TAX COMPONENT (POLICY AND ADMINISTRATION) OF THE OECD INVESTMENT REFORM INDEX (IRI) FRAMEWORK

***Version: 22 April 2009*[1]**

I. Introduction

This paper presents elements of the tax component of the *Investment Reform Index (IRI)* framework, involving a set of 'indicators' assessing the performance of South East European (SEE) economies in applying certain basic analytical frameworks to guide tax policy making, and in modernizing tax administration systems and practices. A central purpose of the 'indicators' exercise is to help determine the content of a series of OECD-led technical workshops elaborating policy applications of analytical frameworks, and possible reforms of tax administration, and providing guidance (if requested) in 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 SEE economies – derived using similar models and thus comparable across countries – to be used as a basis for tax policy dialogue.[2] In particular, comparable data is required to enable assessments and cross-country comparisons of tax policy as it impacts investment, employment and fiscal stability, at future meetings of the SEE Working Group on Tax Policy Analysis of the OECD SEE Investment Committee.[3] SEE economies are also encouraged under the framework to modernize data collection and management to improve revenue collection efficiency, while at the same time easing taxpayer compliance costs and improving taxpayer services more generally.

The indicator exercise relies on self-assessment by participating SEE economies combined with peer review, in which a senior tax official in each SEE economy is assigned responsibility for providing an accurate assessment of his/her economy's position under each of the 'indicators' listed in section II and elaborated in section III. Assessments, submitted to the OECD Secretariat, would then be circulated to all SEE economies involved in the exercise, enabling exchanges by e-mail on the findings, leading to a discussion of the assessments at subsequent SEE Working Group on Tax Policy Analysis meetings. In particular, SEE economies with a relatively high score on one or more 'indicators' will be asked to present at the Working Group meetings an overview of their activities and progress corresponding to the areas identified under the IRI indicators.

Section II of this paper lists the categories and elements of the assessment exercise, while section III presents these in detail, indicating the different levels of performance corresponding to the ranking (1-5). An Annex to the paper provides background information (notes) to the indicators.

SEE economies are requested to complete Section III (assignment of a number (1-5) for each indicator), and ensure that the completed Section III is forwarded as soon as possible to:

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1 This version replaces an earlier version (12 February 2009) which did not include tax administration indicators.

2 Tax burden measures of interest include: aggregate tax revenue by type of tax; average and marginal tax rates on wage income, and on investment income; measures of tax burden variation across taxpayers, sectors, regions.

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

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II. Summary of Indicators of Tax Policy Assessment and Tax Administration

This section of the paper lists the categories and elements of the assessment 'indicator' exercise. The indicators are structured around ***four tax topics*** (A-D) impacting economic development:

A. Fiscal position and planning

A.1. Indicator for forecasting aggregate tax revenues.

A.2 Indicator for assessment of fiscal balance and policy feedback.

B. Taxation, investment and employment

B.1 Indicator for firm-level analysis of corporate tax burden by sector.

B.2 Indicator for METR analysis of tax impediments to domestic investment.

B.3 Indicator for transparency in provision of corporate tax incentives for investment.

B.4 Indicator for 'tax wedge' analysis of tax impediments to employment.

C. Taxation of SMEs and MNEs

C.1 Indicator for analysis of tax impediments to equity financing of SMEs.

C.2 Indicator for analysis of tax arbitrage by SME owners.

C.3 Indicator for analysis of tax impediments to risky investment in SMEs.

C.4 Indicator for assessment of tax compliance costs and remedial measures.

C.5 Indicator for analysis of non-resident withholding tax payments.

C.6 Indicator for analysis of thin capitalization of the tax base.

D. Tax Administration

D.1 Indicator of consolidation of management of revenue administration.

D.2 Indicator of organization of revenue administration tasks.

D.3 Indicator of strategic management.

D.4 Indicator of centralized electronic processing of taxpayer information.

D.5 Indicator of compliance assessment and risk management.

D.6 Indicator of provision of taxpayer services.

The following section III presents the criteria used to assess performance in relation to each of the indicators listed above, with SEE economies asked to self-assign, for each indicator, a ranking (ranging from 1 to 5) for each indicator, with a level 1 signalling a lack of attention to the indicator topic, and a level 5 signalling a high level of interest and commitment. Unless otherwise indicated, the assessments consider activities of the main central government department(s) normally responsible for the development, legislation and administration of tax systems.[4] In many if not most SEE economies, the relevant departments are the central government Ministry of Finance, and Revenue Administration.

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

III. IRI TAX INDICATORS

Please assign a level (1-5) to each of the indicators under the four headings (A-D).

A. Fiscal position and planning[5]

A.1. Aggregate (GDP-based) forecasting of aggregate tax revenues for each main tax.

Indicator for Forecasting Aggregate Tax Revenues

1. The Ministry of Finance does not maintain aggregate (e.g. GDP-based) tax revenue forecasting models to provide forecasts of tax revenues to inform tax and expenditure policy making. No current plans for implementation.
2. The Ministry of Finance does not maintain aggregate tax revenue forecasting models, but is taking steps towards implementation.
3. The Ministry of Finance does not maintain aggregate tax revenue forecasting models, but is currently taking steps towards implementation within one year.
4. 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 per cent or more to total tax revenues).
5. Aggregate tax revenue forecasting models are maintained by the Ministry of Finance for each main tax.

A.2. Fiscal balance (total tax revenues, non-tax revenues, public expenditures).

Indicator for Assessment of Fiscal Balance and Policy Feedback

1. Neither tax revenue collection nor public expenditures are monitored on a regular basis (e.g. monthly) to enable assessment of the fiscal balance. No current plans to implement systematic data collection systems for tax revenues and public expenditures.
2. Tax revenue collection and public expenditures are not monitored on a regular basis, but the government is currently taking steps towards implementation of systematic data collection systems within one year.
3. Tax revenue collection and public expenditures are monitored on a regular (e.g. monthly) basis.
4. Level 3 plus the requirement that 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).
5. Level 4 plus the requirements that: a) expenditure items classified by type are ranked/prioritized 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 some fixed percentage of GDP (i.e. mandatory feed-back of fiscal balance/debt projections into budget decisions including tax policy).

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[5] Revenue and expenditure data should be analyzed for both central and sub-central levels of government, as fiscal imbalances at the sub-central level may impact 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 IRI.

B. Taxation, investment and employment

B.1. Firm-level analysis of corporate income tax burden, by sector.

Indicator for Firm-level Analysis of Corporate Tax Burden by Sector

1. The Ministry of Finance does not maintain a corporate income tax (CIT) micro-simulation model enabling firm-level/sectoral 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.
2. The Ministry of Finance does not maintain a CIT micro-simulation model enabling firm-level/sectoral 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 towards implementation.
3. The Ministry of Finance does not maintain a CIT micro-simulation model enabling firm-level/sectoral 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.
4. The Ministry of Finance maintains a CIT micro-simulation model. The model is routinely used to analyze firm-level/sectoral CIT revenues, revenue effects of adjustments to CIT rates, main CIT base provisions and tax incentives, and effective tax rates on corporate profits.
5. 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); and 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.

B.2. Tax distortions to domestic investment.[6]

Indicator for METR Analysis of Tax Distortions to Domestic Investment

1. 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.
2. 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.
3. 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.
4. The Ministry of Finance maintains a METR model. The model is routinely used to analyze tax effects on (distortions to) domestic investment and the implications of tax reform proposals.
5. Level 4 plus the requirements that a) the METR model is disaggregated across machinery and equipment, buildings, inventory and land; and b) METR results are explained in summary reports for consideration by Ministers to help inform policy-making.

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[6] For information on METR models, 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, p.262-79. See also: http://www.fraserinstitute.org/Commerce.Web/product_files/EffectiveTaxRatesEnterprises.pdf .

B.3. Transparency (tax expenditure reporting) of corporate tax incentives for investment.

Indicator for Transparency in Provision of Corporate Tax Incentives for Investment

1. 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.
2. 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 the production of such estimates.
3. 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 the production of such estimates within one year.
4. 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.
5. 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.

B.4. 'Tax wedge' analysis of tax impediments to employment.[7]

Indicator for 'Tax Wedge' Analysis of Tax Impediments to Employment

1. 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.
2. 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.
3. The Ministry of Finance maintains a 'tax wedge' model measuring marginal and average tax rates on labour income. The model is used to analyze possible tax distortions to entering the labour market, to work-effort, and possible 'bracket-creep' accompanying inflation.
4. Level 3 plus the requirement that the model/framework covers a number of possible household structures (e.g. single individual, married couple, with/without children), alternative wage earnings levels, part-time work and spousal work.
5. Level 4 plus the requirement that the results from the model/framework are compared with results for other countries (e.g. as available in 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.

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[7] 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, other factors), 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).

<u>**C. Taxation of SMEs and MNEs**</u>

C.1. Tax impediments to equity financing of SMEs.

Indicator for Analysis of Tax Impediments to Equity Financing of SMEs

1. Studies examining implications for enterprise financing and investment of double taxation of distributed and retained profit have not been undertaken by tax officials.
2. 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.
3. Level 2 plus the requirement that the analysis of double taxation includes an assessment of pros and cons (advantages, disadvantages) and tax revenue implications of alternative ‘integration’ systems to relieve double taxation of distributed and retained profits.
4. 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.
5. 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.

C.2. Tax arbitrage by SME owners.

Indicator for Analysis of Tax Arbitrage by SME Owners

1. 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 realized 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).
2. 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 realized as capital gains, to assess possible tax distortions to earnings payout policies.
3. 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.
4. 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.
5. Level 4 plus the requirement that measures have been adopted to address the most common forms of tax arbitrage.

C.3. Tax impediments to risky investment in SMEs.

Indicator for Analysis of Tax Impediments to Risky Investment in SMEs

1. 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 analyzed, documented and discussed amongst senior tax officials of the Ministry of Finance.
2. 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 analyzed with findings documented and reported to senior Ministry of Finance officials for discussion and consideration.
3. 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.
4. Level 3 plus the requirement that 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.
5. 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.

C.4. Tax compliance costs of SMEs and remedial measures

Indicator for Assessment of Tax Compliance Costs for SMEs and Remedial Measures

1. 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) imposed by central government.
2. The Ministry of Finance or Tax Administration has assessed the average cost to SMEs of complying with certain main taxes (e.g. income tax, VAT) imposed by the central government.
3. The Ministry of Finance or Tax Administration has assessed the average cost to SMEs of complying with all main taxes imposed by the central government.
4. Level 3, plus the requirement that studies have been prepared to determine the pros/cons of simplifying certain elements of central government tax administration (e.g. less frequent tax instalments, electronic filing).
5. Level 4, plus the requirement that studies have been prepared that consider criteria and options for establishing threshold level(s) determining the application of alternative regimes (e.g. VAT exemption, versus presumptive tax regime, versus basic VAT regime), and possible distortions (e.g. to firm size) introduced by different threshold levels.

C.5. Non-resident withholding tax payments.

Indicator for Analysis of Non-Resident Withholding Tax Payments

1. The Ministry of Finance does not have a framework for measuring and analyzing 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.
2. The Ministry of Finance does not have a framework for measuring and analyzing non-resident withholding tax separately for outbound payments of dividends, interest, royalties, and fees, but is taking steps towards implementation.
3. The Ministry of Finance does not have a framework for measuring and analyzing non-resident withholding tax separately for outbound payments of dividends, interest, royalties, and fees, but is currently taking steps towards implementation within one year.
4. The Ministry of Finance has a framework for estimating and analyzing 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.
5. The Ministry of Finance has a framework for estimating and analyzing 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.

C.6. Thin capitalization (debt leveraging) effects on the corporate tax base.

Indicator for Analysis of Thin Capitalization of the Tax Base

1. The Ministry of Finance does not have a framework for identifying and analyzing, by industry, possible thin-capitalization of resident foreign-controlled companies. No current plans for implementation.
2. The Ministry of Finance does not have a framework for identifying and analyzing, by industry, possible thin capitalization of resident foreign-controlled companies, but is taking steps towards implementation of such a framework.
3. The Ministry of Finance does not have a framework for identifying and analyzing, by industry, possible thin capitalization of resident foreign-controlled companies, but is currently taking steps towards implementation within one year.
4. The Ministry of Finance has a framework for identifying and analyzing, by industry, possible thin capitalization 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-capitalization is leading to an excessive reduction in the corporate tax base.
5. Level 4 plus the requirement that, where analysis reveals excessive reduction in the corporate tax base due to thin capitalization of resident companies, the relative pros/cons (strengths and weaknesses) of alternative thin-capitalization rules are currently being actively examined.

D. Tax Administration

D.1. Consolidation of management of revenue administration.

Indicator of Consolidation of Management of Revenue Administration

1. Income tax administration, social security tax administration, and VAT/sales tax administration are each managed separately and independently. Studies have not been carried out examining potential efficiencies from consolidating the administration of two (or all three) of these taxes.
2. Income tax administration, social security tax administration, and VAT/sales tax administration are each managed separately and independently. Detailed plans are currently being examined that would introduce consolidated management of i) income tax and social security tax administration, or ii) income tax and sales tax administration, or iii) income tax, social security tax and sales tax administration.
3. Income tax administration, social security tax administration, and VAT/sales tax administration are each managed separately and independently. The government has recently decided to consolidate, within one year, the management of i) income tax and social security tax administration, or ii) income tax and sales tax administration, or iii) income tax, social security tax and sales tax administration.
4. Income tax and social security tax administration, or income tax and VAT/sales tax administration, are currently under a unified management structure, within one department/agency.
5. Income tax, social security tax, and VAT/sales tax administration are under a unified management structure, within one department/agency. Close co-operation exists between the administration of income tax, social security tax, VAT/sales tax departments, and customs administration (e.g. sharing of taxpayer information to help underpin taxpayer compliance).

D.2. Organization of revenue administration tasks.

Indicator of Organization of Revenue Administration Tasks

1. Revenue administration organisation and tasks are currently based on separate main taxes, rather than functions and/or taxpayer groups. Consideration is not being given to reorganize administration tasks, based on i) functions (taxpayer registration; taxpayer declarations; taxpayer audit; appeals, adjustments and refunds; taxpayer services); or ii) taxpayer groups (e.g. large corporate taxpayers, SMEs, persons), or iii) a combination of both approaches (functions and taxpayer groups).
2. Revenue administration organisation and tasks are currently based on separate main taxes, rather than functions and/or taxpayer groups. Detailed plans are currently being examined by government that would reorganize revenue administration tasks based on i) functions; or ii) taxpayer groups; or iii) a combination of both approaches (functions and taxpayer groups).
3. Revenue administration organisation and tasks are currently based on separate main taxes, rather than functions and/or taxpayer groups. The government has recently decided to reorganize, within one year, revenue administration tasks based on i) functions; or ii) taxpayer groups; or iii) a combination of both approaches (functions and taxpayer groups).
4. Revenue administration organisation and tasks are currently based on a functions approach, or a taxpayer group approach, or some combination of both approaches.
5. Revenue administration organisation and tasks are currently based on a functions approach, or a taxpayer group approach, or some combination of both approaches. Detailed plans are currently being examined that would consider whether a modified approach might be more desirable (e.g. functions approach plus a Large Taxpayers Unit.)

D.3. Strategic management.

Indicator of Strategic Management

1. The Revenue administration does not have a formal mission statement and performance objectives for main administrative functions. No plans are being developed to address this area.
2. The Revenue administration does not have a formal mission statement and performance objectives for main administrative functions. However, draft mission statements and performance objectives for main administrative functions are currently being considered.
3. The Revenue administration does not have a formal mission statement and performance objectives for main administrative functions. However, a formal mission statement will be announced by the government within the next 6 months. Furthermore, performance objectives for main administrative functions will be announced within one year. Where information is currently not collected on the total budget of revenue administration and it allocation, steps are being taken to gather this information on a routine basis within one year.
4. The Revenue administration has announced a formal mission statement and performance objectives for main administrative functions. Information is gathered annually on the total budget of revenue administration and its allocation.
5. The Revenue administration has announced a formal mission statement and performance objectives for main administrative functions for each main tax. Performance objectives are output or outcomes based, rather than input based. Information is gathered annually on the total budget of the revenue administration; the total number and composition of staff (managers, professionals, support staff); the distribution of staff between central, regional, local offices.

D.4. Centralized electronic processing of taxpayer information.

Indicator of Centralized Electronic Processing of Taxpayer Information

1. Taxpayers are not assigned a Taxpayer Identification Number (TIN), and information required for tax collection purposes is not gathered by a centralized data processing centre and recorded electronically. No plans are being developed to establish a TIN registration system and centralized data processing centre.
2. Taxpayers are not assigned a TIN, and information required for tax collection purposes is not gathered by a centralized data processing centre and recorded electronically. Detailed plans for a TIN registration system and centralized data processing centre are currently under examination.
3. Taxpayers are currently not assigned a TIN, and information required for tax collection purposes is not gathered by a centralized processing centre and recorded electronically. However, the tax administration has announced plans to implement a TIN registration system within one year, and a centralized data processing centre within two years.
4. Taxpayers are systematically assigned a TIN (e.g. when registering for tax purposes), and information required for the purpose of collecting income tax, social security tax, or sales tax (or some combinations of these taxes) is gathered by a centralized data processing centre and recorded electronically. Taxpayer data is checked periodically for accuracy (data 'cleansing') and recorded data is backed-up on a daily basis.
5. Taxpayers are systematically assigned a TIN (e.g. when registering for tax purposes), and information required for tax administration purposes (covering registration, declarations, payments, audit, adjustments), covering all main taxes (e.g. income tax, social security tax, sales tax), received from and provided to taxpayers and third parties, is gathered by a centralized data processing centre and recorded electronically in the 'current account' of each taxpayer. Taxpayer data is routinely checked for accuracy (data 'cleansing') and recorded data is backed-up on a daily basis.

D.5. Compliance assessment and risk management.

Indicator of Compliance Assessment and Risk Management

1. Assessments of taxpayer compliance are not based on integrated case management of taxes applicable to taxpayers (unified tax system approach), and electronic access to relevant third-party information.[8]
2. Assessments of taxpayer compliance are not based on integrated case management of taxes applicable to taxpayers (unified tax system approach) and electronic access to relevant third-party information. However, the tax administration has announced plans to implement a unified tax system approach within one year, and to establish within two years electronic access to relevant third-party information.
3. Assessments of taxpayer compliance are based on integrated case management of taxes applicable to taxpayers (unified tax system approach), and electronic access to relevant third-party information.
4. Assessments of taxpayer compliance are based on integrated case management of taxes applicable to taxpayers (unified tax system approach), and electronic access to relevant third-party information. Compliance risk management applies internal compliance assessment tests to identify causes of apparent non-compliance and determine follow-up action.[9] Systems are in place to detect non-filing, stop-filing, non-payment of taxes.
5. Assessments of taxpayer compliance are based on integrated case management of taxes applicable to taxpayers (unified tax system approach), and electronic access to relevant third-party information. Compliance risk management applies internal compliance assessment tests to identify causes of apparent non-compliance and determine follow-up action. Systems are in place to detect non-filing, stop-filing, non-payment of taxes. The selection of cases for tax audit is based on industry-specific risk-analysis assessment, and audit techniques include indirect income measurement, and comparative pricing and margin analysis.

D.6. Provision of taxpayer services.

Indicator of Provision of Taxpayer Services

1. Rights and obligations of taxpayers, and performance service standards in the provision of information and assistance to taxpayers are not published.
2. Rights and obligations of taxpayers, and performance service standards in the provision of information and assistance to taxpayers are not published. However, the tax administration has announced plans to publish taxpayer rights and obligations and performance service standards in the provision of information and assistance to taxpayers. within one year
3. Rights and obligations of taxpayers, and performance service standards in the provision of information and assistance to taxpayers, are published.
4. Rights and obligations of taxpayers, and performance service standards in i) the provision of information and assistance to taxpayers; and ii) the handling of appeals (with regard to timeliness and impartiality),are published and available on a revenue administration website.
5. Rights and obligations of taxpayers, and performance service standards in i) the provision of information and assistance to taxpayers; ii) the handling of appeals (with regard to timeliness and impartiality), and iii) the provision of information and certainty of procedures for taxpayer interviews and audits, are published and available on a revenue administration website.

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[8] Integrated assessments of information (e.g. declarations) on all applicable taxes may be used to identify anomalous reporting in relation to one or more taxes. Third-party (external) data may include information on land registration (ownership), company registration, vehicle registration.

[9] A key distinction would be apparent lack of information on tax liability, and possible tax fraud trigerring audit procedures.

Annex I – Background notes to tax indicators

Notes to indicators A.1 (Aggregate (GDP-based) forecasting of aggregate tax revenues for each main tax) and A.2 (Fiscal balance (tax revenues, non-tax revenues, public expenditures))

Indicators A.1 and A.2 under 'Fiscal Position and Planning' address country practices in developing short- and medium-term fiscal policy plans, which typically involve ongoing iterations, as tax bases and corresponding revenue estimates and expenditure plans are reconsidered and reconciled. The second indicator considers whether efficient information systems are in place to accurately monitor tax revenue collection an public expenditures on an on-going (e.g. monthly) basis; whether expenditure items, classified by type, are prioritized/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 feed-back 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 feed-back of fiscal balance/debt projections into policy decisions).

Relevant models and data include the following:[10]

- GDP-based tax revenue estimation models (for each main tax.)[11]
- Historical tax revenue data.
- National Accounts income, expenditure and balance of payments data (historical data).[12]
- 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 with expenditure items 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 taxes, 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.[13] Where the fiscal balance is negative, consideration should be given to adjusting the mix and level of taxes, and restricting low-ranked public expenditures.[14] This

[10] 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.

[11] 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).

[12] 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.

[13] 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

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 alongside assessments of the actual and target reliance on other taxes.[15] 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 micro (firm-level) data.

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/provisions determining 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 actual and potential tax burden on business income, and anticipated revenues from other taxes (under possibly 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 to economic development (e.g. trade taxes, capital taxes), with revenue reductions possibly replaced by increasing the 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 (implying limited negative impact on the tax base).

Notes to indicator B.1 (Firm-level analysis of corporate income 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 with corporations classified by industry and location,[16] and used regularly to analyze actual (and post–reform): total CIT revenues in the current year and forecast

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grants) less primary (non-interest) expenditures, provides an indicator 'fiscal effort' (with interest payments predetermined by the size of the debt (previous deficits).

[14] 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 be impeding to 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.

[15] 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 liberalization may require/imply reduced future reliance on trade taxes (custom duties).

[16] Industry, location, asset size and possibly other 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 size threshold, with 'large' corporations assigned to different cells depending on their characteristics and stratification criteria). Other stratification criteria of policy interest (e.g., high/low R&D expenditure/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 departments/regions). Using firm-level data that distinguishes domestic versus and foreign-owned/controlled 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.

years, CIT revenues by sector, CIT revenues foregone by tax incentives;[17] and average tax rates (ATRs) on corporate profits by industry and location.[18]

Relevant models and data include the following:[19]

- 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.

Notes to indicator B.2 (Tax distortions to domestic investment

This indicator considers whether a METR model measuring marginal effective tax rates (METRs) on domestic profits is in place and regularly used to assess non-neutralities introduced by the corporate tax system on domestic investment scale and location decisions. (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, p.262-79. A useful summary article of METR analysis with applications for Canada is found at: http://www.fraserinstitute.org/Commerce.Web/product_files/EffectiveTaxRatesEnterprises.pdf .

Notes to indicator B.3 (Transparency (tax expenditure reporting) of corporate tax incentives for investment)

This indicator considers whether tax expenditure accounts are prepared periodically, including estimates of tax revenues foregone by main corporate tax incentives for investment. For proper fiscal management, tax expenditure (TE) accounts should be prepared to inform fiscal planning, improve investor as well as taxpayer confidence in the system, support good governance, and promote economic development. Preparation of TE accounts, identifying and estimating public expenditures through the tax system resulting from special (targeted) tax relieving provisions (e.g. tax incentives), requires the development of TE frameworks, differentiated according to the type of tax (e.g. personal income tax, corporate income tax, value-added tax).

Development of personal and corporate income tax TE frameworks requires the construction of micro-databases, based on representative samples of individual and corporate taxpayers. Development of a value added tax TE framework generally requires input-output information from National Accounts data.

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[17] 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 sub-section A).

[18] 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 than large companies may be in a loss position).

[19] A GDP-based corporate income tax (CIT) revenue forecasting model (as considered under section 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).

Notes to indicator B.4 ('Tax wedge' analysis of tax impediments to employment)

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, household type, including 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[20] on employment decisions.[21]

Notes to indicator C.1 (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[22] 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.[23]

Notes to indicator C.2 (Tax arbitrage by SME owners)

This indicator considers whether (tax parameter-based) effective tax rates are calculated for different types of income of an owner/worker of a closely-held SME, to determine cases where tax rate differences arise that could be expected to encourage owner/workers to mischaracterize certain income types 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).[24]

Notes to indicator C.3 (Tax impediments to risky investment in SMEs)

This indicator considers whether cross-country comparisons are regularly carried out for business loss offset rules (that is, rules determining what types of taxable income that business losses can be deducted or set-off against), and 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).

Notes to indicator C.4 (Tax compliance costs of SMEs and remedial measures)

This indicator considers whether assessments are made of tax compliance costs of SMEs, linked to tax policy and tax administration, and whether consideration has been given to adjusting tax administration

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[20] 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)).

[21] See *Taxing Wages* at http://www.oecd.org/document/57/0,3343,en_2649_34533_40233913_1_1_1_1,00.html .

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

[23] 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).

[24] 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/PIT treatment of profits is fully or partly integrated, and the base of social security contributions is gross wage earnings.

where compliance costs are found to be too high, in order to encourage SME compliance and business activities.[25] Additionally, this indicator considers whether consideration been given to the pros/cons of alternative tax policy measures to reduce the tax compliance burden on SMEs, to encourage SME tax compliance and business activities.

Notes to indicator C.5 (Non-resident withholding tax payments)

This indicator considers whether a framework/data are 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.

Under its current account, a country's international balance of payments data would normally report investment income payments to non-residents including i) direct investment income (income on equity, interest income on debt); ii) portfolio investment income (income on equity, interest income on debt); and iii) other investment income (including interest on loans and other capital). Direct investment income on equity includes dividends, branch profits and reinvested earnings. If a national statistical agency producing National Statistics data can provide data on interest income, and components of equity income, rough estimates may be made of the revenue impact of adjustments to statutory non-resident withholding tax rates on interest and dividends (and to adjustments in a branch profits tax.) However, additional detail on individual payment amounts showing the country of residence of non-resident recipients is needed for roughly accurate estimates given differences between statutory and tax treaty withholding tax rates. Similarly, estimates of the revenue impact of adjusting a given tax treaty rate require data on payments to the relevant treaty country.

In some countries, taxpayers and agents (e.g. bank, trust company) 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, such as interest, dividends, royalties, rents, paid to non-residents, the amount paid, the recipient country, and the amount of tax withheld. Compilation of a non-resident withholding tax model on the basis of such data is ideal.

Notes to indicator C.6 (thin capitalization effects on the corporate tax base)

This indicator considers whether a framework/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 implications for the domestic corporate income tax base – in particular, whether the tax base is thinly-capitalized possibly on account of a relatively high statutory corporate tax rate.[26]

[25] 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.

[26] Possible thin capitalization may be assessed by comparing, at the disaggregate industry level, the debt/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/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.