

Ten years of in-depth analysis on tax systems in 189 economies. A look at recent developments and historical trends.

Paying Taxes 2016



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Chapter 1: World Bank Group commentary

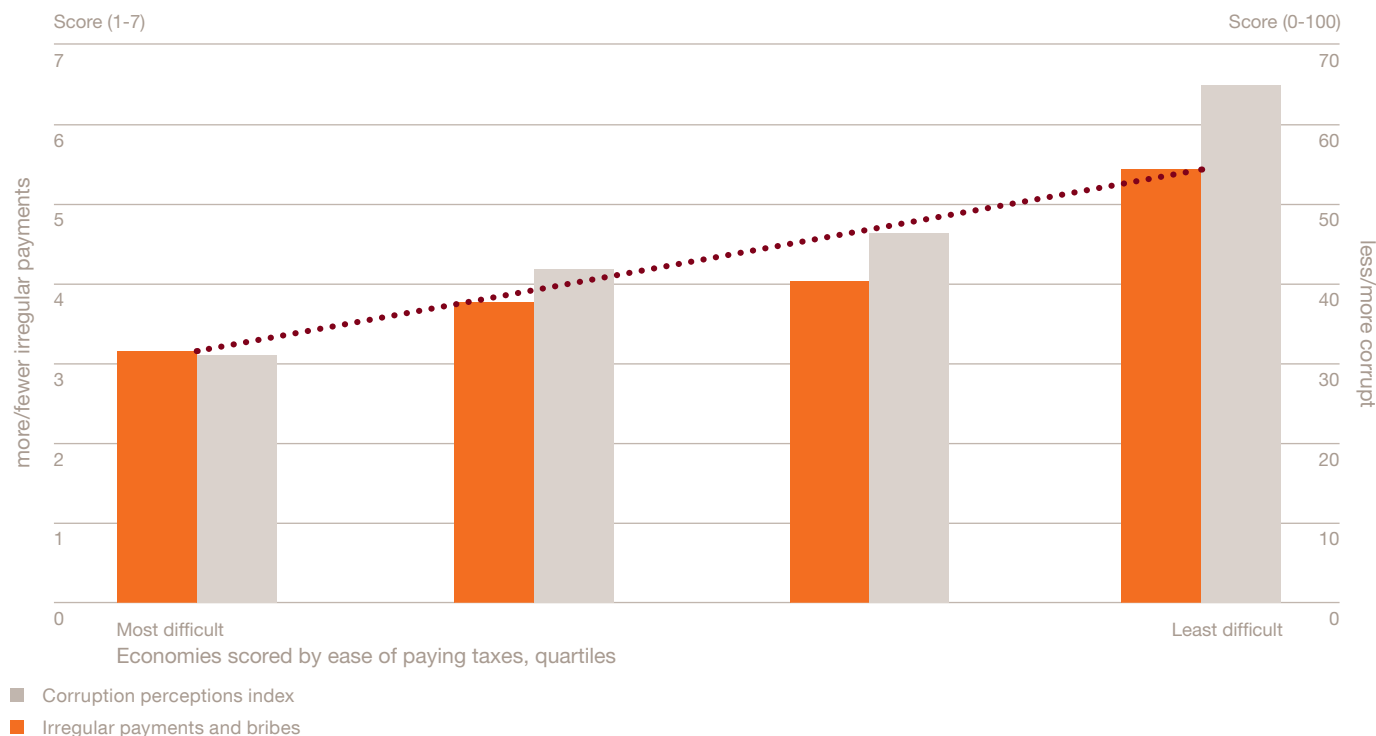
Recent developments in the *Paying Taxes* sub-indicators

Taxes are essential to finance public services. Governments need sustainable funding for social programs and public investments to promote economic growth and development. Programs providing health, education, infrastructure and other amenities are important to achieve the common goal of a prosperous, functional and orderly society. And they require that governments raise revenues. But the challenge is to design a tax system that will not discourage taxpayers from formally participating. The design of a tax system can influence firms' decisions on whether to operate in the formal sector as well as have other important economic effects. And analysis suggests that where the tax system makes compliance more difficult, firms are more likely to perceive corruption as a problem (Figure 1.1).

This is the 10th edition of *Paying Taxes: The Global Picture*. The core purpose of the *Doing Business* indicators on paying taxes remains unchanged: measuring the administrative and financial burden for firms of complying with tax obligations.⁸ In recent years, as more economies have directed efforts toward making tax compliance simpler and easier, the analysis has shifted to detailing features of reforms easing the administrative burden. And this year, for the first time, *Doing Business* is looking at the post-filing process, through a pilot study of procedures relating to value added tax (VAT) refunds, tax audits and tax appeals. Measures of these aspects are not part of the *Paying Taxes* sub-indicators set but are being considered for inclusion in future years.

Figure 1.1

The greater the difficulty of paying taxes, the more likely firms are to perceive corruption as a problem



Note: The sample comprises 144 economies. The economies are grouped into quartiles by their distance to frontier score for paying taxes, which captures the gap between each economy's performance on the *Doing Business* indicators on paying taxes and the best performance recorded on these indicators. The score for irregular payments and bribes is an average across five components of firms' perceptions of how common it is to make undocumented extra payments or bribes in connection with (1) imports and exports; (2) public utilities; (3) annual tax payments; (4) awarding of public contracts and licenses; and (5) obtaining favourable judicial decisions. The answers range from 1 (very common) to 7 (never occurs). The score for the corruption perceptions index relates to the degree to which corruption is perceived to exist among public officials and politicians by business people and country analysts. Score ranges between 100 (highly clean) and 0 (highly corrupt).

Sources: *Doing Business* database; World Economic Forum 2014, Transparency International 2014.

⁸ The *Paying Taxes* sub-indicators comprise three measures: Total Tax Rate as a percentage of commercial profit (a measure of the financial burden), number of tax payments and time in hours per year (measures of the administrative burden). See Appendix 1 for details.

Who reformed in 2014 and what did they do?

Doing Business recorded 40 reforms in 2014 making it easier or less costly for firms to pay taxes. OECD high-income economies accounted for the largest number, with nine. Globally, the most common feature of tax reforms in the past year was the introduction or enhancement of electronic systems for filing and paying taxes. Such changes were implemented by 18 economies: Costa Rica, Cyprus, Indonesia, Jamaica, Malaysia, Montenegro, Morocco, Mozambique, Peru, Poland, Rwanda, Serbia, the Slovak Republic, Spain, Tajikistan, Uruguay, Vietnam and Zambia. Businesses in these economies now file tax returns electronically, spending less time to prepare, file and pay taxes. Beyond saving businesses time, electronic filing helps prevent human errors in returns. And by increasing transparency, electronic filing limits opportunities for corruption and bribery.

Serbia improved the ease of paying taxes the most in 2014. The government initiated a 'consolidated billing project' that electronically centralised all communications between the taxpayer and the tax administration, including the filing and payment of taxes. The project consolidated the payment of different taxes into a single account and automated the exchange of data with banks (electronic banking). The majority of businesses now file and pay VAT and social security contributions online. This has reduced administrative costs both for businesses (in complying with tax obligations) and for the tax administration (in printing invoices). In addition, starting 1 January 2014, the government abolished the urban land usage fee – a fee that previously had to be paid monthly and in person. The changes reduced the time it takes to comply with tax obligations in a year by 34.75 hours and the number of payments by 25 (Figure 1.2).

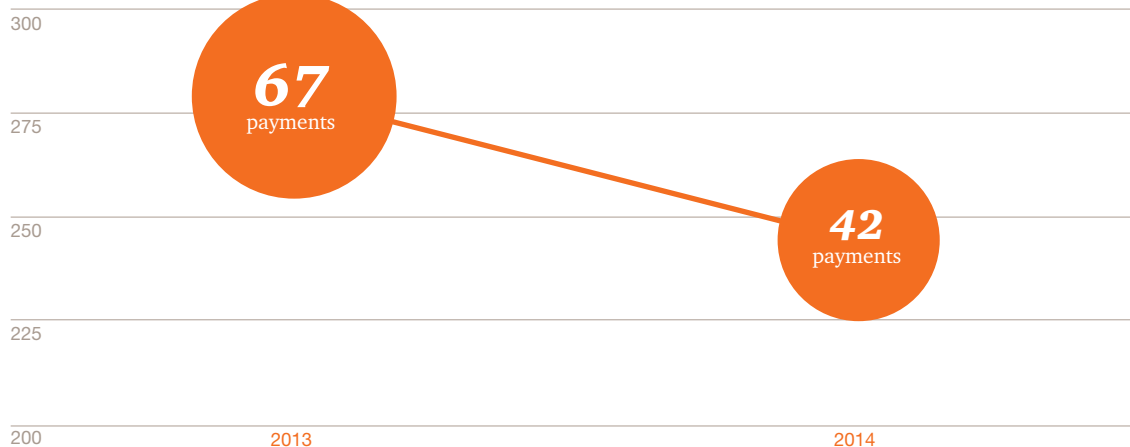
Spain was also among the economies that launched an integrated online platform for submitting tax returns. In addition, it simplified compliance with VAT obligations by introducing a single electronic form within the new online system and promoting the use of electronic invoices. The system enables taxpayers to electronically retrieve previous years' VAT forms and use them to automatically populate some of the fields in the current year's forms. Moreover, Spain reduced the corporate income tax rate for new companies incorporated on or after 1 January 2013, from a 30% flat rate to 15% for the first €300,000 and 20% thereafter. Spain also reduced the environmental tax rate. At the same time, however, Spain limited the deductibility of certain expenses with the aim of broadening the base for corporate income tax. These changes reduced the Total Tax Rate by 8.1 percentage points and the time required for tax compliance in a year by 9 hours.

Four economies – The Gambia; Hong Kong SAR, China; Maldives; and Vietnam – took other measures to simplify compliance with tax obligations. For example, The Gambia improved its bookkeeping system for VAT accounts to better track the input and output records required for filing VAT returns. Vietnam reduced the frequency of VAT filings from monthly to quarterly for companies with an annual turnover of 50 billion dong (about \$2.3 million) or less. Four other economies – Brunei Darussalam, Kosovo, Mexico and Serbia – merged or eliminated certain taxes. Mexico abolished the business flat tax on 1 January 2014. This tax had to be calculated alongside the corporate income tax liability, and the higher of the two would then be taken as the final income tax liability for the year. Calculating the business flat tax was a long process based on cash inflows and outflows, and the elimination of the tax reduced the time required for tax compliance in a year by 48 hours.

Figure 1.2

Serbia has made complying with tax obligations easier for companies

Time to comply (hours per year)



Source: *Doing Business* database.

Other economies directed efforts at reducing the financial burden of taxes on businesses and keeping tax rates at a reasonable level. Seventeen economies reduced profit tax rates in fiscal 2014 (Table 1.1). These economies span all income groups – high income (nine economies), upper middle income (three), lower middle income (four) and low income (one). Norway reduced the corporate income tax rate from 28% to 27%.

Portugal made paying taxes less costly by both lowering the corporate income tax rate and increasing the allowable amount of the loss carried forward.⁹ Brunei Darussalam, Greece, Jamaica, Mozambique, the Slovak Republic and Vietnam also effectively reduced the financial burden of profit taxes on companies by introducing changes to tax depreciation rules and tax deductions.¹⁰

The Bahamas, Greece, Malaysia, the Russian Federation and Spain reduced taxes other than profit and labour taxes. Malaysia reduced the property tax rate from 12% to 10% of the annual rental value for commercial properties for 2014. Greece made insurance premiums fully tax deductible in addition to reducing property tax rates.

In most economies where the authorities have opted to reduce the tax burden on the business community, they have also attempted to broaden the tax base and protect government revenue. In a few cases in recent years, particularly in economies where tax rates are very high, the motivation has been more closely linked to reducing distortions, such as high levels of tax evasion or a sizable informal sector.

Table 1.1
Who made paying taxes easier and less costly in 2014?

Easing compliance	Introduced or enhanced electronic systems	Costa Rica; Cyprus; Indonesia; Jamaica; Malaysia; Montenegro; Morocco; Mozambique; Peru; Poland; Rwanda; Serbia; Slovak Republic; Spain; Tajikistan; Uruguay; Vietnam; Zambia	Serbia introduced an online system for filing and paying VAT and social security contributions in 2014. Indonesia introduced an online system for filing and paying social security contributions.
	Merged or eliminated taxes other than profit tax	Brunei Darussalam; Kosovo; Mexico; Serbia	Mexico abolished the business flat tax on 1 January 2014. Serbia abolished the urban land usage fee starting 1 January 2014.
	Simplified tax compliance process	The Gambia; Hong Kong SAR, China; Maldives; Vietnam	The Gambia improved its bookkeeping system for VAT accounts to better track the requisite input and output records for filing VAT returns. Vietnam reduced the frequency of VAT filings from monthly to quarterly for companies with an annual turnover of 50 billion dong (about \$2.3 million) or less.
Reducing taxes	Reduced profit tax rate	Angola; Bangladesh; Brunei Darussalam; Finland; France; The Gambia; Guatemala; Hong Kong SAR, China; Jamaica; Norway; Portugal; Slovak Republic; Spain; Swaziland; Tunisia; United Kingdom; Vietnam	Norway reduced the corporate income tax rate from 28% to 27% for 2014. Tunisia reduced the corporate income tax rate from 30% to 25% for the same year. Spain reduced the corporate income tax rate for companies incorporated on or after 1 January 2013, from the standard rate of 30% to 15% for the first €300,000 and 20% thereafter.
	Reduced labour taxes and mandatory contributions	China (Shanghai); Colombia; France; Greece; Indonesia; Mexico; Romania; United Kingdom	Romania reduced the social security contribution rate paid by employers from 20.8% to 15.8% from 1 October 2014.
	Reduced taxes other than profit tax and labour taxes	The Bahamas; Greece; Malaysia; Russian Federation; Spain	Malaysia reduced the property tax rate from 12% to 10% of the annual rental value for commercial properties for 2014.
	Allowed more deductible expenses or depreciation	Brunei Darussalam; Greece; Jamaica; Mozambique; Portugal; Slovak Republic; Vietnam	Portugal allowed 100% of loss carried forward to be deducted for the calculation of taxable profit from 1 January 2014. Brunei Darussalam increased the initial capital allowance for industrial buildings from 20% to 40% and the annual allowance from 4% to 20% for 2014.

Note: The reforms shown are those recorded from 1 January 2014, to 31 December 2014.
Source: *Doing Business* database.

⁹ The corporate income tax was changed from a 25% flat rate to a progressive tax system, with the first €15,000 taxed at 17% and any amount above that taxed at 23%.

¹⁰ Tax deductions are expenses that a company is allowed to deduct from its income for the purpose of calculating corporate income tax.

What trends emerged in tax reforms over the past five years?

Over the past 11 years *Doing Business* recorded reforms making it easier or less costly for firms to pay taxes in 149 economies – around 36 reforms a year on average. For the first six years of this period (2004-09) the most common feature of the reforms was the reduction of profit tax rates. But in the past five years (2010-14) the introduction or enhancement of electronic systems for filing and paying taxes was the most common feature. This shift coincided with the financial crisis of 2008/09. In responding to the challenges of the economic downturn, many governments sought to strike the right balance between reducing the fiscal deficit and promoting growth. One study confirmed the importance of a greater focus on simplifying tax compliance, highlighting the need to increase the simplicity and homogeneity of fiscal systems so as to provide a stable and predictable environment for business.¹¹

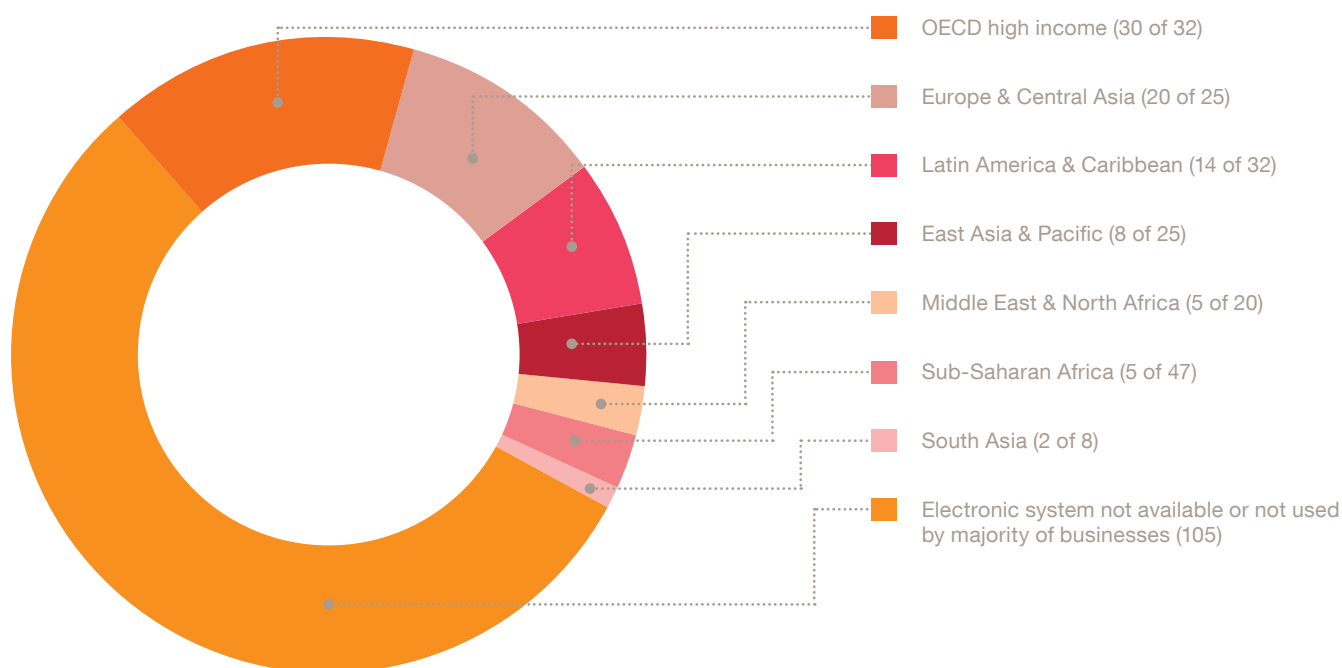
Using technology to simplify compliance

Electronic systems for filing and paying taxes, if implemented well and used by most taxpayers, benefit both tax authorities and firms. For tax authorities, electronic filing lightens the workload and reduces operational costs – such as the costs of processing, storing and handling tax returns. It also increases tax compliance and saves time. For taxpayers, electronic filing saves time by reducing calculation errors in tax returns and making it easier to prepare, file and pay taxes.¹² And it benefits both sides by reducing potential incidents of corruption, which are more likely to occur with more frequent contact between taxpayers and tax administration staff.

Rolling out an electronic filing and payment system and educating taxpayers in its use are not easy tasks for a government. The necessary infrastructure must be put into place, and this can be especially challenging where not everyone has broadband access. Yet by 2014, 84 economies had fully implemented electronic filing and payment of taxes (Figure 1.3). In the past five years *Doing Business* recorded 70 reforms in 53 economies introducing or enhancing electronic systems for filing and paying taxes. More than a third of these economies adopted an electronic system for the first time.

Figure 1.3

Eighty-four economies have a fully implemented electronic system for filing and paying taxes



Note: An electronic system is counted where both the filing and payment of taxes are done online and used by the majority of medium-size businesses.
Sources: *Doing Business* database.

¹¹ Hudson and Roy-Chowdhury 2010.

¹² Zolt and Bird 2008

Among OECD high-income economies, the Slovak Republic both fully implemented and further improved its electronic filing system in the past five years. The country's government has been focusing on modernising and increasing the efficiency of public administration.¹³ As part of this effort, it implemented multiple changes in tax administration, from rationalising the network of tax offices (reducing their number from 101 to 8 in January 2012) to improving tax filing and payment processes.

The Slovak Republic's first attempt to introduce electronic filing of taxes was in 2005. For the first several years, however, companies continued to prefer filing and paying taxes in person. But as the electronic system was improved, more taxpayers began to use it, and in 2011 the Slovak Republic made electronic filing mandatory for health and social insurance contributions for companies with more than 20 employees. By that time electronic payment of taxes was already widespread. Electronic filing was also expected to be made mandatory for VAT in 2011, but the deadline was postponed several times. Not until January 2014 did the majority of companies start filing VAT returns electronically.

The global trend toward greater use of electronic tax filing and payment systems is likely to continue. In the next few years many other OECD high-income economies, having introduced requirements for electronic filing and payment for larger businesses, plan to extend them to smaller ones. Economies in Europe & Central Asia implemented the most reforms (22) in electronic tax filing and payment in the past five years (Figure 1.4). Economies in South Asia had the fewest, with only three.

Figure 1.4

Europe and Central Asia accounted for the most reforms in electronic tax filing and payment in the past five years

	2010	2011	2012	2013	2014
East Asia & Pacific			1	3	3
Europe & Central Asia	3	6	3	6	4
Latin America & Caribbean	4	2	3	2	4
Middle East & North Africa	1	2	1		1
OECD high income	2	5			3
South Asia	1		2		
Sub-Saharan Africa		1	2	2	3

Reforms introducing or enhancing electronic system for filing and paying taxes

Note: The reforms shown for each year until 2014 are those recorded from 1 June of that year to 1 June of the following year. For 2014 the reforms shown are those recorded from 1 January to 31 December of that year.

Source: *Doing Business* database. *Doing Business* uses the World Bank regional and income group classifications, available at <http://data.worldbank.org/about/country-and-lending-groups>. Regional data averages presented in figures and tables in the *Doing Business* report include economies from all income groups (low, lower middle, upper middle and high income), though OECD high income economies are assigned the 'regional' classification.

¹³ OECD 2014b.

Reducing tax rates

The reduction of corporate income tax rates remains a very common feature of reforms making it easier or less costly to pay taxes – the second most common one over the past five years. Globally, the Total Tax Rate as calculated for the *Doing Business* case study company averages 40.76% of commercial profit. This is 4 percentage points lower than five years ago, thanks in large part to 55 reforms reducing profit tax rates in 42 economies. OECD high-income economies implemented the largest number of reforms reducing profit tax rates, followed by economies in Sub-Saharan Africa and in East Asia & the Pacific.

The United Kingdom, for example, reduced its corporate tax rate progressively and smoothly. In 2010 the corporate income tax rate was 28%. This rate dropped to 26% starting April 2011, then to 24% in 2012, 23% in 2013, 21% in 2014 and 20% in April 2015. The rate is expected to be further reduced to 19% in 2017 and to 18% by 2020. Efforts in many economies to reduce the tax burden on the corporate sector have often been accompanied by a broadening of the tax base and other measures to protect revenue levels, against the background of further attempts at fiscal consolidation following the emergence of large budget deficits after the global financial crisis.

Besides the profit tax, the Total Tax Rate also includes two other types of taxes: labour taxes and government-mandated contributions and ‘other’ taxes.¹⁴ Seventeen economies lowered labour taxes and mandatory contributions in the past five years. For example, Romania reduced the social security contribution rate paid by employers by 5 percentage points, from 20.8% to 15.8%, effective 1 October 2014. Colombia used a different approach, selectively lowering the labour tax burden. As of May 2013 companies were exempted from paying two types of contributions for employees earning less than 10 times the statutory minimum wage – the 3% contribution for the Colombian Family Welfare Institute and the 2% contribution for the National Apprenticeship Service (SENA). This reduced the payroll tax from 9% to 4%. In 2014 the exemption was extended to the 8.5% welfare contribution.

Thirteen economies have no requirement for employers to pay social security contributions or labour taxes – Afghanistan, Armenia, Bangladesh, Bhutan, Botswana, the Comoros, Eritrea, Georgia, Lesotho, the former Yugoslav Republic of Macedonia, Suriname, Timor-Leste, and West Bank and Gaza. In some economies the responsibility for paying labour taxes falls on the employee rather than the employer. Such cases are beyond the scope of the *Doing Business* analysis and are not captured by the *Paying Taxes* sub-indicators.

Globally, labour taxes and contributions paid by the employer account on average for almost 40% of the Total Tax Rate for the case study company. ‘Other’ taxes account for 20% on average.

Allowing more tax deductions and tax depreciation

The statutory tax rate provides the factor to be applied to the tax base. The tax base is therefore another factor affecting a company’s tax liability. For corporate income tax the tax base generally is taxable profits after accounting for tax-deductible expenses and the maximum allowed annual tax depreciation.

These allowed deductions can make a substantial difference for the effective total tax burden. In the Philippines, for example, the case study company would face a statutory rate for corporate income tax of 30% but pay an effective rate after allowable deductions of around 20% of its commercial profit. In New Zealand the same case study company would face a statutory rate of 28% but an effective tax rate of around 30% of the commercial profit. In some economies, however, the statutory rate is very close to the effective tax as a share of commercial profit. This is the case in Kenya, for example. In recent years some economies have increased allowable deductions.

In 2012, Cyprus increased the tax depreciation rate for industrial and hotel buildings purchased in 2012, 2013 and 2014 from 4% to 7%. In 2012, Belarus allowed 2% of operating loss occurred in previous periods to be tax deductible. Previously, operating losses were not tax deductible.

¹⁴ ‘Others’ include property taxes, turnover taxes, property transfer taxes, road taxes, environmental taxes and other small taxes (such as municipal fees and vehicle taxes).

Making tax compliance easier

Globally on average, complying with tax regulations would take 26 payments and 261 hours a year for the case study company. This reflects improvements, with tax compliance taking 4 fewer payments and 15 fewer hours today on average than five years ago. Indeed, 38 economies made compliance easier over the past five years by simplifying processes or by merging or eliminating some taxes. For example, in 2010 Mexico eliminated the requirement to file a yearly VAT return as well as the requirement to file the *dictamen fiscal* (tax certification), which amounted to more than 40 pages.

Instead, companies prepare and file a report with a 19-page annex. In 2012 the Republic of Congo introduced a single tax on salaries at a statutory rate of 7.5%, replacing three labour taxes that had been levied separately: the National Construction Fund contribution; the lump sum tax owed by employers and payers of a life annuity; and the tax on training.

Economies worldwide continue to introduce substantial improvements in their tax environment. As more economies have adopted the good practices of those with the best performance on the *Paying Taxes* sub-indicators, these efforts have eased the administrative burden of paying taxes for companies.

On average around the world, tax compliance takes 4 payments fewer and 15 hours less today than it did five years ago.



What's next for the Paying Taxes sub-indicators?

The existing *Paying Taxes* sub-indicators measure the cost of complying with tax obligations through the stage of filing the tax returns and paying the taxes. But this is not the end of the story. Businesses often have to complete post-filing procedures such as claiming a VAT refund or receiving a tax audit – and these can be the most difficult interactions that they might have with the tax authority. In recent years *Doing Business* has been asking respondents for their views on a range of aspects of tax administration, including how easy it is to deal with tax authorities, with tax audits and with other post-filing procedures. In the majority of economies the post-filing process is the aspect of the tax system that respondents felt was most in need of improvement.

Doing Business is expanding the analysis of *Paying Taxes* as a pilot this year to include three aspects of the post-filing process: settlement of VAT refund claims resulting from a large purchase of raw material; tax audits; and administrative tax appeals. This expanded analysis covers the full cycle of a taxpayer's interaction with tax authorities, encompassing all major transactions that generate external costs to the taxpayer. The new area of research matters because of the regressive nature of tax compliance costs, which fall disproportionately on lower-income people and small and medium-size enterprises.

Settlement of VAT refund claims

VAT is largely designed to be borne by the final consumer, not by businesses, so VAT refunds are a natural part of a modern VAT system. According to OECD guidelines, a VAT system should be neutral and efficient.¹⁵ The main premise is that the burden of VAT should not fall on businesses. When businesses incur VAT that is not refunded, or that can be reclaimed only with long delays and large compliance costs, the principles of neutrality and efficiency are undermined. This alters the nature of VAT by making it in part a tax on production. Where this occurs, any irrecoverable tax and the resulting cascading effect on the final tax liability might distort market prices and competition and consequently affect growth.¹⁶

A 2005 International Monetary Fund (IMF) study that examined the VAT refund mechanism in 36 countries around the world showed that the refunding of credits was the “Achilles’ heel” of a VAT system.¹⁷ Even in countries where refund procedures are in place, businesses are often concerned about the complexity of the process. The study looked at the treatment of VAT credits by the tax authorities, the size of refund claims, the procedures followed by refund claimants and the time and arrangements for processing VAT refunds. The results show that statutory time limits for making refunds are crucial but are often not applied in practice.

The preliminary findings of the new research by *Doing Business* show that many economies have legal time limits for issuing a decision on a VAT refund claim and processing the payment if approved. These include Albania, Belarus, Cyprus, Georgia, Hungary, Iceland, Indonesia, Israel, Lithuania, Mexico, Moldova, the Netherlands, Norway, Rwanda and the Slovak Republic. In Albania, for example, the tax administration has 60 days to issue a decision from the time a taxpayer submits a request for a refund and 30 days to make a payment if approved. If a tax audit is conducted before the payment is made, however, the statutory timeline is put on hold during the audit. In Moldova, by contrast, the timeline includes time for tax inspections. The tax authority has a total of 45 days from the time the refund request is submitted, from which 37 days are available for conducting a tax inspection and issuing a decision and eight days for making the payment.

In some economies the time limits depend on the value of the claim. In Romania, for example, if the claim is less than lei 45,000 (about \$11,500), the time limit for issuing a decision is five days and the refund is paid automatically. If the claim is more than lei 45,000, the time limit for both approval and payment is 45 days.

¹⁵ OECD 2014a.

¹⁶ OECD 2014a.

¹⁷ Harrison and Krelove 2005.

According to respondents, the tax authority abides by the time limits in most cases. In Georgia, Greece, Romania and Rwanda, however, respondents reported significant delays. And in some countries – such as Australia, France, Germany and Japan – there are no legal time limits. In France, while there are no legal time limits, a claim is considered to be rejected if no response is received within six months.

To reduce the number of refunds, most VAT systems allow VAT credits to be carried forward for a specified period. The rationale for this arrangement is that a tax period in which a business has a VAT credit would normally be followed by periods in which it has net VAT liabilities that would absorb the credit brought forward, especially if the business is one producing and selling in the domestic market. A refund is then paid only if a credit remains to be recovered by the taxpayer at the end of the carry-forward period.

In a few economies the excess VAT input can be credited against other tax liabilities. In Singapore, for example, the tax authority can withhold a VAT refund to offset any outstanding tax liabilities (for both sales tax and corporate tax). In Germany in certain cases a company's excess VAT input can offset its income tax obligation. In Canada a taxpayer has to make a specific request in advance to have the Canada Revenue Agency transfer a VAT credit or part of a credit to other accounts if the taxpayer owes other taxes under the agency's jurisdiction.

In some economies taxpayers with excess VAT input arising entirely from domestic transactions are not entitled to a refund unless they are a zero-rated supplier (that is, an exporter). Instead, their excess VAT input is carried forward as an offset against future liabilities. This is the case in Antigua and Barbuda, Argentina, Guatemala, Maldives and Sri Lanka. In Sri Lanka excess VAT input from domestic transactions is carried forward to subsequent tax periods to offset VAT output or, if there will be no VAT liability in the future, to offset corporate income tax liability. In Antigua and Barbuda excess VAT input is carried forward to the next six consecutive tax periods. Any credit remaining after six months is then refunded within the following three months.

If the payment of a refund is delayed, the VAT laws in some economies require the tax authority to pay interest on the late refund. The interest usually begins to accrue the first day after the tax authority misses the deadline for the refund and continues to accrue until the day the funds are transferred to the taxpayer's account. In Albania the interest rate is 120% of the interbank interest rate. In Armenia, where the tax authority is required to pay VAT refunds within 90 days after their approval, interest is paid for each day of delay at a rate recalculated daily based on the central bank's published rate. The practice is similar in Indonesia, Lithuania, Luxembourg, Malta, Mauritius, Norway, Singapore and Slovenia. In Croatia taxpayers have to submit a separate request for interest payment. In practice, however, the tax authority usually rejects such requests for default interest for a delayed tax refund. In Argentina regulation provides for a 0.5% monthly interest rate from the day a refund claim is filed.

Several factors can contribute to delays in making VAT refunds. To begin with, delays could arise at the time a VAT refund claim is submitted if the tax authorities require supporting documents, such as copies of invoices, financial statements or contracts with suppliers. In some economies, however, no additional documents are required unless there is an investigation. And in some economies taxpayers are not required to submit a separate form to claim a VAT refund; instead, they need only check a box in the VAT return. This is the case in Antigua and Barbuda, Belgium, Croatia, the Czech Republic, the Arab Republic of Egypt and Germany.

Once the claim is submitted, delays might arise in inputting the information, checking the application and deciding whether an audit is needed. If an audit is needed, this would impose additional delays as the audit is arranged and conducted and reports are completed. Moreover, once the audit takes place, there are often delays as the audit teams seek additional information or as the auditors write up their reports and approve the claim for repayment.

Finally, some delays may arise in the finance division that checks and approves claims and makes payments. Once a claim has been approved, the finance division will be expected to make the payment, but there can be delays in transmission as well as additional procedural checks at this stage prompted by fear of fraud. To avoid delays in payments of VAT credits, it is important for tax authorities and finance ministries to provide for extra payments of VAT refunds in their budgets.

Tax audits

In some cases a claim for a VAT refund may automatically trigger an audit. These audits can be administratively costly, and they can undermine the effectiveness of a VAT system.¹⁸ An effective audit program and payment of VAT refunds are inseparable processes. The IMF recommends applying computerised risk-based checks to claims to select a certain share for audit verification before payment.¹⁹ Rather than screening claims and automatically clearing some of them, however, the VAT system in some economies subjects all claims to audit verification before payment. This ties up a large share of the audit resources, leaving fewer resources for potential cases of tax evasion.

While tax auditing of both VAT and corporate income tax may be a post-filing procedure, audit strategies can have a fundamental impact on how businesses file and pay taxes. An effective tax audit system begins with the selection process.²⁰ One study found that taxpayers are more likely to comply with tax obligations if they know that they may be audited.²¹ Random selection puts all firms equally at risk of being audited and instils a level of uncertainty that will lead to voluntary compliance if taxpayers believe that the auditing will be effective enough to detect evasion.²²

A risk-based selection strategy takes into consideration different aspects of a business, such as size, industry characteristics, historical tax compliance and debt-credit ratios for VAT-registered businesses. Firm characteristics are also used to assess which businesses are most prone to tax evasion. One study showed that a selection process using data-mining techniques, regardless of the technique, captured more noncompliant taxpayers than random audits.²³

One study stated that in economies using a risk-based approach, the exact criteria used to capture noncompliant firms should, in many cases, be concealed, to make it more difficult for taxpayers to devise a strategy for avoiding detection and to allow the uncertainty needed to encourage voluntary compliance.²⁴ The preliminary findings of the new *Doing Business* research show that most economies have in place a risk-assessment system for selecting companies for tax audits and do not disclose the criteria for selection. Even so, in some economies a VAT refund claim is very likely to trigger an audit. This is the case in Albania, Canada, Lithuania and the former Yugoslav Republic of Macedonia.

¹⁸ Harrison and Krelove 2005.

¹⁹ Harrison and Krelove 2005.

²⁰ Khwaja, Awasthi and Loeprick 2011.

²¹ Alm and McKee 2006.

²² Snow and Warren 2005.

²³ Gupta and Nagadevara 2007.

²⁴ Alm and McKee 2006.

Tax appeals

A certain number of tax disputes is a normal part of any system of taxation. But a serious backlog of tax cases threatens revenue collection.²⁵ So disputes between the tax authority and taxpayers need to be resolved in a fair, timely and efficient manner.²⁶ As a first step, taxpayers should try to settle the final tax assessment with the tax officials who first issued the assessment. If a dispute continues, taxpayers should have the opportunity, within a prescribed period of time, to appeal to a special administrative appeal board or department.

The creation of appeal boards within tax administrations can be an effective tool for addressing and resolving complaints and avoiding overcrowding in the courts. An internal administrative review by the tax authorities – through a process removed as much as possible from the original auditor and assessor – can ensure independence in handling complaint cases. Surprisingly, many economies do not separate the appeal board from the auditor. This is the case in Armenia, Bosnia and Herzegovina, the Arab Republic of Egypt, Germany, Israel, Moldova, Namibia, Rwanda and Switzerland

In addition to relying on a separate appeal board or division, there are other possible ways to conduct these internal reviews, such as through a senior official who does not directly supervise the original case auditor or through a new auditor with no previous knowledge of the case. To ensure that those conducting the reviews are qualified and unbiased, it is important to ensure that there are clearly defined criteria for their selection. Also recommended is that operational manuals be developed, decisions published and annual statistics on appeals reported. Most economies impose time frames (legislatively and sometimes administratively) on taxpayers and the internal review authority for each stage. The objective is quick resolution of a tax dispute. To ensure fairness, taxpayers who disagree with the outcome of the internal review should be able to appeal the decision to the courts.

The new research on settlement of VAT refund claims, tax audits and tax appeals provides a broader data set on the tax compliance process. In line with the core purpose of the existing *Paying Taxes* sub-indicators, the objective is to enable policy makers seeking to design an optimal tax system to benchmark their economy against others on the administrative burden of complying with post-filing procedures.

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²⁵ Gordon 1996.

²⁶ Thuronyi 2003.

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