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Paying Taxes 2016

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Contents

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Chapter 3: Tax policy and administration

Having looked in the previous chapters at the results from the *Paying Taxes* study since 2004 and in detail at the reforms made in 2014, this chapter looks at some broader issues of tax policy and administration

The first section considers the role of employment taxes in creating a balanced tax system, the next looks at how good tax systems can help reduce the informal economy and finally we consider how co-operation between tax authorities and taxpayers can be improved, especially in Africa.

Uncovering the impact of hidden taxes on employment

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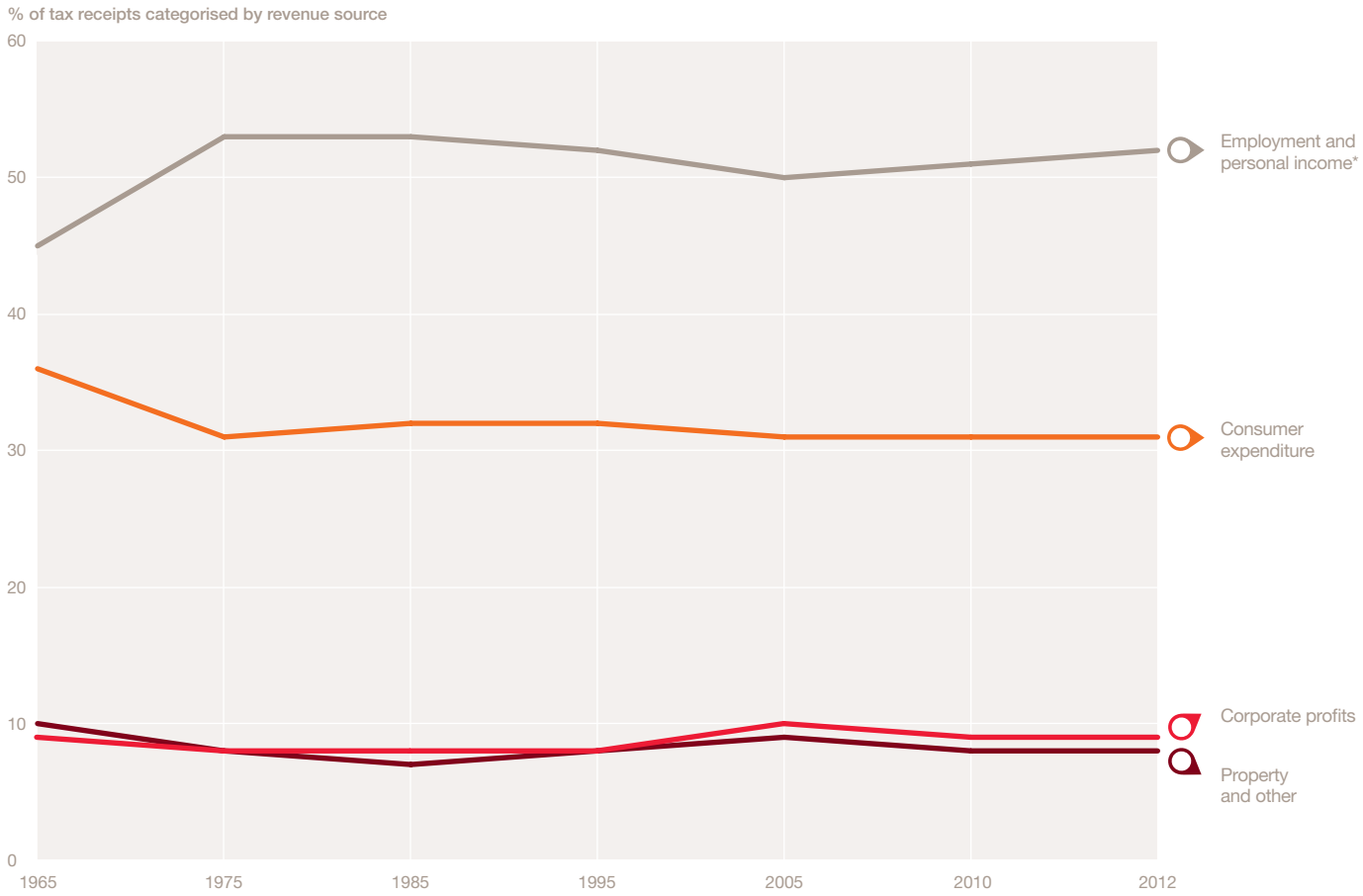
This year's *Paying Taxes* report confirms a pattern in the structure of business taxation which has been evident for a number of years. Certain amounts paid by firms in labour taxes, levied on employment income, are just as significant as profits taxes. In the latest survey both labour taxes and profit taxes averaged 16.2% of commercial profits worldwide. These two components of the Total Tax Rate account for four-fifths of the taxes paid directly by businesses according to the latest *Paying Taxes* results. Taxes on employment income represent a hidden tax on business, as significant as the more direct taxes levied on company profits.

The *Paying Taxes* survey measures just one component of the total tax levied on income and employment – the amounts paid directly by employers, normally in the form of social security contributions. The two other main components are social security contributions paid by employees (and the self-employed) and income taxes paid by individuals. However, businesses act as major tax collectors in all aspects of employment income taxes – by deducting the amounts due from the pay of their employees.

In the OECD countries, total taxes on personal income, payroll taxes, plus social security contributions paid by employers and employees accounts for just over half of the total revenue raised in the OECD countries. As Figure 3.1 shows, this has been a consistent feature of the tax structures in the advanced industrialised economies since the 1970s. By contrast, taxes on company profits have raised around 8 to 10% of total revenue while consumption taxes have generated just over 30% of tax receipts since the 1970s. The relative stability of these shares over four decades is quite remarkable.

Figure 3.1

Tax structures in OECD economies



*Personal income tax and social security contributions
Source: OECD Revenue Statistics, 2014

This article discusses the impact that taxes on employment income can have on economic growth and employment, and how these effects might be mitigated. This is a particularly important issue for European countries, where both the amounts paid by business in terms of labour taxes and the overall level of tax on employment income is high relative to other regions in the world.

Economic impact of taxes on employment income

The effect of taxes on employment income is to create a 'wedge' between the amount that the employer pays and the amount that the employee receives. Imagine an economy with a 30% income tax rate and social security contributions of 10% of employment income from both employers and employees. In such an economy, an extra $1 earned by an employee would cost the employer $1.10 and the employee would receive 60 cents. The other 50 cents goes to the taxman, creating an effective tax rate or 'tax wedge' of over 45 percent (50/110).

There are two reasons why this might have adverse employment and economic effects. First, the tax wedge acts as a disincentive to employment. The employer has to come up with substantially more in wage payments than the employee receives – in the example earlier nearly twice as much. This raises the cost of labour across the economy and makes employment less attractive. Taxes or social security payments which are levied specifically on the employer may have particularly damaging effects on employment.

Second, employees may be disincentivised from working extra hours or even taking a job at all. If tax rates are moderate, these disincentive effects may not be very great for the majority of workers. But they can bite quite hard for low income workers when they face relatively high taxes on their earnings.

If taxes have a negative impact on employment, they are likely to hamper growth. A lower level of employment will have adverse consequences for GDP as there are fewer workers adding to the output of the economy. High unemployment and low rates of labour force participation are normally associated with disappointing economic growth. However, changes in labour market and employment structures are making the disincentive effects of taxes on employment income more complex to analyse and to take into account in policy decisions. The percentage of self-employed and part-time workers is increasing in many economies. In the UK, around 37% of working people are either self-employed or part-time – up from less than 30% in the mid-1980s.[58] So the design of tax and benefit systems needs to take into account not only the impact on regular full-time workers but also the way it affects these more flexible employment patterns. If tax and benefit systems do not adapt to accommodate more flexible labour market patterns, employment may be significantly constrained.

[58] Data from the UK Labour Force Survey, published by the Office for National Statistics

A European problem?

The *Paying Taxes* survey shows that labour taxes paid directly by business are a particularly large element of the taxes levied in Europe. From a historical perspective, this is perhaps not a great surprise. Income tax was levied originally in Britain in 1799 to pay for the war against Napoleon and social security contributions were first introduced in Germany in the late 19th Century.

In Europe, labour taxes paid by employers are the largest component of the Total Tax Rate, equivalent to 26.5% of commercial profits. The global average is 16.2% and in other regions the labour taxes (including mandatory contributions) component of the Total Tax Rate paid by employers is in the range 10 to 19%. Broader measures of the tax wedge on employment income tell the same story. Figure 3.2 shows the OECD's latest measure of the tax wedge on an employee on average earnings in selected OECD countries. In a number of major EU economies, the tax wedge is close to 50% or above. In North America, it is just over 30%. In the Asia-Pacific region and Latin America, the labour tax wedge is generally below 30%.

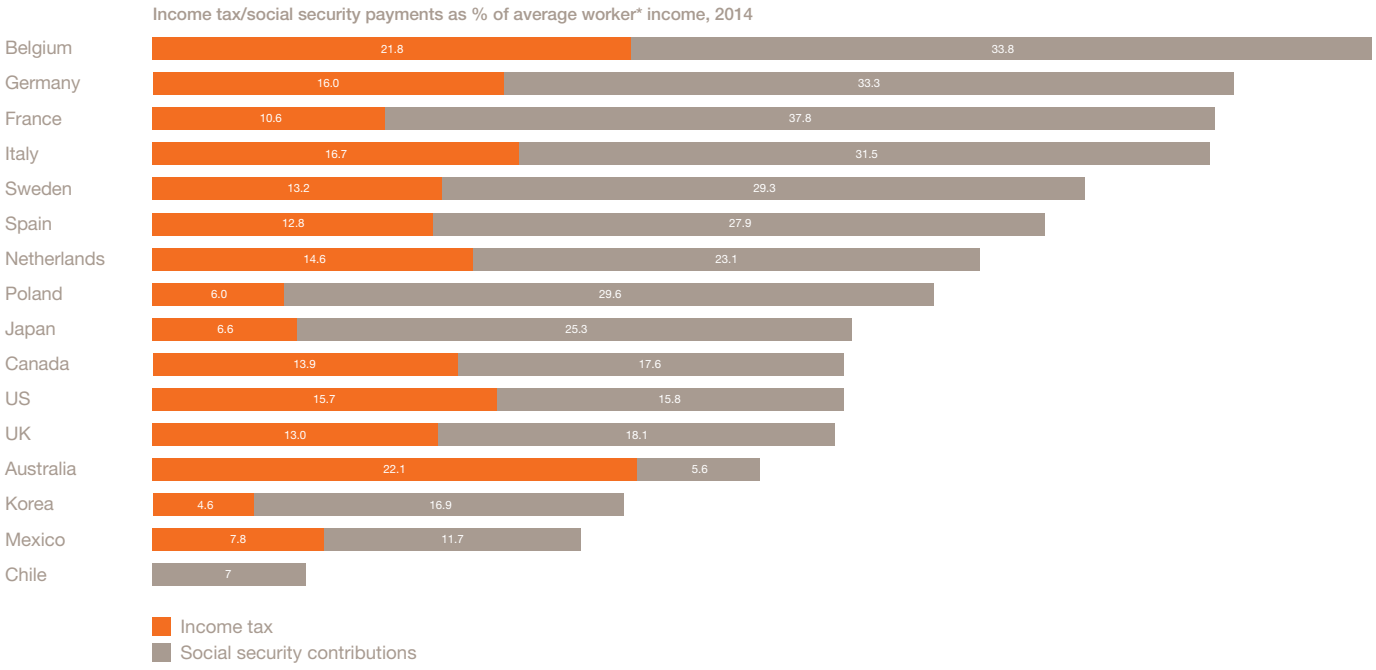
One reason for these high employment income tax wedges in Europe is the high level of public spending. In the Eurozone, government spending as a percentage of GDP in 2014 was 49%, compared to an OECD average of just over 40%.[59] With taxes on income and earnings from employment such an important source of revenue, it is not surprising that this higher spending pattern is reflected in a higher taxes levied on employment income.

This high tax wedge in a number of continental European economies appears to be one of a number of factors contributing to their high unemployment. Spain, Italy and France have the highest unemployment rates of the major EU economies, and they have relatively high employment income tax wedges.[60] Clearly many other factors are at work in contributing to the labour market problems in these economies. But their relatively high taxes on labour are not helping to support employment.

By contrast, countries with a lower tax wedge – of around 30% or below – seem to have a much better employment experience. In the UK and US, the unemployment rate is just above 5%. In Japan and Korea it is around 3.5%, and in Mexico and Chile 5 to 6%.[61]

Figure 3.2

Tax wedges in major OECD economies



*Single individual with no children
Source: OECD Taxing Wages Report, 2015

[59] Data from OECD Economic Outlook, June 2015. The Eurozone contains 19 EU members, of which Germany, France, Italy, Spain, Netherlands and Belgium are the most significant economies.
[60] Eurostat report that in September 2015 the unemployment rate in Spain was 21.6%, in Italy it was 11.8% and in France 10.8%. The EU average unemployment rate in September 2015 was 9.8%
[61] OECD Economic Outlook, June 2015, projections for 2015. National definitions of unemployment.

Potential for policy change and tax reform

How can countries which are heavily reliant on taxes on employment income, especially the high-spending EU economies, improve their economic and employment prospects? There are three potential avenues for policy change and tax reform, and a successful strategy is likely to need to include all three components to some extent.

The first potential policy lever is the level of public spending. European economies with high spending levels need to raise the revenue to fund their expenditure programmes, and this can often fall on employment income taxes. Finding efficiencies in government spending programmes, using technology to improve the delivery of public services, and welfare reforms – aimed at capping and limiting the availability of benefit payments – can all help to ease the amount of tax which falls on labour income.

A second policy lever is to shift the burden of tax to other areas of the economy. The three other main revenue-generating areas for government, as Chart 1 shows, are taxes on profits, spending and property. Environmental taxes represent an additional source of revenue which governments can tap. In Europe, expenditure taxes are already high with VAT rates in the range 19 to 24% – though there may be some scope for narrowing the range of items which carry a zero or lower rate of VAT. The mobility of business across international borders constrains the ability of governments to raise significant extra sums through profits taxes. Higher rates are likely to undermine the tax base by encouraging businesses to invest elsewhere. Taxes on profits also penalise wealth-creation and investment so also have potentially adverse consequences for economic growth. This leaves property taxes and new environmental taxes as the most promising avenues for shifting where tax is levied away from employment income.

The third policy lever is the structure of the taxes and social security contributions which are applied to employment income. It was noted earlier that these levies can have the biggest adverse impacts on low-paid workers and flexible forms of employment. So governments can target these potentially disadvantaged sectors of the workforce – raising the threshold for paying tax and social security contributions and easing the burden on part-time workers and the self-employed.

The UK is an example of an economy where all these approaches are being applied or considered. Public spending is being constrained and welfare reform is now being embraced by the government. The VAT rate has been raised from 17.5% to 20%. Property taxes have been increased – mainly through raising the tax rate of property transactions (Stamp Duty), which is not necessarily the most economically efficient route – as it may discourage housing moves and labour mobility. The personal tax threshold has been raised significantly and is set to rise further. And the interaction between personal income tax and social security contributions (National Insurance) is being reviewed and considered. Within Europe, the UK has one of the lowest tax wedges on employment income, as Figure 3.2 shows.

Growth and employment prospects within Europe would probably be helped by more countries following a similar path of public spending and tax reform, and reducing the employment income tax wedge, particularly for lower-paid workers.

Conclusion – it's a question of balance

Taxes on employment earnings and other forms of income play a key role in financing vital public services and benefit payments. Across the OECD they raise more than half of total revenue. These are taxes which governments will need to rely on in many countries for the foreseeable future. The issue is to ensure they play their role in a balanced tax system which supports a well-functioning economy, supportive of growth and employment.

These labour taxes are particularly high in some parts of Europe, and there is evidence – from economic theory and from recent experience of high unemployment in countries with large tax wedges on labour income – that this has not been good for employment. But there is no single lever which can be pulled to address this problem. It requires control of the overall levels of public spending, a shift to other sources of tax revenue, and changes to the structure of income taxes and social security contributions so new employment opportunities can develop – particularly in the more flexible aspects of the labour market – among part-time workers and the self-employed.

The flow of employment income is a major contributor to income and wealth generation in most economies. So it is natural that it should be a key part of the revenue-generating tax base. But we need to get the balance right, so that labour income is not taxed too heavily, other parts of the tax system bear a reasonable share of revenue-raising, and the structure of taxation reflects the changing structure of the economy and an increasingly flexible labour market.

The structure of taxation should reflect the changing structure of the economy and an increasingly flexible labour market.

Combatting the shadow economy: a taxpayer-centric approach

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Informal economic activity is described through a diverse range of terms: commentators refer variously to the shadow sector, hidden work, concealed employment, or the underground economy (to mention but a few examples) to describe fundamentally similar phenomena. What unites these concepts is the idea of otherwise licit remunerated activity that is carried out beyond the full scrutiny of the state. Informal economic activity is distinct from criminal activity (for instance, drug-trafficking) as its illegality consists only in the fact that it is not adequately declared to the relevant authorities for tax, social security and/or labour law purposes. It is distinct from the domestic or family economy, as work that occurs in this sphere is generally unpaid.[62] This definition includes the market trader who finds it too costly or burdensome to meet the requirements of the tax system, particularly if the risks of discovery and prosecution seem remote; well-educated professionals otherwise operating on a legitimate footing, such as the doctor who does not declare cash receipts from certain patients; and large enterprises that have the understanding and capacity to comply but choose to avoid some or all of the burdens involved, for example by keeping employees off the books and out of the reach of labour laws, or by only putting part of their salaries through the formal payroll system.

Bringing economic activity out of the shadow economy is an important objective for governments across the world. From a revenue authority perspective, the focus of formalisation efforts is usually on increasing revenue yields, but combatting informality can advance a diverse range of public policy objectives. Formalisation can drive economic efficiency by ensuring that all businesses compete on a level playing field, under the same tax and regulatory burdens; it can improve quality of life for employees by guaranteeing minimum working conditions and salary levels; it can enhance growth by offering businesses better access to finance; and it can strengthen civic engagement, as citizens demand a say in how their taxes are spent.

This is not to say that the shadow economy is entirely without value, either for those who participate in it or for society more broadly. Some commentators have suggested that the informal sector is home to a dynamic and vibrant entrepreneurial culture, though the low productivity levels associated with informality suggest a more nuanced picture.[63] Informal economic activity also acts as a valuable source of employment, helping people to enter the labour market who might otherwise be excluded, benefiting them and increasing the productive capacity of the economy as a whole. Many of the informally employed are drawn from marginalised groups, such as the low-skilled, young people, female workers, and migrants (legal and otherwise). Clearly, however, undeclared work can be a mixed blessing for these individuals: often exposing the already vulnerable to insecure jobs, exploitative practices, and dangerous working conditions.

[62] Colin C. Williams and Jan Windebank (1998) Informal employment in the advanced economies: implications for work and welfare, Routledge.

[63] International Labor Office (2002) Decent Work and the Informal Economy, International Labor Office; Colin C. Williams and Alvaro Martinez (2014) "Is the informal economy an incubator for new enterprise creation? A gender perspective", International Journal of Entrepreneurial Behavior & Research, 20(1), 4-19; Colin C. Williams & John Round (2007) "Entrepreneurship and the informal economy: a study of Ukraine's hidden enterprise culture", Journal of developmental entrepreneurship, 12(1), 119-136.

From a public policy perspective, informal economic activity constitutes one of the more intractable problems facing governments. While most countries have seen a downward trend in informality over the last decade, the gains have been gradual. Convergence with the level of informality enjoyed by leading countries is slow, with corresponding implications for the development of public services and the economy as a whole. Moreover, even countries with highly developed economies and tax administrations show surprisingly high residual levels of informal economic activity. Figure 3.3 illustrates the persistence of informality, limited convergence, and gradual pace of change by reference to EU15 countries and new member states acceding to the European Union in 2004 and 2007.

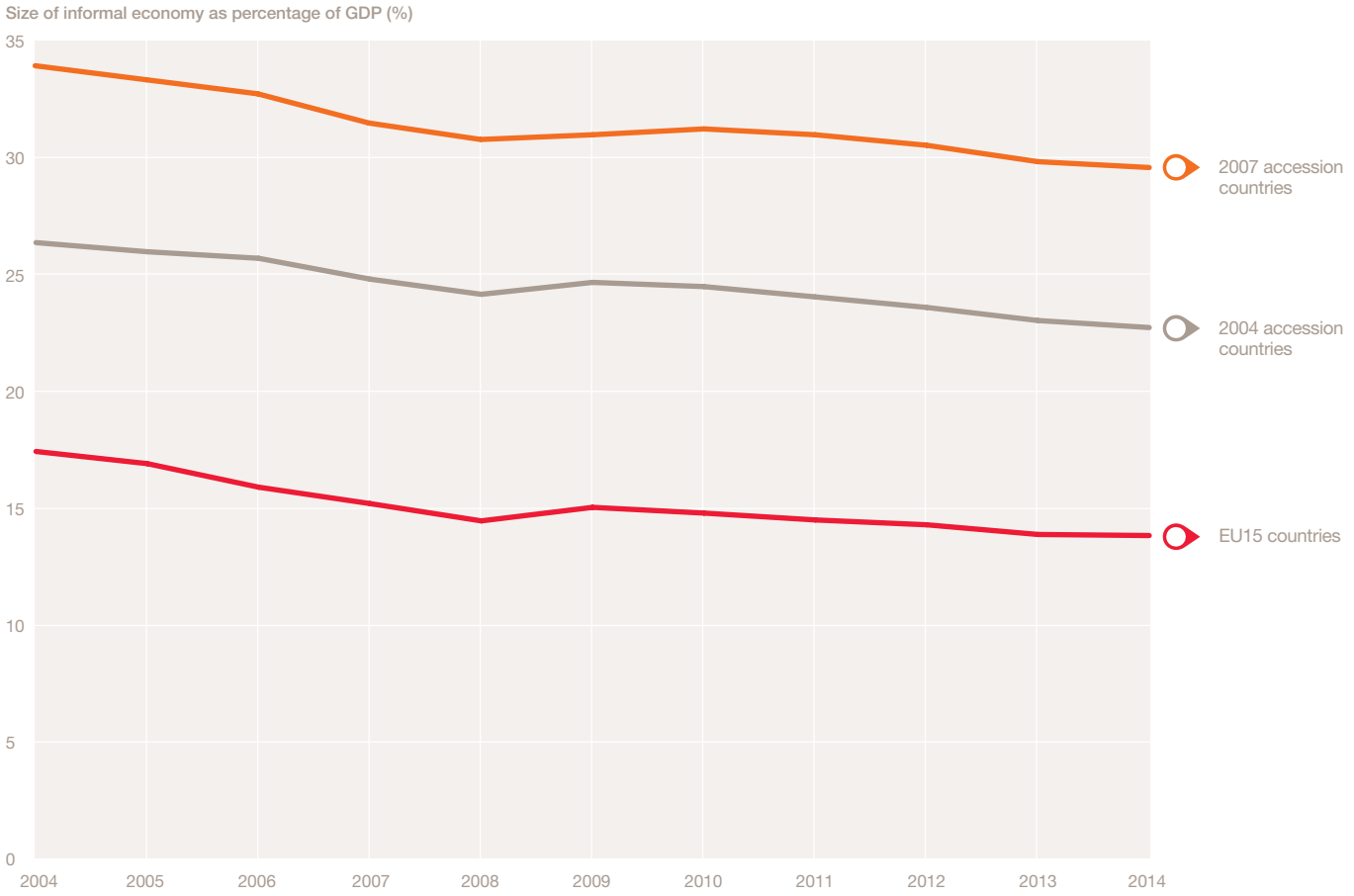
Paying Taxes and the informal economy

One of the key drivers of informality is taxation: both tax policy, and how that policy is administered. Perhaps the most often-cited reason for operating informally is the desire to avoid paying taxes, and the associated compliance costs.

Traditionally, revenue authorities have adopted a repressive approach to bringing the informal economy into the tax net: focusing on effective penalties and improving detection and enforcement rates. In recent years, however, greater emphasis has been placed on facilitating formalisation, reducing the costs of compliance that can deter businesses from exiting the shadow economy.[64] This has led to a proliferation of initiatives, including the introduction of online tax returns, investment in improving taxpayer services, information campaigns designed to boost tax morale, tax amnesties to encourage movement out of the undeclared sphere, and simplified tax regimes for smaller sized businesses.

Figure 3.3

Trends in the size of the informal economy as a percentage of GDP in selected EU member states, 2004-2014 (unweighted averages of national-level data).



Source: Friedrich Schneider, Konrad Raczkowski & Bogdan Mróz (2015) "Shadow economy and tax evasion in the EU", *Journal of Money Laundering Control*, 18(1), 34-51.

[64] Colin C. Williams, Jan Windebank, Marijana Baric & Sara Nadin, (2013) "Public policy innovations: the case of undeclared work", Management Decision, 51(6), 1161-1175.

Here, the *Paying Taxes* sub-indicators can be an invaluable source of information to decision-makers, providing an independent assessment of whether interventions are resulting in a simplified compliance process for a standardised model business, and highlighting instances of best practice internationally.[65] For example, Turkey and Romania are countries where informal economic activity accounts for a substantial proportion of GDP, but which have also seen a higher reduction in these levels over the last decade than many of their peers. Examining their *Paying Taxes* sub-indicators, we find that in both countries the Total Tax Rate and time to comply have fallen dramatically over the same time period.

Understanding the formalisation choice

Nevertheless, it is important to recognise that correlation does not equate to causation, and the decision to formalise or operate in the shadow economy is affected by much more than tax compliance costs alone. By adopting a taxpayer-centric perspective on the informal economy, policy-makers become better able to understand the drivers of informal economic activity, and thereby appreciate the diverse range of measures that they can deploy to improve compliance (See Table 3.1). These include measures to reduce the costs of formalisation, enhance deterrence, increase the benefits of formalisation, and improve tax morale.

The centrality of tax policy and administration to the problem of informality is particularly evident in the first two of these four categories. Reducing the costs of formalisation might involve reductions in both the direct financial burden of tax (for example, through lower or zero-rated bands for smaller enterprises) and the indirect burden of tax compliance (for example, through simplifying and consolidating taxes, streamlining the administration of tax, improving online services, or offering information and support throughout the compliance process). Enhancing deterrence increases the costs of non-compliance – primarily, non-compliance with the tax regime – for any given taxpayer, by making it more likely that they will be caught and punished. This category might include novel uses of data and technology, strengthening tax investigations and enforcement proceedings, or closing off opportunities for tax inspectors to grant exemptions in return for bribes. One of the more innovative schemes to deter VAT avoidance has been the introduction of VAT lotteries, whereby consumers can submit sales receipts to a government-sponsored competition offering prizes such as luxury cars, as well as other benefits such as income tax reductions.[66] Following the introduction of a VAT lottery in Portugal in 2014, a 4% increase in VAT revenue has been reported, against only a 2% rise in private consumption.[67]

Table 3.1

Taxpayer perspective	Measures to combat the informal economy
Reduce costs of formalisation	• Improve tax policy and administration • Improve taxpayer services • Improve wider business environment
Enhance deterrence	• Improve detection and enforcement • Review penalty regime • Combat corruption in revenue collection
Increase benefits of formalisation	• Access to property rights/contract enforcement • Access to welfare entitlements/labour rights • Access to finance/business support
Improve tax morale	• Minimise inefficient uses of public funds • Provide high quality public goods and services • Increase tax compliance in population as a whole

[65] Friedrich Schneider, Konrad Raczkowski & Bogdan Mróz (2015) "Shadow economy and tax evasion in the EU", *Journal of Money Laundering Control*, 18(1), 34-51.
[66] Joe Stanley-Smith (2015) "VAT lotteries – driving up compliance from the consumer's end", International Tax Review.
[67] Patricia Kowsmann (2015) "Get Receipts, Win a Car: How Greece's VAT Lottery Plan Worked in Portugal", The Wall Street Journal.

However, it is also clear from a taxpayer-centric approach that taxation is not the sole factor influencing the decision to operate on a formal or informal basis. The wider benefits of formalisation have a significant impact on the attractiveness of compliance for any given business or individual. Businesses operating on a legitimate footing generally enjoy better legal protection than their informal counterparts; conversely, where even formal businesses struggle to access justice due to an inefficient or corrupt court system, the incentive to formalise is reduced. Finance is another key area where formal businesses tend to have an advantage, as they offer a more secure prospect to lenders; but again, a lack of finance or financial institutions serving particular regions or market sectors may undermine the potential incentive effect. From an employee perspective, legal protections and welfare entitlements will make formal employment preferable to informal employment, other things being equal. However, without industrial representation workers may find they have limited capacity to demand formalisation from their employers.

The fourth category of measures focuses on tax morale. To a large extent, this is a function of the level of compliance in the population as a whole: it is very easy to rationalise non-compliance when no-one else appears to pay tax either, and especially so when paying tax puts individuals and businesses at a disadvantage vis-à-vis their competitors. However, it is also important to look at the other side of the fiscal contract between citizens and the state, and scrutinise how tax revenues are spent. High quality public goods and services will increase tax morale, whereas money lost to poor political decisions and corruption will tend to decrease it. Initiatives such as participatory budgeting and increased transparency may help to improve the allocation of resources and the efficiency of public spending.

Finally, it is crucial to note that the public needs to be aware of these measures for them to have the desired behavioural impacts. Initiatives targeted at raising public awareness should be understood as an integral component of any reform intended to combat informal economic activity. For example, in 2010 and 2011 the Estonian Tax and Customs Board launched a series of public information campaigns, linking the payment of tax to the provision of prominent public services such as ambulances and kindergarten places.[68]

The role of revenue authorities

Public servants working in the field of taxation have limited control over many of the policy areas outlined above. Generally speaking, they cannot directly influence the wider business policy agenda, let alone factors such as the justice system or the overall efficiency of public spending. While improvements in tax policy and administration can remove many of the obstacles to compliance, and a well-constructed investigation and enforcement regime can help to compel compliant behaviours, the best efforts of revenue authorities and tax policy-makers may be undermined by poor decision-making in other parts of government.

Nevertheless, a taxpayer-centric approach to the problem of formalisation highlights the importance of coordinated cross-governmental action as part of efforts to increase tax compliance and reduce the scale of the informal economy. Given their investigative remit and overall responsibility for revenues, tax authorities have a unique insight into the informal economy that leaves them well-placed to play a constructive or even coordinating role in developing and evaluating policy ideas.

[68] European Monitoring Centre on Change (2013) "Information campaign on tax compliance, Estonia", European Foundation for the Improvement of Living and Working Conditions (Eurofound).

Conclusion

The informal economy poses a complex set of problems for revenue authorities, and for governments more broadly. Viewed over a longer time horizon, informal economic activity tends to reduce as countries develop, and as populations shift from agriculture to industry, from rural settings to large cities. Yet the rates of change are not uniform, and even over relatively short periods of time, policy interventions can have a tangible impact.[69]

Improving both tax policy and tax administration is central to any action plan intended to tackle informality. While the formalisation process takes place against a baseline that is conditioned by many social, cultural, economic and historical factors that are unrelated to taxation, reductions in the financial and administrative burdens of taxation do appear to be associated with increases in the level of compliance. Moreover, adopting a taxpayer-centric approach to the shadow economy can help policymakers to appreciate the wealth of options that are available to promote compliance. These options are not limited to repressive measures intended to enhance detection and enforcement. Rather, they include reforms aimed at reducing the financial and administrative costs of formalisation, encouraging individuals and businesses to operate on a formal basis from the outset, enhancing the wider social, legal and economic benefits available to those who do operate on a formal footing, and assisting vulnerable individuals currently dependent on undeclared employment to transition to the formal sector. Taken in aggregate, these reforms have real potential to improve taxpayer morale and drive forward formalisation. Convergence with the low rates of informality seen in some countries cannot be achieved overnight, but there are many ways to speed up the journey.

The informal economy poses a complex set of problems for revenue authorities, and for governments more broadly... Improving both tax policy and tax administration is central to any action plan intended to tackle informality.

[69] Timothy Besley and Torsten Persson (2014) "Why do developing countries tax so little?", Journal of Economic Perspectives, 28 (4), 99-120.

The relevance and sustainability of co-operative compliance models for tax in African countries[70]

Authors: **Eelco van der Enden and Kuralay Baisalbayeva**, PwC Netherlands

[70] This paper is an extract of the paper presented at the African Tax Research Network (ATRN), 1st Annual Congress, Contemporary Tax Challenges for African Countries, 02 – 04 September 2015, Cape Town, South Africa.

Introduction

Tax authorities have always felt the pressure 'to do more with less' due to budget constraints and limited capacity within tax administrations; these issues are increasingly becoming a common challenge for many countries, but especially in the developing world. To improve their position, many countries have already incorporated a co-operative compliance model into their tax enforcement strategies, along with a traditional command-and-force manner. Co-operative compliance is a new way to effective tax compliance management based on transparency, 'justified trust' and a better understanding of the taxpayer's business and risk profile. If properly designed and executed, it has proved capable of enabling tax authorities and taxpayers to build a sustainable tax compliance infrastructure.

In the previous edition of *Paying Taxes* we introduced the idea of co-operative compliance and its history. This paper investigates the relevance and sustainability of co-operative compliance models for tax in African countries. Given the culture and challenges faced by both businesses and the tax authorities in these countries,[71] we suggest some practical measures that can enable the effective and efficient implementation of sustainable co-operative compliance models in Africa. Although co-operative compliance is generally targeted at large companies, often operating across country borders, the underlying principles are relevant for companies of all sizes.

[71] African tax administrations: a Dutch multinationals perspective. In a recent study by the Dutch Association of Investors for Sustainable Development (VBDO, 2015), tax directors of the Dutch listed companies have identified the following challenges to taxation in developing countries:

- Opportunistic / aggressive behaviour of local tax authorities towards MNEs;
- Overly hierarchical and bureaucratic tax organisation, difficult to get a single point of contact;
- Time-consuming and costly appeal procedures;
- Multi-interpretable, complex and fast-changing tax laws;
- Corruption within governmental bodies;
- Lack of capacity and skills of local tax authorities;
- Different perspectives, difficult to establish an open and transparent relationship with local tax authorities.

Businesses struggles to establish the right dialogue and good working relations with local tax authorities in many developing countries. However, MNEs are crucial for the financial development and economic sustainability of these countries with an estimated annual contribution of 750 billion dollars to local economies (UNCTAD, 2015). *Paying Taxes* refers to a medium sized enterprise, however we believe that the concepts outlined in this paper remain relevant.

Co-operative compliance – what, how and why?

The co-operative compliance concept can be best described as a means to effective tax compliance management based on mutual transparency, justified trust and a better understanding of the taxpayer's business and risk profile. The objective is improved tax compliant behaviour – payment of the right amount of tax due on time, at lower costs of compliance for both tax administrations and businesses.

In 2006 the OECD's Forum on Tax Administrations (FTA)[72] concluded that tax authorities should have effective risk-management processes in place, enabling them to effectively allocate their resources to those taxpayers with a higher risk profile. Tax authorities were prompted to create solid relationships with taxpayers by:

- understanding the business based on commercial awareness,
- being impartial,
- acting in a proportionate manner,
- being prepared to be open (transparent), and
- being responsive.

In theory, if tax authorities could demonstrate these attributes, taxpayers from their side should be more likely to engage in "a relationship with revenue bodies based on co-operation and trust with both parties going beyond their statutory obligations" (OECD, *Study into the Role of Tax Intermediaries*, 2008, p. 5).

Since 2008 many tax authorities have implemented compliance risk management strategies and co-operative approaches to businesses. In addition, increased attention has been given to the concept of a 'tax control framework' (TCF) 'as a key tool to disclosure and transparency' (OECD, *Co-operative Compliance: A Framework – From Enhanced Relationship to Co-operative Compliance*, 2013, p.13). In May 2013, the OECD published the report 'Co-operative Compliance: A Framework, From Enhanced Relationship to Co-operative Compliance', thus providing more practical guidance on how to achieve improved compliance. 'How do I know as a tax administration that I can trust a tax payer?' was a question that was raised by many tax officials. The trust element of the relationship between tax authorities and a taxpayer has to be justified. This justification can be found if a taxpayer has an internal control system in place that assures the accuracy and completeness of the tax returns submitted by the taxpayers. In other words, if the taxpayer has a functional TCF in place.

Co-operative compliance in African countries

This section is based on the results of a survey of telecommunications operators and PwC offices in Botswana, Cameroon, Democratic Republic of the Congo, Ghana, Kenya, Namibia, Nigeria and South Africa. The selection of countries from all over Africa represents a comprehensive approach to studying compliance practices on the African continent.

To date, only one of the surveyed countries has incorporated a co-operative compliance model in its risk management strategies – South Africa. The South African Revenue Service has introduced a formal co-operative compliance program – 'taxpayers engagement strategy'. It involves compliance enforcement activities to mitigate prioritised risks and adjust the audit strategy depending on the taxpayer's compliance profile. Whilst Botswana, Kenya and Namibia have taken steps to enhance the relationships with some taxpayers, still a majority of tax authorities in African countries perform detailed testing of almost all underlying records of the tax returns and rely on the taxpayer's audited financial statements to a certain extent.

The survey respondents identified the following specific challenges in complying with their tax obligations:

- lack of suitably qualified and experienced tax officials;
- poor quality record keeping at the tax authority;
- delays in tax assessments and audits, obtaining clarifications and responses to issues;
- burdensome tax system, time demanding for preparation and submission of tax returns;
- lack of IT infrastructure at the tax authorities;
- lack of transparent guidelines from the tax authorities;
- high rate of tax evasion;
- no timely revision of tax legislation.

[72] The OECD Forum on Tax Administration (FTA) for Commissioners from 45 OECD and non-OECD countries, including every member of the G20, was created in 2002 with the aim to improve taxpayer services and tax compliance by helping tax administrations increase the efficiency, effectiveness and fairness of tax administration and reduce the costs of compliance. See OECD / FTA website http://www.oecd.org/site/ctpfta/

Faced with these challenges many businesses struggle to establish the right dialogue and good working relations with local tax authorities. However, businesses are crucial for the financial development and economic sustainability of African countries. If tax authorities want to improve their relations with businesses, as well as assure their proper tax compliance, introducing a co-operative compliance model could be an effective solution. A number of suggestions for how to apply the co-operative compliance models in practice are provided below.

Suggestions for African countries on co-operative compliance models

1. Set up clear measurable key performance indicators

Defined measurement parameters will enable the tax authorities to evaluate its effectiveness afterwards. This could for example be measured in terms of reduced compliance costs and hours.[73]

2. Define the benefits for taxpayers – quid pro quo

Co-operative compliance requires ultimate transparency and providing information beyond formal legal obligations. Taxpayers should know what the benefits are and which value add it derives in return from the tax authorities, e.g. lower costs of compliance and/or greater certainty on tax positions.

3. Define the concept of trust – Tax Control Framework

A TCF is the basis for establishing an open dialogue and justified trust between tax authorities and taxpayers. The focus of the TCF is "to be … able to detect, document and report any relevant tax risks to the revenue body in a timely way" (OECD, *Co-operative Compliance: A Framework – From Enhanced Relationship to Co-operative Compliance, 2013*, p.59).

4. Define an auditing standard for TCF

A TCF should be auditable and based on clearly defined and communicated standards or guiding principles. There may be a need for additional certainty – assurance on the reliability of the taxpayer's 'in control' statement, e.g. by auditing TCF on the basis of existing internationally recognised auditing standards.

5. Managing disputes within co-operative compliance programs

If disputes arise, co-operative compliance helps ensure that disputes are managed in the most effective and efficient way. It is also very important to demonstrate impartial treatment of all taxpayers within and outside co-operative compliance relations.

6. Enable tax authorities employees

It is of great importance to train tax administration employees on the co-operative compliance concept. It is based on a broad 'system' type of approach and it involves understanding business processes and assessing the TCF, including the quality of the technological infrastructure; these are not within most tax administrations' traditional data testing approach.

7. Leverage on technology to ensure compliance

Many tax authorities are beginning to understand the value of leveraging technology to achieve compliant behaviour in the most efficient way. As shown by the sustained falls in the *Paying Taxes* time to comply and payments sub-indicators, taxpayers are increasingly using advanced digital self-services, which make it easier and more efficient to comply with tax obligations.

Conclusion

The search for new and effective ways to assure tax compliance is becoming a common issue for many countries worldwide. In African countries, capacity building of tax authorities and domestic resource mobilisation are among the top priorities for many economies. Taking steps to create a culture that builds on the principles of co-operative compliance may be a way forward for many African countries, with the potential to instigate pilot projects using the co-operative compliance model.

[73] *Paying Taxes* identifies the time to comply with tax systems in 189 economies.

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