- registrants' services, provided by departments in different tax offices to raise taxpayers' awareness and guide them through the tax system.

The Sales Tax Authority and the Large Taxpayer Unit appear to be the most advanced in providing taxpayer services, just as they are in other areas. Their websites' service provision is impressive. Not only do they offer Arabic and English versions, they also include information for taxpayers (*e.g.* how to register, legislation, regulations, FAQs), guides (*e.g.* one on the rights and duties of taxpayers), tax forms (registration forms, tax invoices, tax returns, etc.), e-filing, information on tax refunds and appeals, and the addresses of regional and district offices.

SUMMARY AND CONCLUSIONS

Egypt leads the recent tax reform drive in the MENA region. These efforts, particularly the 2004-5 fundamental income tax reform, have significantly contributed to improving the business climate in Egypt. They have simplified tax legislation and brought it closer to international practices, reduced the overall tax burden (through a base-broadening, low-rate approach), and modernised tax administration.

The Tax Policy and Administration Dimension of the BCDS (Dimension I-3) shows that there remains scope for improvement both in developing tax policy and modernising tax administration. Governments are encouraged to carefully weigh the pros and cons of alternative tax policy reform options in order to develop and implement more informed tax policies. Such analysis plays a crucial role in producing a competitive system where the tax burden is acceptable, administration and compliance costs are minimised, and tax revenues maximised. (Tax revenues finance government expenditure on non-tax requirements identified by investors as key to their investment decisions, *e.g.* infrastructure or education). In addition, developing and maintaining internationally comparable tax measures and indicators would strengthen regional dialogue on tax issues and enable cross-country comparisons.

Assessments in the Tax Policy and Administration Dimension use rough yardsticks to rate Egypt on its progress to date in implementing tax policy frameworks and in modernising and improving the efficiency and efficacy of tax administration. Tax policy analytical frameworks are useful for gauging the impact of reforms on tax revenues, assessing the tax treatment of investment and labour, and exploring different ways of increasing revenue collection efficiency while easing taxpayer compliance costs and generally improving taxpayer services.

While Egypt does not at present use many of the frameworks outlined in this chapter, the Ministry of Finance currently has plans to strengthen its analytical capacity by creating a Higher Council for Taxes in 2010. The main tasks of this tax policy analysis body will probably include developing and maintaining some of the analytical frameworks (models).

Currently, Egypt maintains aggregate tax revenue forecasting models for all main taxes and systems are in place to monitor revenues and public expenditures on a regular basis. These analytical tools are essential for sound management of public finances and play a key role in the process of restructuring Egyptian public finances to support fiscal consolidation. However, Egypt has not yet implemented micro-simulation models capable of estimating disaggregated revenue effects and simulating the tax revenue consequences of fine-tuning tax systems. Nevertheless, there is great interest in a CIT micro-simulation model and steps have been already taken towards implementing it.

Egypt does not currently prepare estimates of the revenues foregone by each main corporate tax incentive for investment. However, work on implementing a CIT micro-simulation model will enable tax expenditure estimates to be drawn up in order to guide tax incentive policy.

A tax wedge model for analysing how tax distortions affect employment decisions is not currently maintained in Egypt. This parameter-based analytical tool would be particularly useful for understanding the impact of taxation on decisions relating to labour market participation and work effort (number of hours worked). Its findings could be particularly important for low-wage workers. The tax wedge model should be incorporated into Egypt's policy toolkit within 1-2 years.

Another key analytical tool for guiding tax policy assessment and development is the marginal effective tax rate (METR) model. METR models analyse how tax distortions deter investors and how tax reform proposals affect tax distortion. One attraction of METR models is that they generate summary tax burden indicators, which incorporate a high number of tax provisions and interactions while also offering the advantage of relying on tax codes and regulations for input data. Although Egypt does not at present maintain a METR model, it is recommended that the Egyptian tax policy toolkit should incorporate it within 3-5 years.

Egypt is urged to assess how taxation may distort the earnings payout decisions of closely held corporations (*i.e.* whether earnings are paid out as business income, dividends, interest, or capital gains). Significant differences in taxation rates between income types are observed, particularly when social security contributions levied on wage income are taken into account. This assessment may help inform decisions over tax rates on different types of income

Detailed analyses have not yet been carried out in Egypt to assess how alternative loss treatment affects investment in small firms with relatively high-risk business ventures. There has been no assessment either of the scope that alternative loss treatment offers for tax avoidance though the mischaracterisation of personal consumption expenses as business expenses.

Egypt has made significant strides in addressing tax compliance costs, arguably the most important impediment to maximising tax revenues. However, there is no evidence that compliance cost assessments have been conducted. The only ones reported concerned the costs of poor compliance caused by time-consuming procedures. (However the methodology of these assessments contained weak points). Despite of the lack of evidence that Egypt has ever conducted an assessment of the implications of alternative income regimes to reduce SMEs compliance costs, it recently introduced a simplified tax regime for SMEs.

Egypt is encouraged to implement a framework for measuring and analysing non-resident withholding tax on interest, royalties, dividends, and other payments. Such a framework would be useful for assessing

the possible implications of reducing the rates of non-resident withholding tax, with special focus on related-party cross-border payments.

In order to protect its domestic tax base from aggressive tax planning, Egypt should conduct assessments of the debt/equity structure of companies and strengthen the thin capitalisation rules it introduced in 2005.

Egypt established a Large Taxpayer Centre in 2005, then integrated the MoF's Income and Sales Tax Departments into a single unified Egyptian Tax Authority in 2006. It is urged to further integrate its revenue authorities' management structures and move them towards an organisational structure that is more functional and client-oriented, and based on taxpayer segment criteria. Such moves would not only make Egypt's tax authorities more efficient and effective, but more transparent and accountable. They would also contribute to improved delivery of taxpayer services and reduce taxpayer compliance costs.

Centralised systems of taxpayer information collection and assessment of collection are key to efficient, effective tax administration. The introduction of a taxpayer identification number (TIN) for income tax, general sales taxes, and customs duty in 2005 was a positive step in this direction. Further improvements to these centralised systems are encouraged. They could include electronically transmitting and cross-checking information provided with withholding regimes, self-assessment regimes, advance and instalment payment of taxes, or third-party information reporting (third parties being, for example, businesses and financial institutions).

The introduction of a self-assessment and random audit systems as part of the 2004-5 tax reforms contributed to strengthening trust between taxpayers and revenue authorities, to improving the Egyptian tax authorities' compliance strategy, and to reducing administrative costs.

The self-assessment compliance-based system has been reinforced by a significant improvement in such taxpayer services as access to information, supporting documentation, and assistance for taxpayers in helping them to understand and comply with the tax system. The improvement is particularly impressive in taxpayer service provisions of the Large Taxpayer Centre and Sales Tax Authority. The services that their webpages offer include: information on how to register, legislation and regulations; guides (*e.g.* to the rights and duties of taxpayers); tax forms (registration forms, tax invoices, tax returns, etc.); electronic filing; and information on tax refunds and appeals. Further efforts in this direction are strongly encouraged.

Notes

[1] http://www.thedeal.com/newsweekly/community/egypt's-reforms-inspire-investments.php The Deal Magazine, June 2nd 2009

2. Fundamental tax reform in Egypt in effect started in 1991 when the General Sales Tax replaced a sales tax regime. This reform changed the structure of consumption taxes, reducing the economic distortions that were damaging Egypt's international competitiveness.

3. Almost all the tax reforms in the OECD area of the last two decades involving income tax can be characterized as rate-reducing and base-broadening reforms, following the lead given by the United Kingdom in 1984 and the United States in 1986. Today most OECD countries have top rates below, and in some cases substantially below, 50%. Similarly, top statutory corporate income tax rates in the 1980s were rarely less than 45%. In 2009, the OECD average rate was close to 26% and an increasing number of countries have rates below 25%.

4. Tax reformers worldwide, aware of the need to maintain taxpayers' faith in the integrity of their tax systems, have adopted fairness, simplicity and transparency as bywords for tax policy and administration reforms. Fairness requires that taxpayers in similar circumstances pay similar amounts of tax and that the tax burden is appropriately shared. Simplicity requires that paying taxes becomes as painless as possible (not something easily achieved in modern societies), and that the administrative and compliance costs of tax collection are kept at a minimum. Transparency requires that the operation of the tax system is well understood, helping provide the certainty which investment and other economic decisions require.

5. As discussed in Sub-Dimension 3.4 on Tax Administration, the establishment of the Large Taxpayers Unit is a first move towards a more client-oriented approach to revenue administration. Such an approach in organising services and enforcement functions around taxpayer segments allows tax administration bodies not only to improve their efficiency and effectiveness but also their delivery of services to taxpayers.

6. The 2004-5 tax reform also helped to improve compliance: the number of taxpayers doubled between 2004 and 2005.

7. Taxpayers' compliance costs include all the costs related to tax rules and obligations (taxpayers' access to information, documentation, tax forms, taxpayers' assistance and education services) and to administrative procedures (reporting requirements and payments requirements, treatment of VAT refunds, audit and appeal procedures and scope for tax avoidance).

8. The Egyptian Ministry of Finance estimates that the overall deficit will increase to 8.4% of GDP in 2009-10, continuing the upward trend started in 2008-9 and moving away from the 3% target.

9. The OECD *Policy Framework for Investment* (2006) gave rise to the BCDS.

10. "Policy change without administrative change is nothing." (Richard M. Bird and Milka Casanegra de Jantscher in *Improving Tax Administration in Developing Countries*, IMF, Washington, 1993).

11. The Sales Tax Authority has already taken steps towards setting up Small and Medium Taxpayer Centre.

12. It is clear that, in general, host country taxation adds to investment costs, particularly in purely domestic cases. However, the predicted direct effect – that investment will increase if host country taxes are reduced – is often not observed. The more difficult issue is when – that is, under what circumstances and by which means – can a relatively low host country tax burden discourage capital flight, encourage additional investment, and swing location decisions in a country's favour? When, for example, can reduced statutory tax rates or special tax incentives be expected to attract additional investment? By identifying the factors that condition whether host country tax relief or subsidies can be expected to deliver additional investment, policy makers can assess how best to design an overall policy approach – one with mutually reinforcing components – to provide an environment encouraging to direct investment.

13. The tax component of the BCDS focuses on effects on direct investment, including business expansion, investment in subsidiaries and branches, and mergers and acquisitions. This chapter also looks at the tax effects on physical capital (*e.g.* plant, property, and equipment) scale and location decisions. Special tax considerations relating to the development and use of intangibles are not explicitly covered.

14. The costs associated with complying with tax obligations and requirements constitute a large share of the taxpayer's total tax burden.

15. Modern, simple, stable, transparent and, in general, good governance, are also key features for tax administration agencies seeking to securing an attractive investment environment. Revenue authorities need modern, flexible structures that enable them to adapt to changes, particularly those related to taxpayers. Increased transparency improves accountability and taxpayer trust in the tax system, which is essential for building a taxpaying culture. Finally, simplicity and stability contribute to maintaining compliance costs at an acceptable level. However, when resources are scarce, revenue authorities are often faced with a trade-off between such desirable features and high administrative costs.

16. Recognizing that printing money to finance government programmes is inflationary, while borrowing funds is also subject to constraint.

[17]. While the definition of a tax may vary, the BCDS framework adopts the OECD definition of a tax as a payment that is: 1) compulsory; 2) paid to general government; and 3) unrequited (no actuarially defined relationship between payments and benefits/receipts from government).

[18]. The overall fiscal balance (identifying net financing requirements) measures total revenues (including grants) less total expenditures, plus borrowing, minus repayments. The primary balance, which measures total revenues (excluding grants) less primary (non-interest) expenditures, provides an indicator of "fiscal effort", with interest payments predetermined by the size of the debt (previous deficits).

[19]. Micro-simulation models may be applied to estimate current year and forecast future year aggregate tax revenues by type of tax (*e.g.* personal income tax, corporate income tax, value-added tax), and provide a useful check on GDP-based tax revenue model estimates, as part of a macro assessment of a country's fiscal position. The use of micro-simulation is addressed separately in the framework.

[20]. A "main tax" may be defined as one that contributes 5% or more of total tax revenues. Examples include income tax (corporate and personal), payroll tax, value-added tax, excise taxes, property tax, and customs duties (trade taxes).

[21]. GDP/national accounts-based tax forecasting frameworks estimate for each major tax the time-series relationship between adjusted tax revenue (net of estimated changes resulting from tax policy changes) and a proxy for the relevant tax base from national accounts (*e.g.* consumption expenditures for VAT; tobacco sales for excise tax on tobacco; wages, salaries, interest, dividends rents, unincorporated business profits for personal income tax). Forecasts for the proxy (national accounts) tax base are then applied to forecast tax revenues, by type of tax.

[22]. Similarly, where the fiscal balance is zero or positive, actual and target tax revenues and effective tax rates on business income should be regularly assessed, as part of an overall assessment of the tax mix in balancing policy goals and objectives. Consideration should be given to reducing reliance on taxes believed to impede economic development (*e.g.* trade taxes, capital taxes), possibly replaced by increasing the effective tax rate on business income where the actual rate is well below potential. At the same time, public expenditures should be subject to ongoing scrutiny to ensure allocations consistent with a ranking of expenditures in meeting policy objectives.

[23]. Forecasts of future revenues by type of tax should incorporate anticipated developments in underlying tax bases, including those arising from commitments in other policy areas. For example, pursuit of trade liberalisation may require/imply reduced future reliance on trade taxes (custom duties).

[24]. A GDP-based corporate income tax (CIT) revenue forecasting model (considered under indicator 3.1.1, based on historical aggregate CIT revenue data and national accounts profit data) is not included in this section, as such a model generally does not provide a basis for yearly estimates of effective tax rates on investment, or for analyzing the impact of corporate tax reform on CIT revenues (and on the tax burden on investment).

[25] Where micro-data are compiled, more precise economy-wide measures of the average corporate tax burden may be derived, resulting from more precise measures of corporate tax corresponding to aggregate corporate profit (with adjustments made to both aggregate profits and corporate tax in order to ensure that the measures are consistent in their coverage and treatment of business losses). Moreover, with micro-data average corporate tax rates may be derived at a disaggregate level (*e.g.* with corporations disaggregated by firm size [total assets], sector, location). Additionally, micro-data provide a basis for micro-simulation estimation of corporate tax revenues under alternative corporate tax policy regimes, and the computation of corresponding average corporate tax rates. Other uses of micro-data analysis may also be identified.

[26] For example, a change in the statutory corporate income tax (CIT) rate, replacement of a single CIT rate with a tiered CIT rate structure, or less generous treatment of business expenses, may have different effects on firms in different industries, firms of varying size, and even firms located in different provinces or regions of a country. Policy makers may also be interested in how a given reform affects domestic-owned versus foreign-owned resident firms.

[27] For example, micro-simulation models are needed to estimate the impact on total tax revenue of certain broad-based tax reforms (*e.g.* changes to tax depreciation rates or other rules affecting the CIT base), as well as reforms targeted at certain taxpayers (*e.g.* single parents, small business owners), or at certain expenditures (*e.g.* investment in machinery and equipment, R&D), or according to some other targeting criteria.

[28]. Industry, location, asset size, and other possible criteria may be used to stratify a corporate dataset. Stratification by asset size would involve setting asset size ranges (note that a corporate sample would normally include *all* corporations with assets in excess of a "large" asset threshold, with "large" corporations assigned to different cells depending on their characteristics and stratification criteria. Other stratification criteria of policy interest (*e.g.* high or low R&D expenditure or total assets) may be used. Location would generally be an important stratification criterion in a federal country (and possibly in a unitary country comprised of various regions). Using firm-level data that distinguishes between domestic and foreign-owned corporations, separate CIT revenue estimates may be made for both groups. For domestic-owned corporations, it is generally not possible to isolate CIT revenues on domestic versus foreign-source income.

[29]. Revising lists of data fields for taxpayers to report on their tax return in order to gather taxpayer information required for micro-simulation purposes can be carried out at relatively low cost. More resource-intensive is the establishing of mechanisms to transfer taxpayer data into an electronic format to be used for computer-based micro-simulation analysis (obviously much lower where e-filing is used and involving a significant start-up cost). Where data is manually transcribed, costs are controlled by limiting the sample size (*i.e.* by limiting the number of firms included in the sample) and the number of transcribed data fields. The number of firms to include in a representative sample may be reduced by increasing the degree of stratification (dimensions) of the data (*e.g.* with firms differentiated on the basis of size (assets), industry, location, etc). Detailed information on tax return sampling procedures is provided to participants of the OECD *Tax Modelling* W*orkshop*, held each year at the Ankara Multilateral Tax Training Centre.

30 . See indicator 3.4.4, "centralised electronic processing of taxpayer information", in the Tax Administration Sub-Dimension (3.4).

[31]. For more on the METR model and its applications, see Boadway, R., N. Bruce, and J. Mintz (1984), "Taxation, Inflation, and the Effective Marginal Tax Rate on Capital in Canada", *Canadian Journal of Economics*, Vol. 17, pp. 262-79. The website, *http://www.fraserinstitute.org/Commerce.Web/product_files/EffectiveTaxRatesEnterprises.pdf*, provides a useful summary article of METR analysis with applications for Canada.

[32]. Parameter-based METRs/AETRs (average effective tax rates) generally provide greater scope for computing tax burden measures on a disaggregate basis, compared with tax revenue-based ATRs, given the ability to incorporate tax parameters in METR/AETR measures applicable to targeted investment types (with parameter values specified by income tax laws and regulations). The ability to measure METRs/AETRs specific to a given investment-type is however limited by the amount of information available on representative capital and finance weights used in such measures.

[33]. See Jorgenson, D. (1963), "Capital Theory and Investment Behaviour", *American Economic Review*, No.53, pp. 247-59.

[34]. Recent work at the OECD has extended the cross-border model to incorporate various types of tax-planning techniques now commonly employed by multinationals to lower both host and home country taxation on foreign direct investment.

35. In general terms, a tax expenditure is a public expenditure implemented through the tax system by way of a *special tax concession* (that falls outside the basic tax norm or benchmark tax system). Special tax concessions can take the form of a reduced tax rate, a tax allowance or deduction against the tax base, a tax credit against tax payable, a tax deferral or tax exemption, or other form of tax offset.

[36]. When introduced, tax incentives (an important form of TE) should be introduced with clearly stated objectives and sunset clauses. Moreover, the effects of tax expenditures should be periodically evaluated against their stated objectives, including at the time of their termination, under a sunset clause. Evaluation may include discussions with tax administrators involved in screening qualifying investments, surveys of investors (those who do and do not qualify for the incentive), formal cost-benefit assessment, where TE estimates provide the main cost input to cost-benefit assessment of tax incentives.

37. This is particularly relevant for tax relief that is open-ended and non-wastable (tax relief that may be carried forward if unused within the time period for which it is intended).

[38]. TE estimates together with results of cost-benefit assessments should be considered in order to allow policymakers to assess the current prioritisation of public expenditures (tax, non-tax), and possible adjustments to expenditure ranking and amounts. It is important to note that TEs are implicitly ranked ahead of direct expenditures, in that they reduce tax revenues available to fund direct expenditures. Tax expenditures, which directly reduce revenues, are implicitly given higher priority than (all) direct expenditures. When direct expenditures are ranked and compared with an overall revenue cap, even top-rated direct expenditures (*e.g.* for economic development) are assessed against revenues already measured net of tax expenditures.

39. For more information, see *Taxing Wages* at: *www.oecd.org/document/57/0,3343,en_2649_34533_40233913_1_1_1_1,00.html*.

40. Typically, these assessments focus on personal income tax and employer and employee social security contributions, with standard tax allowances factored in. A variant of the *Taxing Wages* framework introduces consumption taxes, recognizing that consumption taxes, by reducing the amount of earned income available for consumption, may reduce labour supply.

[41]. Social security contributions (employee's and employer's) may account for a large proportion of the total tax burden on wage income of individuals and, therefore, may significantly affect labour supply and labour demand. The *Taxing Wages* framework allows assessments of the size of these contributions (relative to personal income tax) in the total tax burden and labour costs, at various income levels and across household groups.

[42]. The basic *Taxing Wages* framework may be expanded to include certain non-standard benefits (*e.g.* unemployment insurance), allowing policy makers to examine interactions between tax systems and benefit systems including their net impact on take-home income, where a central objective is to ensure that desired policy effects are observed, and unintended effects avoided. For example, with the introduction of benefit systems in more advanced developing countries, the interaction between tax and benefit systems may fail to "make work pay" (*i.e.* involve financial disincentives to work) if tax and benefit systems are not properly integrated, leading to various labour market disincentives (*e.g.* a poverty trap situation, where incremental increases in earnings lead to withdrawal of benefits and higher tax payments, so people on low incomes receiving benefits are discouraged from additional effort). Another is an unemployment trap arising where benefits paid to the unemployed are high relative to potential earnings in work, so they have little incentive to find a job (more of an issue for relatively high-income countries with generous benefit programs).

[43]. Profits of incorporated small businesses are normally subject to corporate income tax. When after-tax profit is distributed, it may be subject – under so-called 'classical' tax treatment – to personal shareholder income tax, or final withholding tax on dividends at the distributing company level, implying some degree of double taxation of distributed profit. In the absence of some adjustment to integrate corporate and personal-level taxation to avoid or limit double taxation, this may result in a relatively high pre-tax 'hurdle' rate of return on new equity capital, relative to an investment subject to single taxation. Similarly, capital gains on retained after-tax profit may be taxed on a realisation basis, implying some degree of double taxation of retentions (in the absence of integration relief) tending to increase the hurdle rate of return on invested (retained) earnings. Increased hurdle rates linked to double taxation may be more likely to arise for small businesses with limited access to global capital markets. For large firms with such access, domestic shareholder tax rates may not be expected to factor into the cost of capital. Thus when considering small businesses that must rely on local financing, domestic shareholder taxes would be predicted to increase hurdle rates of return on funds particularly for this group.

[44]. Returns on certain other investments (*e.g.* interest on bonds) may be subject to only a single layer of taxation (*e.g.* personal taxation), or otherwise subject to preferential tax treatment (*e.g.* principal residence, pension savings).

[45]. Under most tax systems, unincorporated business income (comprising a blend of returns on labour and capital inputs) is subject to personal income tax alone (no corporate-level income tax). Self-employed social security contributions may also apply. In the incorporated business case, in addition to corporate and shareholder-level income tax considerations, employer and employee social security contributions may apply to labour income (*e.g.* that of an owner-employee).

46 In contrast, income from capital gains of non-listed shares is subject to personal income taxation.

[47]. Tax systems may also affect levels and the allocation of savings and investment, and employment participation and work-effort decisions, so raising efficiency concerns. Policy makers are, therefore, encouraged to assess how various features of income and other taxes may influence real behaviour. This section and its corresponding "indicator" focus on the exploitation of tax rate differences to minimize income tax for a given set of economic (as opposed to financial) variables (*i.e.* holding labour and capital fixed), by mischaracterizing one form of income (*e.g.* wages) as another (*e.g.* capital income). For example, a worker/owner may pay himself less than an arm's length wage for a given amount of labour input, in order to characterize labour income as tax preferred capital income.

48. Egyptian 2009 tax parameters: 20% corporate income tax rate, dividends and income from capital gains are exempted at the personal level, 20% top marginal personal income tax rate, 14% employee social security contributions are deductible from the PIT base, and 24% employer's social security contributions are deductible from the CIT base.

49. However, capital gains are only exempted in the case of shares of listed-companies; otherwise this income is subject to personal income taxation.

[50]. Depending on risk preferences, symmetric treatment of gains and losses may *increase* the level of risk-taking (*i.e.* increase the percentage of capital placed in assets generating uncertain returns) relative to the no tax case. While this outcome is debatable, in practice risk-taking in small businesses may be expected to be discouraged where the tax system treats small business profits and losses asymmetrically.

[51]. The total resource cost to business of a given tax system may be considered as consisting of two parts – the amount of money that taxpayers are required to pay to government, to meet their tax liabilities (which may be loosely referred to as the "statutory tax burden), and the amount of administrative resources not paid to government but required to determine, document and make tax payments – so-called "tax compliance costs (recording transactions, maintaining accounts, computing and filing tax returns, etc). Measures that reduce tax compliance costs (*e.g.* less frequent filing and payments of a given amount of tax liability) may involve reduced payments to government. Likewise, measures that adjust the statutory tax burden, or the way the tax burden is computed, may result in decreased (or increased) tax compliance costs. A further

consideration is an analysis of the economic incidence of these costs – that is, an examination of how the burden of this total resource cost is reflected in higher consumer prices, reduced total returns to labour and reduced total returns to capital.

52 . See also Sub-Dimension 3.4, Tax Administration.

53. While addressing underreporting of taxable sales and profits is a challenge in dealing with businesses of all sizes, the problem of informality – that is, businesses operating outside the tax system – is a particular challenge in dealing with small firms, where remaining below the radar screen of the tax authorities is generally less difficult. Reducing tax compliance costs is likely to encourage more small businesses to operate within the formal economy, but may not necessarily reduce the level of underreporting of profits, or guarantee that businesses entering the formal economy will fully report all profits.

54. Possible thin capitalisation may be assessed by comparing, at the disaggregate industry level, the debt-to-asset ratio of foreign-controlled firms (inbound FDI) versus domestic-controlled firms. Inbound FDI may include capital of resident shareholders invested in the domestic economy through offshore tax havens. High debt-to-asset ratios of foreign-controlled firms may signal the need to consider the introduction or tightening of thin capitalisation rules, possibly together with a reduction in the statutory corporate income tax rate.

55. Lending is determined as excessive, either by reference to some sort of arm's length test (*i.e.* by a comparison with what independent parties would do), or by reference to certain financial ratios or by a combination of both (*e.g.* fixed financial ratios used only as safe harbours). In addition to the fixed debt-to-equity ratio approach, other categories of thin capitalisation rules often introduced include: arm's length (independent banker) approach; earnings stripping approach; and the consolidated group capital structure approach.

56. See the *Fiscal Blueprints* developed by the European Commission. The *Fiscal Blueprints* provide useful guidance to the desirable features of an efficient institutional setup for tax administration in terms of strategic objectives and performance indicators.

57. See Kidd, M. and W. Crandall (2006), "Revenue Authorities: Issues and Problems in Evaluating their Success", *IMF Working Paper*, No. 06/240, IMF, Washington DC.

58. The integration of the collection of SSCs with tax collection operations mainly reflects rationalisation activities by governments as well as the increased use of the tax system to deliver social policies. The reasons for this integration have been the subject of recent research by officials of the IMF's Fiscal Affairs Department, *IMF Working Paper*: "Integrating Tax and Social Security Contribution Collections Within a Unified Revenue Administration: The Experience of Central and Eastern European Countries", Peter Barrand, Graham Harrison, and Stanford Ross, December 2004.

59. See "Tax Administration in OECD and Selected Non-OECD Countries", in *Comparative Information Series*, prepared by the OECD Forum on Tax Administration and published in January 2009.

60 . There is also a clear trend to allocate other tasks of a non-taxation nature to the national revenue body. Such tasks include government valuation tasks, the payment of various social welfare benefits, the collection of non-tax government debts (*e.g.* child support, student loans), and the maintenance of population registers.

61. The Model Customs and Tax Centre (MCTC) was created with the assistance of USAID. It was phased out following a recommendation from the IMF. At the same time that the LTC was created, the MCTC was replaced on the customs side by a series of modern customs centres with operations at Egypt's key ports and other points of entry.

62. See Indicator 3.4.6, "provision of taxpayer services".

63. Historically, revenue bodies (like other public sector agencies) have tended to focus their reporting for accountability purposes on "outputs" rather than on "outcomes". The main reason for this is the difficulty in measuring "outcomes. Output and outcome measures each present a different set of challenges. Outcomes are technically more difficult to measure: they are complex and involve the interaction of many factors, planned and unplanned. Also, there are problems with time lag issues and in some cases the results are not within the control of the government. Outcomes, however, have a strong appeal for the public and politicians. Most countries appear to have adopted a combination of outputs and outcomes. This is potentially more beneficial than concentrating on just one type of measure.

64. While the term "effectiveness" is typically associated with the extent to which "outcomes" are being achieved, "efficiency" relates to reducing or minimising the use of resources to produce a given level of outputs.

65. While the practice of preparing a multi-year business plan and performance reports is widespread, some revenue bodies do not publish these reports or performance results, whilst others do not include key tax administration-related information (for example tax debts) in their public documents.

66. For some revenue bodies, registration involves the maintenance of basic taxpayer identifying information (*e.g.* for individuals, full name and address, date of birth, and for businesses full name, business and postal addresses) using a citizen or business

identification number that is used generally across government and which, for tax administration purposes, permits the routine identification of taxpayers for a range of administrative functions (*e.g.* issue of notices, detection of non-filers and follow-up enforcement actions). For others, the registration system involves the operation of a system of unique taxpayer identification numbers (TINs) which similarly facilitates general administration of the tax laws. Regardless of whether the identification and numbering of taxpayers is based on a citizen number or a unique TIN, many revenue bodies also use the number to match information reports received from third parties with tax records to detect instances of potential non-compliance, to exchange information between government agencies (where permitted under the law), and for numerous other applications .

67. Traditionally, these reports have been used to verify the information reported by taxpayers in their returns. However, a more recent development has seen use of these reports to pre-fill tax returns. The OECD Forum of Tax Administration‘s initial study of the use of pre-filling-type approaches for personal income tax can be found in the 2006 publication *Information Note – Using Third Party Information Reports to Assist Taxpayers Meet their Return Filing Obligations: Country Experiences With the Use of Pre-populated Personal Tax Returns.*

68. In general, there is strong business case for revenue authorities to invest substantial funds and efforts to establish modern and comprehensive systems of electronic filing and payment. However there are also a number of key issues that revenue bodies need to consider before implementing an increased e-services approach. These key issues include; 1) the provision of e-services needs to be part of an integrated channel strategy and needs to correspond to taxpayer levels of e-capability (e.g. computer literacy and access); and 2) increased use of electronic data requires a robust security strategy to maintain confidentiality, integrity and availability of data. For further information see ‘Survey of Trends in Taxpayer Service Delivery Using New Technologies’ (February 2005), ’Strategies for Improving the Take up Rates of Electronic Services‘, (March 2006), and ‘Survey of Revenue Body Developments and Plans for eServices’ (October 2008).

69. Revenue risk management for revenue authorities implies trying to ensure appropriate taxpayer’s compliance in terms of 1) the right taxpayers paying and, 2) the right amounts of tax paid (at the right time).

70. Compliance risk management describes a process for the identification, assessment, prioritisation, and treatment of compliance risks, and the monitoring and evaluation of the impacts of treatment strategies as part of a revenue body’s strategic management process. It is, therefore, a proactive, systematic analysis of possible events and responses to them rather than a mere reaction mechanism to those limited events that are detected. It is about managing the future rather than administering past events.

71. In practical terms, the application of this more strategic approach has led to better targeting of compliance improvement efforts, more effective matching of compliance improvement strategies with the underlying behaviour to be addressed and, for some countries, demonstrated improvements in specific areas of taxpayers’ compliance.

72 . Central to the risk management process is the measurement of compliance levels. Without a comprehensive compliance measurement programme - which would allow knowing the relative compliance rates, revenue exposure and responsiveness of each of the client segments- the problem of selecting the right client sub-segments to review becomes a subjective management decision. Some assistance can be gained by the use of external data to profile industries, issues and clients, and from the use of a series of risk assessment reviews or scoping audits in a number of client segments to develop a feel for the risks and their relative importance.

1. [73]. While these taxpayer’s charters are a guide to the law and are not legal documents in themselves, in some tax systems they may constitute a ‘ruling’ (although they generally do not provide additional rights and obligations other than those contained in relevant legislation).

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ANNEX

DIMENSION I-3
TAX POLICY AND ADMINISTRATION

A1. Assessor Information

Name	
Organisation/Ministry/Agency	
Title/Position	
E-mail	
Phone	
Fax	
Mailing Address	
Date of Assessment	

A2. Key Data to assist the analysis of the taxation system and framework

Taxation System	2009
Individuals	
Income tax rates	
Personal and family allowances	
Family taxation	Spouses taxed separately? Family unit taxed as a group?
Treatment of:	
- dividend income	Included in investment income and taxable?
- interest income	Included in investment income and taxable?
- capital gains (shares)	Taxable?
- royalties	Included in investment income and taxable?
Withholding tax on:	final: yes/no
- dividends	
- interest payments	
- royalties	
Taxable period	calendar year?
Unincorporated Companies	
Tax regime – business income	
	Directors' remuneration
Treatment of losses	Number of years carried forward Number of years carried back

	2009
Corporations	*CIT on worldwide income?*
CIT	*Rate*:
	Depreciation: Compulsory? Method?
Treatment of losses	Years carried forward Years carried back
Taxable period	Calendar year?
Non-resident withholding tax on:	
- dividends	
- interest payments	
- royalties	
SSC	
Employee	Base: gross wages?
	Rates:
	Thresholds:
	Deductible: yes/no
Self-employed	Base: labour and capital income?
	Rates:
	Thresholds:
	Deductible: yes/no
Employer	Base:
	Rates:
	Thresholds:
	Deductible: yes/no
Payroll tax	
Property tax (corp.)	

	2009
VAT/GST	
Rates	*Standard rate:* *Reduced rates:* *Zero rates:* *Exemptions:*
Taxable persons	
Introduction date	
SMEs taxation	
Definition of SMEs	
Special CIT rate/treatment	
Other taxes on small businesses	
Customs duty	
Excise duty	
Tax incentives	
For foreign investment	
For local investment	

A3. General Observations

To be filled in by the assessor Please use this space to include any additional observations regarding the assessment of this policy dimension.

A4. Overview of Scores

I-3 TAX POLICY AND ADMINISTRATION		SCORE
3.1	**Fiscal position and planning**	
3.1.1	Forecasting aggregate tax revenues	**5**
3.1.2	Assessment of fiscal balance and policy feedback	**5**
3.2	**Taxation, investment and employment**	
3.2.1	Firm-level analysis of corporate tax burden by sector	**2**
3.2.2	METR analysis of tax impediments to domestic investment	**1**
3.2.3	Transparency in provision of corporate tax incentives for investment	1
3.2.4	'Tax wedge' analysis of tax impediments to employment	**1**
3.3	**Taxation of SMEs and MNEs**	
3.3.1	Analysis of tax impediments to equity financing of SMEs	**n.a.**
3.3.2	Analysis of tax arbitrage by SME owners	**1**
3.3.3	Analysis of tax impediments to risky investment in SMEs	**1-2**
3.3.4	Assessment of tax compliance costs and remedial measures	**2**
3.3.5	Analysis of non-resident withholding tax payments	**1**
3.3.6	Analysis of thin capitalization of the tax base	**1**
3.4	**Tax Administration**	
3.4.1	Consolidation of management of revenue administration	**4**
3.4.2	Organization of revenue administration tasks	**4-5**
3.4.3	Strategic management	**2**
3.4.4	Centralized electronic processing of taxpayer information	**3**
3.4.5	Compliance assessment and risk management	**3-4**
3.4.6	Provision of taxpayer services	**4**

A5. Assessment Framework

The tax component of the *Business Climate Development Strategy* (*BCDS*) framework contains a set of indicators for assessing country performance against various analytical frameworks, including basic standard tax models. They examine various tax policy issues and guide policy development with regard to revenue effects, distributional effects, behavioural effects, and efficiency implications of tax systems. A central purpose of the indicator exercise is to help determine the targeting and content of OECD-led technical workshops for MENA countries, developing the construction and policy applications of analytical frameworks (models) and providing guidance (if requested and feasible) in their implementation.

A second, related, purpose of the exercise is to work towards the development of policy-relevant and comparable tax data (*e.g.* tax revenue mix, tax burden measures) within the Ministries of Finance in MENA countries to be used as a basis for tax policy dialogue.[74] (The tax data are derived using similar models and are thus comparable across countries.) Comparable data are required, in particular, to enable assessments and cross-country comparisons of tax policy as it impacts investment, employment and fiscal stability at future meetings of Working Group 3 (WG3) on Tax Policy Analysis of the MENA-OECD Investment Programme.[75]

The indicator exercise relies on self-assessment by participating MENA countries combined with peer reviews: a senior tax policy official in each country is assigned the task of providing an accurate assessment of his/her country's position under each of the indicators in section A7 below. Country assessments would be submitted to the OECD Secretariat, then circulated to all MENA countries involved in the exercise to prompt exchanges of e-mails on the findings and discussions of the assessments at subsequent WG3 meetings.

At WG3 meetings MENA countries with relatively high scores on one or more indicators will be asked to present an overview of their analytical frameworks and tax measures that correspond to the BCDS indicators and policy applications.

The following section, A5.2, provides an overview of three standard frameworks, or models, that form the core of tax policy assessment under the BCDS exercise. Section A7 presents the indicators used to determine the extent to which these frameworks, or models, are applied in the assessment of tax policy.

A6. Overview of Standard Models and Policy Applications

Tax policy development requires certain key information and data as a basis for analysis and assessment. Given the complexities of taxation, analytical frameworks are important. The basic kind are the standard tax models commonly used in developed and developing country contexts to assess tax systems. Informed tax policy making requires, at a basic level, information on the contribution of different taxes to total tax revenue (the tax mix) and estimates of how tax revenues are likely to change when tax rates or other tax parameters change. Anticipating levels of taxpayer support for a given tax reform requires assessing who stands to gain (pay less tax) and who will lose out (pay more). It also involves considering whether a package of measures might be possible or desirable in producing a balanced outcome.

It is also important that policy officials have in place analytical frameworks to measure effective tax rates on employment income and capital income, which includes returns in interest, dividends and capital gains. Where possible, disaggregate estimates should be assessed, given that tax rates can vary by a significant margin across taxpayer groups, be they households with different compositions and income levels or firms of varying size, structure, and business activity. Disaggregation enables horizontal and vertical equity assessments, assessments of tax distortions (efficiency effects), and precision in revenue estimation. Measurement of marginal and average tax rates allows policy makers to separately address how tax distortions affect work effort, labour market participation, investment financing, and location and scale decisions.

Assessments of analytical capacity recognise the advantages of using transparent modelling approaches and of relying not only on macro-data but on taxpayer-level micro-data, too. Policy makers are also encouraged to produce tax burden measures (of tax revenues and effective tax rates) that are derived from approaches and under assumptions similar to those used in other countries in order to facilitate meaningful international comparisons of tax systems.

The key policy assessment indicators detailed in section A7 address capacity in the following areas:

1. micro-simulation analysis of tax revenues – estimates the effects of tax reform on total tax revenues and on the distribution of tax burden across taxpayers and sectors of the economy;
2. effective tax rate analysis of investment (METR framework) – assesses tax distortions and impediments to investment.
3. effective tax rate analysis of employment (*Taxing Wages* framework) – assesses tax distortions and obstacles to employment.

A6.1. Micro-Simulation Analysis of Tax Revenues (Total and Distributional Effects of Tax Reform)

Central to the development of successful reform of personal and/or corporate income tax are estimates of how reform affects total income tax revenues (aggregate effects) and the amounts of tax paid by different taxpayer groups (distributional effects). The standard modelling framework used to estimate the effects of broad-based or targeted tax reforms on total tax revenues and on the distribution of the tax burden is a micro-simulation model. The main distinguishing feature of such models is that they rely on taxpayer-level micro-data collected from corporate and personal income tax returns, rather than on aggregate economy-wide macro-data (*i.e.* national statistics). Key advantages of micro-simulation models based on taxpayer-level data are that: they can be used to examine the effects on revenue of a broad array of possible tax policy adjustments; they can assess the distributional impacts of tax reform; and they can also be used to check the accuracy of aggregate revenue forecasts produced by models based on aggregate (national accounts) data.

A discussion of the procedures for compiling representative samples of taxpayer data as input for micro-simulation models is well beyond the scope of this chapter. OECD tax modelling workshops, however,

cover micro-simulation data construction in detail,[76] while it does lie within the scope of this chapter to further examine why micro-simulation models are critically important.

All countries that rely on tax systems to raise revenues in order to finance government expenditure are encouraged to have in place frameworks that provide policy makers with estimates of current and future tax revenues under both current tax rules and revised tax rules introduced as part of tax reform.[77] To properly inform policy decisions, such models should be able to estimate the aggregate revenue effects and distributional effects of both broad-based and targeted tax reforms.

Revenue estimation models based on aggregate (national accounts) data, while generally able to produce estimates of the impacts of certain broad-based tax changes on tax revenue, are generally not capable of estimating tax revenues affected by reforms targeted at certain taxpayers (*e.g.* single parents or small business owners), at certain expenditures (*e.g.* investment in plant, R&D), or at some other dimension. Moreover, macro-models based on aggregate data cannot be used to assess the distributional impact of any tax reform, *i.e.* how it affects different household groups and companies of different sizes in different sectors and regions. In other words, in order to assess the revenue impact of targeted tax changes, and to assess the distributional effects of tax reform, micro-simulation models must be used.

Assessments of the distributional effects of broad-based tax reform are centrally important for two main reasons. First, broad-based (generally applicable) tax provisions often affect different taxpayer groups in different ways. The second reason is tied to equity considerations surrounding tax reform (like income inequality across households before and after reform) and to the political importance of seeking public support for reform decisions.

For example, adjustments to basic personal income tax provisions typically affect different individual taxpayers or households differently, depending on taxpayer income and household structure (married or single, with or without children). Tax rules typically take into account not only income but also family characteristics. Similarly, corporate income tax reform – *e.g.* a change in the CIT rate, replacement of a single CIT rate by a tiered CIT rate structure, or less generous treatment of business expenses – may affect firms differently, depending on the industry, the size of the firm, and even the province or region of the country where it is located.[78] Policy makers may also be interested in how a given reform affects domestically owned compared to foreign-owned resident firms.

By assessing which taxpayer groups are negatively or positively impacted by the reform of a particular tax provision, policy makers may consider how to address (possibly unintended) distributional effects, *e.g.* by introducing or adjusting other tax parameters that may provide a more balanced outcome across taxpayers. Distributional considerations are also generally important not only for equity, but also for assessing the efficiency of a tax system.

The ability to estimate the distributional effects of targeted tax reform is also obviously important, with many, if not most, tax systems incorporating some element of targeting. Tax incentives for investment may, for example, be targeted at one business activity, *e.g.* manufacturing, to the exclusion of others. Changes to personal income tax rates often involve changes to rates applicable only to certain taxable income ranges or "bands".

In addition to assessments of the distributional effects of broad-based or targeted reform, micro-simulation models provide estimates of effects on current and projected total tax revenues. As noted above, such estimates may be more accurate than those derived from aggregate macro models. Micro-simulation models are thus helpful in managing the fiscal position of the government, as they produce forecasts of total tax revenues considered alongside projected expenditures. Accurate forecasts are, of course, important in guiding policy-making and avoiding the large unanticipated adjustments in tax or expenditure policy that are likely to arise when such information is not monitored and accurately assessed. Erratic tax and expenditure policy is to be avoided as it impairs the certainty of host country conditions, routinely placed high on (if not at the top of) lists of factors which investors identify as key to their investment decisions.

The relevant indicators in section A7 of this annex are as follows:

- firm-level analysis of corporate tax burden by sector
- taxpayer-level analysis of personal taxation of employment income

- firm-level analysis of tax burden on SMEs by sector
- firm-level analysis of tax burden on inbound FDI by sector.

A6.2. Effective Tax Rate (METR) Analysis of Investment (Tax Distortions, Impediments)

In virtually all market-based countries, the integration of national economies forces policy makers to critically re-examine their tax systems and assess likely impacts on investment.[79] Arguably the framework most widely used by tax policy economists to assess the net effect of tax systems on investment behaviour is the forward-looking marginal effective tax rate (METR) model.[80] A METR model calculates "wedges" that tax systems drive between pre-tax rates and after-tax rates of return on investment "at the margin" – *i.e.* on the last currency unit of capital invested, where the marginal benefit just covers the marginal cost. METR statistics may be generated for various capital asset types (machinery, equipment, buildings and inventories), investor types, sources of finance, and at various levels of disaggregation.

The METR framework is highly attractive in that it provides a summary indicator of the net effect of taxation on a given investment type, factoring in (often numerous) key tax parameters – some tending to discourage investment, some to encourage it. These parameters include statutory corporate tax rates and key parameters influencing the tax base, such as depreciation allowances, investment tax credits, capital tax (if applicable), and sales tax (including non-recoverable VAT) on capital inputs. METR models may also factor in personal taxes (investment in micro-enterprises, which relies on local financing), where shareholder dividend tax rates and capital gains tax rates (if applicable) may influence minimum required hurdle rates of return on investment.

The METR model is not restricted to domestic investment. It may also be extended to consider cross-border investment.[81] When combined with elasticity estimates of the sensitivity of investment to taxation, the framework can be used to estimate the percentage change in domestic investment and FDI in response to one or more tax policy adjustments.

To those not familiar with the neo-classical model of firm behaviour from which METR statistics are developed, the interpretation and use of such statistics may not be readily apparent. Indeed, studies using this form of tax rate analysis tend too often to obscure rather than clarify the underlying assumptions and model structure. However, the OECD has developed materials to explain METR analysis in a step-by-step, user-friendly fashion in order to shed light on the basic concepts and address the "black box" reputation of such measures. The technical analysis is supplemented by a review of key underlying assumptions and data limitations to be kept in mind when interpreting METR results.

The relevant indicators presented in section A7 of this annex are as follows:

- METR analysis of tax distortions to domestic investment.
- METR analysis of tax distortions to SME investment.
- METR analysis of tax distortions to cross-border investment.

A6.3. Effective Tax Rate (Taxing Wages) Analysis of Employment (Tax Distortions, Impediments)

Also critical for policy analysis and development are effective tax rate models to assess the likely net impact of tax systems on employment (labour markets).[82] The *Taxing Wages* methodology allows policy makers to assess the impact of alternative tax reforms on average and marginal tax rates levied on wage income for different household types, differing by income level and household composition (married or single, with or without children), and thereby infer employment (labour demand and supply) effects. Typically, these assessments focus on personal income taxation of wage income, as well as employer and

employee social security contributions on labour income. Standard tax allowances are also normally factored in.[83]

Comparative analysis of international trends in personal income tax reforms can be useful for policy makers. However, the modelling of effective tax rates on labour income and analysis of labour market effects are important because policy recommendations on personal income tax reform must be tailored to the specific situation of a country. Labour market issues, such as the importance of youth and part-time, long-term and seasonal unemployment, may differ markedly. Tax levels and structure also vary. Furthermore, reforms tend to build on current systems, targeting problem areas without necessarily disrupting reasonable expectations of links between social security contributions and benefits. They also must be compatible with other policies designed to reduce unemployment.

The *Taxing Wages* methodology considers the detailed structure of a country's tax system as it impacts labour income and allows assessments of the impact of alternative tax reforms on different types of households. In particular, the *Taxing Wages* methodology calculates the personal income tax and social security contributions paid by employees and their employers, and examines how these levies and cash family benefits impact on net household incomes.[84]

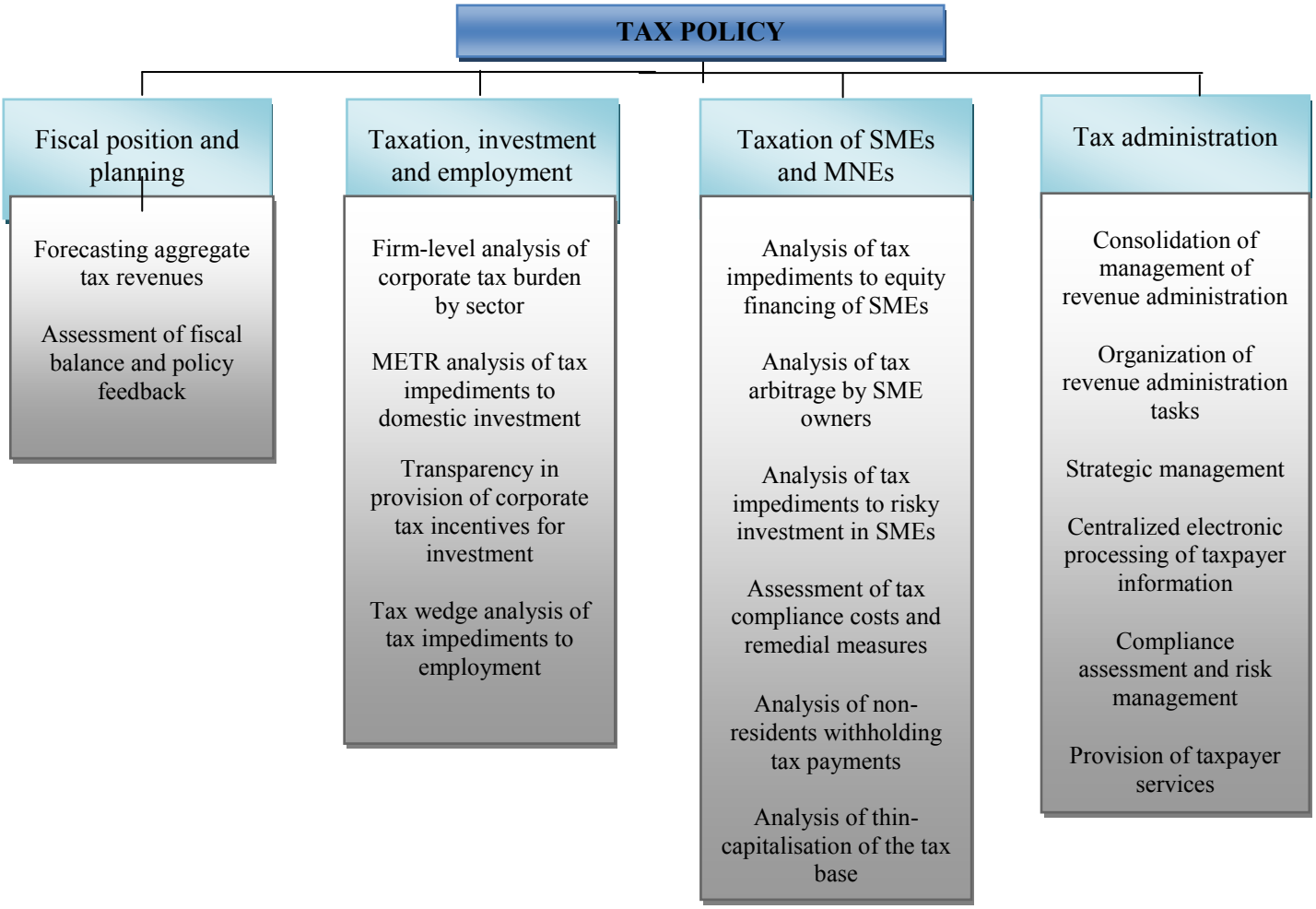
The *Taxing Wages* framework is used to derive average and marginal tax rates on labour income. Average tax rates – which show social security contributions and the percentage of gross wage earnings or total labour costs taken in tax (before and after cash benefits) – are used to analyse the impact of taxes on job market participation decisions. Marginal tax rates, which show the share of an increase in gross earnings or total labour costs that is levied, are used to assess the impact of taxes on work effort at the margin (whether to work longer hours).

The basic *Taxing Wages* framework may be extended to certain non-standard benefits (*e.g.* unemployment insurance). Policy makers may thus examine interactions between tax systems and benefit systems. One example is their net impact on take-home income, where a central objective is to ensure that desired policy effects are obtained and unintended effects avoided. With the introduction of benefit systems in more advanced developing countries, the interaction between tax and benefit systems may fail to make work pay. If tax and benefit systems are not properly integrated, they may act as labour market disincentives. In a poverty trap situation, for example, incremental increases in earnings lead to the withdrawal of benefits and higher tax payments. People on low incomes receiving benefits are discouraged from making any additional efforts.[85]

As in other areas, policy changes that countries may wish to consider can be expected to vary from one country to the next according to tax and benefit structures. For example, reductions in average and marginal tax rates at low levels of earnings will reduce the tax bias against the transition from unemployment (or welfare or black economy) to work. In some countries raising thresholds would be an effective way to reduce average tax rates, while in others taxing employment benefits may be preferable.

The relevant indicator in section A7 of the Annex is "Tax wedge analysis of tax impediments to employment".[86]

Figure A1. Assessment framework for tax policy and administration



A7. Measurement

This core section presents the BCDS framework's tax component indicators with which countries assess and rate their tax policy performance. The focus is on the use of the standard analytical frameworks outlined above, although other policy assessment dimensions are also considered.
The indicators are components of five tax policy topics (*i.e.* sub-dimensions of the BCDS Tax Policy and Administration Dimension) that impact on economic development, particularly investment and employment. The five topics are:

1. Fiscal position and planning

1.1 Indicator for forecasting aggregate tax revenues
1.2 Indicator for assessing fiscal balance and policy feedback

2. Taxation, investment and employment

2.1 Indicator for firm-level analysis of corporate tax burden by sector
2.2 Indicator for METR analysis of tax impediments to domestic investment
2.3 Indicator for transparency in provision of corporate tax incentives for investment
2.4 Indicator for 'tax wedge' analysis of tax impediments to employment

3. Taxation of SMEs and MNEs (cross-border investment)

3.1 Indicator for analysis of tax impediments to equity financing of SMEs
3.2 Indicator for analysis of tax arbitrage by SME owners
3.3 Indicator for analysis of tax impediments to risky investment in SMEs
3.4 Indicator for assessment of tax compliance costs and remedial measures
3.5 Indicator for analysis of non-resident withholding tax payments
3.6 Indicator for analysis of thin capitalisation of the tax base

4. Tax administration [2]

4.1 Indicator for consolidation of management of revenue administration
4.2 Indicator for organisation of revenue administration tasks
4.3 Indicator for strategic Management
4.4 Indicator for centralised electronic processing of taxpayer information
4.5 Indicator for compliance assessment and risk management
4.6 Indicator for provision of taxpayer services

Countries are asked to assign themselves a score, or level, from 1 to 5 for each indicator. Level 1 denotes a lack of interest in pursuing policy assessment under a particular topic. Level 5 signifies a high level of commitment, with levels 2-4 falling between disinterest and commitment.
Unless otherwise indicated, assessments consider the activities of the main central government department normally responsible for the development and legislation of national tax policy.[87] In many countries the relevant department is the Ministry of Finance. In some, however, and in particular for the BCDS indicators that address tax administration issues, the actions and activities of the central tax administration may also be included in the review.

[2] Considerable reforms are currently under way in Egypt's Tax Administration. These are likely to affect performance in the short and long run. Scores recorded in the main body of the text are therefore only indicative. There are no 5-level "grids" for these indicators.

SUB-DIMENSION 3.1.: FISCAL POSITION AND PLANNING [88]

Indicator 3.1.1.: Forecasting Aggregate Tax Revenues

Aggregate (GDP-based) forecasting of aggregate tax revenues for each main tax.

3.1 – TAX POLICY AND ADMINISTRATION: FISCAL POSITION AND PLANNING					
	Level 1	Level 2	Level 3	Level 4	Level 5
3.1.1 Forecasting Aggregate Tax Revenues	The Ministry of Finance does not maintain aggregate (*e.g.* GDP-based) tax revenue forecasting models to produce forecasts of tax revenues for informed tax and expenditure policy making. No current plans for implementation.	The Ministry of Finance does not maintain aggregate tax revenue forecasting models, but is taking steps towards implementing them.	The Ministry of Finance does not maintain aggregate tax revenue forecasting models, but is currently taking steps to implement them within one year.	The Ministry of Finance has implemented an aggregate tax revenue forecasting model for one or more taxes, but not for all main taxes (contributing 5% or more to total tax revenues).	Aggregate tax revenue forecasting models are maintained by the Ministry of Finance for each main tax

Indicator 3.1.2.: Assessment of Fiscal Balance and Policy Feedback

Consideration of fiscal balance (total tax revenues, non-tax revenues, public expenditures).

3.1 – TAX POLICY AND ADMINISTRATION: FISCAL POSITION AND PLANNING					
	Level 1	Level 2	Level 3	Level 4	Level 5
3.1.2 Assessment of Fiscal Balance and Policy Feedback	Neither tax revenue collection nor public expenditures are monitored on a regular (*e.g.* monthly) basis to enable assessment of the fiscal balance. No current plans to implement systematic data collection systems for tax revenues and public expenditures.	Tax revenue collection and public expenditures are not monitored on a regular basis, but the government is currently taking steps towards implementing systematic data collection systems within one year.	Tax revenue collection and public expenditures are monitored on a regular (*e.g.* monthly) basis.	Tax revenue collection and public expenditures are monitored regularly. In addition, estimates of planned public expenditure are routinely considered and decided alongside estimates of total tax revenues, aggregate non-tax revenues, and overall fiscal balance (current year, forecast years).	Level 4 plus the requirements that: a) expenditure items classified by type are ranked/prioritised on the basis of policy objectives, with budget allocations addressing priority expenditures; and b) formal or informal rules are in place requiring adjustments to government expenditure and/or tax design where the fiscal balance is negative and exceeds a fixed percentage of GDP (*i.e.* mandatory feedback of fiscal balance/debt projections into budget decisions including tax policy).

Background Notes to Sub-Dimension 3.1

Indicators 3.1.1 and 3.1.2 under "Fiscal Position and Planning" address country practices in developing short- and medium-term fiscal policy plans. These plans typically involve ongoing iterations as tax bases and corresponding revenue estimates and expenditure plans are reconsidered and reconciled.

Indicator 3.1.2 considers whether efficient information systems are in place to accurately monitor tax revenue collection and public expenditures on a regular (*e.g.* monthly) basis; whether expenditure items, classified by type, are prioritised or ranked on the basis of policy objectives; whether estimates of planned public expenditure are considered alongside estimates of total tax revenues, aggregate non-tax revenues, and overall fiscal balance (current year, forecast years); and whether feedback rules are in place requiring adjustments to public expenditure and/or taxes where the fiscal balance is negative and exceeds some fixed percentage of GDP (*i.e.* mandatory feedback of fiscal balance and debt projections into policy decisions).

Relevant models and data include the following:[89]

- GDP-based tax revenue estimation models (for each main tax);[90]
- historical tax revenue data;
- national accounts income, expenditure and balance of payments data (historical data);[91]
- non-tax revenue data (current year, forecast years);
- public expenditure data, grouped by function (current year, forecast years).

Fiscal policy management involves the maintenance of current and planned public expenditure accounts where expenditure items are classified by function (infrastructure development, education, health) and ranked in terms of importance and efficiency in meeting policy objectives (*e.g.* economic development). Sufficiently detailed current and forecasted revenue accounts must also be prepared with tax revenue accounts disaggregated by type of tax (*e.g.* personal income tax, corporate income tax, VAT, single-stage sales tax, excise, customs duties, capital tax, property tax, non-resident withholding tax). Drawing on these accounts, fiscal balance indicators should be prepared, measuring overall fiscal balance, primary balance, and public debt as percentage of GDP.

Fiscal sustainability should also be assessed.[92] Where the fiscal balance is negative, consideration should be given to adjusting the mix and level of taxes, and restricting low-ranked public expenditures.[93] This includes assessments of actual and target levels of tax on business income and corresponding effective rates, including tax on corporate profits and personal tax on business income of the self-employed. These assessments should be considered alongside assessments of the actual and target reliance on other taxes.[94] Estimates of actual and target tax revenues on business income and corresponding effective tax rates should be based on a combination of aggregate data, and (firm-level) micro-data (addressed in Sub-Dimension 5.2 "Taxation and Investment").

Tax officials should regularly assess corporate tax revenues and corresponding tax rates, alongside analyses of tax revenues and rates on other bases, as part of an ongoing assessment of the ability of the tax system to meet policy goals and objectives. Policy consideration may be given to adjusting the tax rate on business income by adjusting parameters and provisions that determine the statutory tax burden, if the existing tax burden on business income is judged to be inappropriate (*e.g.* too low in relation to revenue needs or in relation to the current reliance on other tax bases).

Target tax burden assessments should be made taking into account fiscal policy objectives, the fiscal position of government, estimates of the actual and potential tax burden on business income, and anticipated revenues from other taxes (possibly under a revised tax mix). Possible adjustments to tax on business income may be considered alongside some combination of adjustments to expenditures and/or other taxes, taking into account the desired trajectory of the fiscal balance. Consideration may be given to reducing reliance on taxes believed to be impeding economic development (*e.g.* trade taxes, capital taxes). Revenue reductions could be replaced by an increased effective tax rate on business income where the actual rate is judged to be too low, in the sense that increasing the rate is expected to raise additional tax revenues (the implication being limited negative impact on the tax base).

SUB-DIMENSION 3.2.: TAXATION, INVESTMENT AND EMPLOYMENT[95]

Indicator 3.2.1.: Firm-Level Analysis of Corporate Tax Burden by Sector

This indicator considers whether:

- a corporate income tax (CIT) micro-simulation model is maintained – with input data from a stratified sample of CIT returns from corporations classified by industry and location;[96]
- the model is used regularly to analyse actual (post-reform) total CIT revenues in the current year and forecast years; CIT revenues by sector; CIT revenues foregone by tax incentives;[97] and average tax rates (ATRs) on corporate profits by industry and location.[98]

Relevant models and data include the following:[99]

- corporate income tax (CIT) micro-simulation model;
- corporate tax return data (stratified sample of tax returns), survey data;
- depreciation calculator model;
- corporate and shareholder-level tax parameter data.

3.2 – TAX POLICY AND ADMINISTRATION: TAXATION AND INVESTMENT					
	Level 1	Level 2	Level 3	Level 4	Level 5
3.2.1 Firm-level analysis of corporate income tax burden, by sector	The Ministry of Finance does not maintain a corporate income tax (CIT) micro-simulation model enabling firm-level and sector-specific analysis of CIT revenues, revenue effects of adjustments to CIT rates, main CIT base provisions and tax incentives, and effective tax rates on corporate profits. No current plans for implementation.	The Ministry of Finance does not maintain a CIT micro-simulation model enabling firm-level and sector-specific analysis of CIT revenues, revenue effects of adjustments to CIT rates, main CIT base provisions and tax incentives, and effective tax rates on corporate profits, but is taking steps to implement them.	The Ministry of Finance does not maintain a CIT micro-simulation model enabling firm-level and sector-specific analysis of CIT revenues, revenue effects of adjustments to CIT rates and main CIT base provisions and tax incentives, and effective tax rates on corporate profits, but is taking steps towards implementation within 1 year.	The Ministry of Finance maintains a CIT micro-simulation model. The model is routinely used to analyse firm-level and sector-specific CIT revenues, revenue effects of adjustments to CIT rates, main CIT base provisions and tax incentives, and effective tax rates on corporate profits.	Level 4 plus the requirements that: a) underlying corporate tax return data are checked to identify entry and/or transcription errors; b) the CIT model is updated each year (involving transcription of new tax return data each year); c) forecasts of corporate tax revenue from the micro-simulation model are cross-checked with forecasts from an aggregate (*e.g.* GDP-based) corporate tax revenue model.

Indicator 3.2.2.: METR Analysis of Tax Impediments to Domestic Investment

Analysis of tax distortions on domestic investment – measurement of marginal effective tax rates (METRs) on domestic corporate profits. This indicator considers whether a METR model is in place and regularly used to assess non-neutralities introduced by the corporate tax system into domestic investment scale and location decisions. (For more on the METR model and its applications, see section A6.2).

3.2 – TAX POLICY AND ADMINISTRATION: TAXATION AND INVESTMENT					
	Level 1	Level 2	Level 3	Level 4	Level 5
3.2.2 METR Analysis of Tax Distortions to Domestic Investment	The Ministry of Finance does not maintain a marginal effective tax rate (METR) model to enable summary analysis of tax effects on (distortions to) the level of investment. No current plans for implementation.	The Ministry of Finance does not maintain a METR model to enable summary analysis of tax effects on investment, but is taking steps towards implementation.	The Ministry of Finance does not maintain a METR model to enable summary analysis of tax effects on investment, but is currently taking steps towards implementation within one year.	The Ministry of Finance maintains a METR model. The model is routinely used to analyse tax effects on (distortions to) domestic investment and the implications of tax reform proposals.	Level 4 plus the requirements that: a) the METR model is disaggregated across machinery and equipment, buildings, inventory and land; b) METR results are explained in summary reports for consideration by ministers to help inform policy-making.

Indicator 3.2.3.: Transparency in Provision of Corporate Tax Incentives for Investment

This indicator considers whether tax expenditure accounts are prepared periodically. These accounts include estimates of tax revenues foregone by main corporate tax incentives for investment. For proper fiscal management, tax expenditure (TE) accounts should be prepared for informed fiscal planning and to improve investor as well as taxpayer confidence in the system, support good governance, and promote economic development. Preparing TE accounts and identifying and estimating public expenditures resulting from special (targeted) tax relieving provisions (*e.g.* tax incentives) requires the development of TE frameworks by type of tax (*e.g.* personal income tax, corporate income tax, value-added tax).
The development of personal and corporate income tax TE frameworks requires the construction of micro-databases, based on representative samples of individual and corporate taxpayers. The development of a VAT TE framework generally requires input-output information from national accounts data.

3.2 – TAX POLICY AND ADMINISTRATION: TAXATION AND INVESTMENT					
	Level 1	Level 2	Level 3	Level 4	Level 5
3.2.3 Transparency in Provision of Corporate Tax Incentives for Investment	The Ministry of Finance does not produce tax expenditure estimates of tax revenues foregone by main corporate tax incentives for investment to be used to inform tax incentive policy-making and to provide transparency in the provision of tax incentives. No current plans for preparing such estimates.	The Ministry of Finance does not produce tax expenditure estimates of tax revenues foregone by main corporate tax incentives for investment, but is taking steps towards producing such estimates.	The Ministry of Finance does not produce tax expenditure estimates of tax revenues foregone by main corporate tax incentives for investment, but is currently taking steps towards producing such estimates within one year.	The Ministry of Finance periodically prepares tax expenditure estimates of tax revenues foregone by main corporate tax incentives for investment. The estimates are considered alongside direct expenditures when developing government expenditure and tax policies.	The Ministry of Finance regularly (*e.g.* annually) publishes and releases to the public tax expenditure reports that include estimates of tax revenues foregone by main corporate tax incentives for investment.

Indicator 3.2.4.: Tax Wedge Analysis of Tax Impediments to Employment.[100]

This indicator considers whether a (parameter-based) model measuring tax wedges and corresponding marginal and average tax rates on labour income are calculated (by gross wage income level and household type, which includes personal income tax and employee/employer social security contributions, as per OECD *Taxing Wages* methodology) and used regularly to assess distortions introduced by the income tax and social security contribution system[101] into employment decisions.[102]

3.2 – TAX POLICY AND ADMINISTRATION: TAXATION, INVESTMENT AND EMPLOYMENT					
	Level 1	Level 2	Level 3	Level 4	Level 5
3.2.4. "Tax wedge" analysis of tax impediments to employment	The Ministry of Finance does not maintain a tax wedge model measuring marginal and average tax rates on labour income to assess tax distortions to employment. No current plans for implementation.	The Ministry of Finance does not maintain a tax wedge model measuring marginal and average tax rates on labour income to assess tax distortions to employment, but is currently taking steps towards implementation within one year.	The Ministry of Finance maintains a tax wedge model measuring marginal and average tax rates on labour income. The model is used to analyse possible tax distortions on labour market participation, on work effort, and possible "bracket-creep" accompanying inflation	Level 3, plus the requirement that the model/framework covers a number of possible household structures (*e.g.* single, married couple, with/without children), alternative wage earnings levels, part-time work, and spousal work.	Level 4, plus the requirement that the results from the model/framework are compared with results for other countries (*e.g.* as available in the OECD *Taxing Wages* publication) and are used systematically to inform policy makers of the labour market implications of alternative policy adjustments to the taxation of wage income.

SUB-DIMENSION 3.3.: TAXATION OF SMEs AND MNEs

Indicator 3.3.1.: Analysis of Tax Impediments to Equity Financing of SMEs

This indicator considers whether (parameter-based) effective tax rates are measured for distributed profits and retained profits of incorporated SMEs[103] in order to analyze possible tax impediments to SME equity finance, and to consider neutrality implications of alternative integration approaches/measures to avoid double taxation of equity income.[104]

3.3 – TAX POLICY AND ADMINISTRATION: TAXATION OF SMES					
	Level 1	Level 2	Level 3	Level 4	Level 5
3.3.1. Analysis of tax impediments to equity financing of SMEs	Studies examining implications for enterprise financing and investment of double taxation of distributed and retained profit have not been undertaken by tax officials.	Studies examining implications for enterprise financing and investment of double taxation of distributed and retained profit have been undertaken by tax officials, with study findings documented and reported to senior Ministry of Finance officials for discussion and consideration.	Level 2, plus the requirement that the analysis of double taxation includes an assessment of pros and cons and tax revenue implications of alternative "integration" systems to relieve double taxation of distributed and retained profits.	Level 3, plus the requirement that findings of studies of double taxation and alternative integration systems are addressed in current tax policy or in planned tax reform over the next two years.	Level 4, plus the requirement that studies of special tax incentives in the current system, or planned for introduction over the next two years, or being proposed by business (main provisions) to increase financing of small enterprises, have been undertaken, documented, and reported to senior Ministry of Finance officials. Tax revenue and efficiency implications of adjusting (possibly eliminating) these incentives have been considered alongside implications of adjusting the degree of double taxation relief in respect of distributed and retained profit.

Indicator 3.3.2.: Analysis of tax arbitrage by SME owners

This indicator considers whether (parameter-based) effective tax rates are calculated for the different types of income of an owner-worker of a closely held SME in order to determine cases where tax rate differences arise that could be expected to encourage owner-workers to mischaracterise certain income types so as to reduce their overall tax burden. For example, an owner-worker of an incorporated SME may be encouraged to report some portion of his/her wage income as dividend income (*i.e.* payout as wages less than an arm's length price for labour services) in cases where the combined income tax and employee plus employer social security contribution on wage income exceeds the combined corporate and personal tax rate on dividend income (or alternatively receive such income as tax-preferred capital gains on SME shares).[105]

3.3 – TAX POLICY AND ADMINISTRATION: TAXATION OF SMES					
	Level 1	Level 2	Level 3	Level 4	Level 5
3.3.2. Analysis of tax arbitrage by SME owners	Studies have not been undertaken by tax officials examining effective tax rates on business income of closely held corporations paid out as wages, or dividends, or realised as capital gains, to assess possible tax distortions to earnings payout policies in such cases. Similarly, studies have not been undertaken examining possibilities for conversion of taxable capital gains (*e.g.* on real property) into tax-preferred (possibly tax-exempt) capital gains (*e.g.* on shares).	Studies have been undertaken by tax officials examining effective tax rates on business income of closely-held corporations paid out as wages, or dividends, or realised as capital gains, to assess possible tax distortions to earnings payout policies.	Level 2, plus the requirement that studies have also been undertaken by tax officials examining possibilities for conversion of taxable capital gains into tax-preferred (possibly tax-exempt) capital gains.	Level 3, plus the requirement that reports have been prepared considering possible means to address tax arbitrage by owners of closely-held companies. The findings have been documented and reported to senior Ministry of Finance officials for discussion and consideration, but measures have not been adopted to address the most common forms of tax arbitrage.	Level 4, plus the requirement that measures have been adopted to address the most common forms of tax arbitrage

Indicator 3.3.3.: Analysis of tax impediments to risky investments in SMEs

This indicator considers whether cross-country comparisons are regularly carried out for business loss offset rules (rules that determine what types of taxable income business losses can be deducted or set off against), capital loss offset rules for SME shares to address the tax treatment of risk taking, and possible behavioural effects (including incentives for risk-taking, and tax-planning).

3.3 – TAX POLICY AND ADMINISTRATION: TAXATION OF SMES					
	Level 1	Level 2	Level 3	Level 4	Level 5
3.3.3. Analysis of tax impediments to risky investment in SMEs	Possible impediments to investment in early-stage, high-risk companies of alternative loss-offset rules governing limits to tax deductibility of business losses and capital losses on shares have not been analysed, documented or discussed amongst senior tax officials of the Ministry of Finance.	Possible impediments to investment in early-stage, high-risk companies of alternative loss-offset rules governing limits to tax deductibility of business losses and capital losses on shares have been analysed with findings documented and reported to senior Ministry of Finance officials for discussion and consideration.	Level 2, plus the requirement that tax-planning opportunities under alternative loss-offset provisions have been examined (taking into account limits to tax audit surveillance that can be carried out by the tax administration), with study findings reported to senior Ministry of Finance officials for discussion and consideration.	Level 3, plus the requirement that the main findings of studies of possible impediments to risk-taking (including investment in equity shares) and possible tax-planning opportunities under alternative loss-offset provisions are addressed in current tax policy, and/or in planned tax reform over the next two years	Level 4, plus the requirement that following the adoption of tax reform that expands or limits loss offset provisions, and/or broadens or contains scope for tax-planning around losses, an ex-post evaluation is carried out that examines implications for risk-taking and tax-planning.

Indicator 3.3.4.: Assessment of Tax Compliance Costs of SMEs and Remedial Measures

This indicator considers whether assessments are made of the tax compliance costs of SMEs that are linked to tax policy and tax administration, and whether consideration has been given to adjusting tax administration where compliance costs are found to be too high, in order to encourage SME compliance and business activities.[106]

3.3 – TAX POLICY AND ADMINISTRATION: TAXATION OF SMES					
3.3.4. Assessment of tax compliance costs of SMEs and remedial measures	Level 1	Level 2	Level 3	Level 4	Level 5
	The Ministry of Finance (or Tax Administration) has not assessed the average cost to SMEs of complying with any of the main taxes (current design) levied by central government.	The Ministry of Finance (or Tax Administration) has assessed the average cost to SMEs of complying with certain main taxes (*e.g.* income tax, general consumption tax like VAT or sales tax, in their current design) levied by central government.	The Ministry of Finance (or Tax Administration) has assessed the average cost to SMEs of complying with all main taxes (current design) levied by central government.	Level 3, plus the requirement that studies have been prepared in order to determine the pros/cons of simplifying certain elements of central government tax administration (*e.g.* less frequent tax instalments, electronic filing). There has been some initial implementation of reforms that address the main findings of these studies.	Level 4, plus evidence that: a) reforms have been implemented that address the main findings of studies into possible simplification of central government tax administration; b) meetings have been held with senior provincial/state-level tax officials to discuss SME compliance costs with local government taxes (*e.g.* property tax) which are excessively high.

Indicator 3.3.5: Assessment of Non-Resident Withholding Tax Payments

This indicator considers whether a framework (or data) is in place to enable analysis of actual/potential non-resident withholding tax on cross-border payments, and whether such a framework is routinely used to assess the implications of alternative non-resident withholding tax rates.

3.3 – TAX POLICY AND ADMINISTRATION: TAXATION OF MNEs					
	Level 1	Level 2	Level 3	Level 4	Level 5
3.3.5. Assessment of non-resident withholding tax payments	The Ministry of Finance does not have a framework for measuring and analysing non-resident withholding tax separately for outbound payments of dividends, interest, royalties, and fees. No steps are currently being taken to implement such a framework.	The Ministry of Finance does not have a framework for measuring and analysing non-resident withholding tax separately for outbound payments of dividends, interest, royalties, and fees, but is taking steps towards implementation	The Ministry of Finance does not have a framework for measuring and analysing non-resident withholding tax separately for outbound payments of dividends, interest, royalties, and fees, but is currently taking steps towards implementation within one year	The Ministry of Finance has a framework for estimating and analysing non-resident withholding tax. The underlying cross-border payments data are drawn from international balance of payments statistics (National Accounts data), and show the payment type (dividends, interest, royalties, and fees), amount, and currency	The Ministry of Finance has a framework for estimating and analysing non-resident withholding tax. The underlying cross-border payments data are drawn from returns that taxpayers (and agents making payments to non-residents on behalf of taxpayers) are required to file, indicating the payment type, amount paid, currency, amount of tax withheld, and recipient country

Indicator 3.3.6.: Analysis of Thin Capitalisation of the tax base

This indicator considers whether a framework and/or data are in place to enable analysis, by industry, of the financial (debt/equity) structure of resident corporations – distinguishing resident-owned and non resident-owned companies – and the implications for the domestic corporate income tax base, particularly whether the tax base is thinly capitalised, possibly on account of a relatively high statutory corporate tax rate.[107]

3.3 – TAX POLICY AND ADMINISTRATION: TAXATION OF MNEs					
	Level 1	Level 2	Level 3	Level 4	Level 5
3.3.6. Analysis of thin capitalisation of the tax base	The Ministry of Finance does not have a framework for identifying and analysing, by industry, possible thin capitalisation of resident foreign-controlled companies. No current plans for implementation.	The Ministry of Finance does not have a framework for identifying and analysing, by industry, possible thin capitalisation of resident foreign-controlled companies, but is taking steps towards implementing such a framework.	The Ministry of Finance does not have a framework for identifying and analysing, by industry, possible thin capitalisation of resident foreign-controlled companies, but is currently taking steps towards implementation within one year	The Ministry of Finance has a framework for identifying and analysing, by industry, possible thin capitalisation of resident foreign-controlled companies, based on balance sheet information required for inclusion in a corporation's tax return. The framework is used to assess whether thin capitalisation is leading to an excessive reduction in the corporate tax base.	Level 4, plus the requirement that, where analysis reveals excessive reduction in the corporate tax base due to thin capitalisation of resident companies, the relative pros and cons (strengths and weaknesses) of alternative thin-capitalisation rules are currently being actively examined.

SUB-DIMENSION 3.4. – TAX ADMINISTRATION

Considerable reforms are currently under way in the Ministry of Finance. The internal tax administration is being reviewed and the changes are likely to have a significant positive impact on the effectiveness of tax administration. Scores noted in the text are therefore only indicative. A follow-up assessment of Egypt's tax administration may be carried out once the reforms have been finalised

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[74] Tax burden measures typically of interest include: aggregate tax revenues by type of tax ("tax mix"); average and marginal tax rates on wage income; average and marginal tax rates on investment income; measures of tax burden variation across taxpayers, sectors, regions.

[75] The confidentiality of taxpayer data is recognized and respected at all times. Where a given model (*e.g.* micro-simulation model) requires confidential taxpayer information as data to input into the model, assistance will be offered to MENA countries in understanding and developing the model for application in their country, with MENA country tax officials alone tasked with the final stage of inputting actual taxpayer data into the model.

[76] Currently, through its Global Relations programme, the OECD Centre for Tax Policy and Administration (CTPA) annually organizes a one-week Tax Modelling Workshop (*e.g.* held in 2007-9 at the OECD Multilateral Tax Training Centre in Ankara).

[77] Estimates of current year tax revenues (rather than actual tax revenue data) are required given that data actual tax revenues are generally available with a time lag (of one or more years).

[78] Even where a single flat tax rate applies (as in the case of corporate income tax in many countries), a given percentage change in the rate cannot be expected to change aggregate corporate tax revenues by the same percentage, on account of business loss carry-over provisions, investment tax credits, and other considerations that imply a non-linear relationship between tax rates and tax revenues.

[79] This section addresses tax effects on investment, while section A6.3 addresses tax effects on employment.

[80] Unlike backward-looking average tax rate (ATR) measures which depend on actual corporate tax paid (influenced not only by tax policy but also profitability and other factors), METR measures (and corresponding parameter-based average effective tax rates (AETRs)) are based on specified non-tax factors (*e.g.* interest rates, profit rates), isolating the influence of tax parameters in explaining METR differences.

[81] Recent work at the OECD has extended the cross-border model to incorporate various types of tax-planning techniques now commonly employed by multinationals to lower both host and home country taxation on foreign direct investment.

[82] The personal tax system and income related social security contributions by employees and employers are expected to have a direct impact on the labour market. Taxes increase the cost of employing workers, particularly low-wage workers, while benefit systems are claimed to leave little incentive to work, especially for low-wage families.

[83] A variant of the *Taxing Wages* framework introduces consumption taxes like VAT (recognizing that consumption taxes, by reducing the amount of earned income available for consumption, may reduce labour supply).

[84] Social security contributions (employee's and employer's) may account for an important proportion of the total tax burden on individuals' wage incomes and, therefore, may significantly affect labour supply and demand. The *Taxing Wages* framework allows assessments of the importance of these contributions (relative to personal income tax) on the total tax burden and labour costs, at various income levels and across household groups.

[85] Another unemployment trap arises where benefits paid to the unemployed are high relative to potential earnings in work, so they have little incentive to look for a job. (This kind of trap tends to be specific to high-income countries).

[86] Additional indicators will be added to this section in a future revision of the tax component of the BCDS framework.

[87] While in general a BCDS exercise is conducted with central government, sub-central taxation must be taken into account (*e.g.* factored into effective tax rate measures).

[88] Revenue and expenditure data should be analyzed at both central and local levels of government, as fiscal imbalances at the local level may impact the fiscal balance of the central government. Issues and questions related to fiscal federalism are not addressed in this version of the tax component of the BCDS.

[89] Micro-simulation models may be applied to estimating current year and forecasting future year aggregate tax revenues by type of tax (*e.g.* personal income tax, corporate income tax, value-added tax), and provide a useful check on GDP-based tax revenue model estimates as part of macro assessments of a country's fiscal position. The use of micro-simulation is addressed separately section A6.1.

[90] A "main tax" may be defined as one that contributes 5% or more of total tax revenues. Examples include income tax (corporate and personal), payroll tax, value-added tax, excise taxes, property tax, customs duties (trade taxes).

[91] Tax forecasting frameworks based on GDP or national accounts estimate, for each major tax, the time-series relationship between adjusted tax revenue (net of estimated changes resulting from tax policy changes), and a proxy for the relevant tax base from national accounts (*e.g.* consumption expenditures for VAT; tobacco sales for excise tax on tobacco; wages, salaries, interest, dividends, rents, and unincorporated business profits for personal income tax). Forecasts for the proxy (national accounts) tax base are then applied to forecasting tax revenues by type of tax.

[92] The overall fiscal balance (identifying net financing requirements) measures total revenues (including grants) less total expenditures, plus borrowing, minus repayments. The primary balance, measuring total revenues (excluding grants) less primary (non-interest) expenditures, provides an indicator of fiscal effort (with interest payments predetermined by the size of the debt (previous deficits).

[93] Where the fiscal balance is positive, actual and target tax revenues and effective tax rates on business income should be regularly assessed as part of an overall assessment of the tax mix in balancing policy objectives. Consideration should be given to reducing reliance on taxes believed to impede economic development (*e.g.* trade taxes, capital taxes), and even replacing them by increasing the effective tax rate on business income where the actual rate is well below potential. At the same time, public expenditures should be subject to ongoing scrutiny in order to ensure allocations consistent with a ranking of expenditures in meeting policy objectives.

[94] Forecasts of future revenues by type of tax should incorporate anticipated developments in underlying tax bases, including those arising from commitments in other policy areas. For example, pursuit of trade liberalisation may call for reduced future reliance on trade taxes (custom duties).

[95] Special issues concerning the taxation of SMEs and issues arising in the context of cross-border investment (inbound/outbound) are considered in section A6.2. Micro-simulation-based corporate income tax estimates cover domestic tax levied on outbound investment of resident corporations, and on inbound investment of non-resident corporations (domestic branch income).

[96] See note 28 to the chapter.

[97] In a pre- versus post-reform assessment, actual current CIT revenues (total and disaggregate) would normally be taken as a pre-reform base case, with post-reform revenues simulated under a revised tax structure. Total CIT payment (tax revenue) estimates may be obtained as the weighted sum of CIT payment estimates for each firm in the stratified corporate sample. Micro-simulation assessments of total CIT revenue may feed into assessments of fiscal position (see A1.1.1).

[98] ATR measurement of weighted adjusted corporate tax, as a percentage of weighted adjusted pre-tax corporate profit, requires inclusion of pre-tax (book) profits as a data field (not a stratification variable) in the dataset. Adjustments to tax and profit are required to ensure consistency between numerator and denominator amounts (*e.g.* excluding loss carry-forward claims in the measurement of tax). See "Using Micro-data to Assess Average

Tax Rates", *OECD Tax Policy Studies Series*, No. 8. In general, total assets (or possibly turnover) would be used as a stratification variable relevant to firm size (not profit, given that large companies may be in a loss position).

[99] A GDP-based corporate income tax (CIT) revenue forecasting model (as considered under section A6.1, based on historical aggregate CIT revenue data and national accounts profit data) is not included in this section, as such a model does not generally provide a basis for yearly estimates of effective tax rates on investment, or for analyzing the impact of corporate tax reform on CIT revenues (and on the tax burden on investment).

[100] Unlike backward-looking ATR measures which depend on actual personal taxes paid (influenced by the mix of personal taxable income, the tax treatment of all forms of taxable income, standard and non-standard reliefs, etc.), marginal and average tax rates on wage income derived using a tax wedge (e.g. *Taxing Wages*) methodology isolate the effects of taxation (excluding non-standard reliefs).

[101] In general, models explaining tax distortions to the labour market should factor in levies on employment income by government-administered social security contribution systems (virtually all such systems have an element of redistribution, in that benefit entitlements are not strictly based on contributions [*i.e.* unrequited payments]).

[102] A future component of the BCDS could address measurement of marginal and average **net** tax rates on labour income (rates of tax net of social assistance benefits, as per the OECD *Benefits and Wages* methodology), net replacement rates, unemployment and inactivity traps.

[103] Effective tax rates on dividends and retained profits should factor in integration relief (if provided) in respect of dividend income and capital gains.

[104] Double taxation arises where business profits are taxed first at the corporate level (without integration relief) and then after-corporate tax profits are taxed in full at personal tax rates (on dividends or capital gains).

[105] Distortions to remuneration decisions may be most likely to arise (for closely-held corporations and unincorporated businesses) under dual income tax systems that separately apply a low personal tax rate to actual or imputed capital income. Such distortions may also arise in non-dual tax systems where CIT and PIT treatment of profits is fully or partly integrated, and the base of social security contributions is gross wage earnings.

[106] Issues to address in tax compliance costs surveys: a) complexity and transparency of tax rules and obligations (taxpayer access to information, documentation, tax forms; taxpayer assistance and education services); b) consistency of policy design, complexity and capacity of tax administration; c) efficiency of tax administration (functional vs. structural organisation (LTU/SME)); d) contribution of tax administration procedures to SME tax compliance: reporting requirements (data, frequency), payment requirements, treatment of VAT refunds; audit procedures, appeal procedures; scope for tax avoidance.

[107] Possible thin capitalisation may be assessed by comparing, at the disaggregate industry level, the debt-to-asset ratio of foreign-controlled firms (inbound FDI) versus domestically controlled firms. Inbound FDI may include the capital of resident shareholders invested in the domestic economy through offshore tax havens. High debt-to-asset ratios of foreign-controlled firms may denote the need to consider the introduction or tightening of thin capitalisation rules, possibly together with a reduction in the statutory corporate income tax rate.