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Chapter 4 – Beyond Paying Taxes: Tax policy and administration

A role for corporates in tax system reform

Authors: Amal Larhlid (PwC UK) and Simon Carey (PwC UK)

Tax and how tax systems operate has moved firmly up the agenda not only for governments, business and the media, but also for the general public. The *Paying Taxes* indicator provides robust information which enables tax systems around the world to be benchmarked. In doing so it provides a tool which assesses how easy governments make it for companies to pay their taxes and so can help to encourage reform and improvement especially around reducing the administrative burden of paying taxes and making compliance easier and more efficient for all.

But governments, particularly in the developing world, need assistance to make these reforms and to build effective, efficient tax systems. The private sector has the potential to offer this assistance and to play a much greater role in the worldwide development of strong tax systems; to do more than just paying its taxes. The private sector has access to resources, expertise and networks that can make a valuable contribution to the development of tax systems and the effective collection of tax revenues, but for this to happen there needs to be an appetite to offer such assistance and an acceptance by other stakeholders that such help is appropriate.

In this article we explore some aspects of corporate social responsibility and the role it can play in tax system reform. We identify the main barriers to effective cooperation in this area and some of the approaches to overcoming these barriers. This is based on international literature and insights gleaned from a series of interviews conducted with experts from multinational corporations, international financial institutions, tax authorities and non-governmental organisations (NGOs) during 2016. The authors are very grateful for the valuable insights these interviews provided.

"The field of CSR … is not a static set of practices, but a constantly evolving field which has been largely driven by business. CR used to be an "add-on," but has evolved to become a more integrated and disciplined field, increasingly managed and assessed as any other business function." [39]

Camilla Drejer, Corporate Responsibility Group

What do we mean by corporate social responsibility?

Corporate social responsibility (CSR) is "a concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis".[40]

Over the years, prevailing views on corporate responsibility have evolved. Companies continue to search for a competitive edge whilst trying to respond to new stakeholder demands and to demonstrate that the two need not be contradictory. A wider group of stakeholders now take a closer interest in companies' impacts and can influence how company brands are regarded.

Part of this evolution in CSR can be attributed to significant shifts in public sentiment. Many companies now have sophisticated, comprehensive and publicised CSR strategies, often with a particular focus on issues like supply chain working conditions, and some have gone so far as to make advocacy for social responsibility a key point of differentiation.

Businesses can be powerful agents of change and their influence can be significant for economic and social development. For developing countries in particular, businesses provide 60% of economic output and 90% of jobs.[41] The Addis Ababa Action agenda, agreed at the United Nations Third International Conference on Financing for Development in 2015, re-emphasised what they regard as the need for improved domestic resource mobilisation to "widen the revenue base, improve tax collection and combat tax evasion and illicit financial flows"[42] and highlighted the need for private business investment to help drive inclusive economic growth and job creation.

Why would companies get involved?

Many corporations are adopting and strengthening their CSR strategies in recognition of a range of benefits for companies; "ultimately, corporates can do well by doing good".[43] There can be lower costs to firms through greater operational efficiencies, reducing waste and costly energy consumption and removing inefficient capital expenditure. For example, in 2006 Wal-Mart reduced transportation costs by $3.5 million through one initiative to reduce packaging on toys.[44] CSR strategies that focus on employees' wellbeing and training can help retain more workers, enhance overall productivity, mitigate health and safety issues and other risks to the business.

By promoting and adopting considerate and responsible business attitudes, companies can engage positively with stakeholders, regulators and governments which can help with risk management and mitigation.[45] In addition this can help change a reputation and can differentiate the business, lead to greater customer loyalty, stronger client relationships and create an attractive workplace for employees which are all indirectly linked to sustainable business success.[46]

For developing countries in particular, businesses provide 60% of economic output and 90% of jobs.

"Ultimately, corporates can do well by doing good."

[39] Department for Business, Innovation and Skills 2014. See page 79 for bibliography.
[40] European Commission 2011.
[41] OECD 2016a.
[42] United Nations 2015.
[43] OECD 2016b.
[44] Wal-Mart 2006.
[45] Kytle and Ruggie 2005.
[46] IISD 2016a.

What role does tax play in corporate social responsibility?

A company's tax strategy can play an important part in their approach to social responsibility. Tax raised in a particular country is an important source of finance for the government, enabling them to meet economic and social objectives and helping to secure overall prosperity and stability. While tax is a cost to business, some say that it could also be regarded an investment in the societies in which a company operates.[47]

In some parts of the world, companies are increasingly being asked to consider their strategic approach to tax taking into account a broader social responsibility agenda. Through social media and greater financial disclosure there has been increasing pressure from citizens, governments, NGOs and the media for companies to think more broadly when planning their tax affairs to consider the wider impacts of their decision-making, and to explain publically the taxes they pay.

This is a particular focus in the developing world, where tax provides the funds to expand much-needed public services such as healthcare and education, and to alleviate deprivation. This should also be complemented by reforms to combat corruption and inefficiency in the public sector, to help ensure the benefits of taxation are accruing to those most in need.

Companies may have more to contribute than just paying their taxes

Companies potentially have more to offer than the contribution they make through paying taxes. They can also bring significant expertise and resource to bear on some of society's biggest issues, which includes contributing to the development of effective tax systems and the building of capability in developing world tax administrations. This should be possible without compromising their commercial competitive advantage, provided certain barriers to their involvement can be overcome. We consider these barriers and how they could be addressed in the final section of this article.

By promoting and adopting considerate and responsible business attitudes, companies can engage positively with stakeholders, regulators and governments which can help with risk management and mitigation.

[47] Action Aid 2015.

The different perspectives on CSR

Many parties have an interest in corporate social responsibility – including businesses, the media, professional bodies, trade associations, universities, research institutes, NGOs, governments, employees and other groups of citizens – and these diverse groups all have different expectations of what corporate social responsibility should entail. The analysis below briefly explores some of these different perceptions with regard to tax.

Governments

The government's responsibility is to look after the collective interests of its citizens, providing an enabling environment for responsible business and making sure that it is equitably enforced.[48] Governments cannot provide for all their citizen's needs alone and must partner with other actors to leverage key resources. Some have an expectation that governments should create a responsible and attractive business environment – often a key factor in a company's decision on whether or not to start doing business in a country.

In return, governments expect corporates to comply with their tax obligations. In some developed countries the input of corporates to the debate around tax policy is sought although to varying degrees, and in many developing and emerging countries governments will also seek the input of the private sector (either directly, or through international institutions and aid agencies) to advise on, and support, major tax system reforms.[49]

Non-governmental organisations (NGOs)

NGOs play a role in international development and help to draw attention to the impact of businesses on society and the environment, in some cases campaigning against businesses that, in their view, could operate differently. The work of some NGOs has impacted consumer and governmental expectations on companies with regard to their approach to tax: "Multinational brands have been acutely susceptible to pressure from activists and from NGOs eager to challenge a company's labour, environmental or human rights record".[50] This doesn't just impact businesses that are directly manufacturing or selling highly visible branded goods it can also affect a broader range of companies and their stakeholders.[51]

A common perception among NGOs is that the role of corporates in supporting tax systems should be limited to paying taxes in accordance with the spirit of the law, and should not extend to support with setting and developing policies that corporates themselves will eventually have to comply with. The practical impact of this view is to discourage the potentially valuable involvement of corporates in other ways, such as the provision of expertise, technical assistance and resources.

The international community

The international community – the United Nations, the OECD, the IMF and the World Bank, to name a few – have identified a major role for the private sector. International agencies themselves play a vital role in setting expectations for corporates to contribute to developing the countries in which they operate through responsible business practices. They play a key role in reshaping traditional perceptions of public and private sector roles by creating the conditions and tools for increased cooperation, such as common standards and best practice fora, in order to increase the access to expertise and information for governments and businesses to make informed decisions.

There is a risk that NGOs support too narrow a view of the role of corporates and discourage them from supporting tax development to their full extent.

[48] OECD 2016c.
[49] See, for example the work programmes of domestic aid agencies DFID, DANIDA and USAID, and international organisations such as the World Bank and European Commission.
[50] IISD 2016b.
[51] IISD 2016b.

The international community also plays a key role in identifying global trends in foreign investment and aid, and coordinating global responses to policy priorities.

The international community also plays a key role in identifying global trends in foreign investment and aid, and coordinating global responses to policy priorities. International organisations expect companies to support development by respecting "both the letter and spirit of the tax laws and regulations of the countries in which they operate"[52] and they may actively seek the input of the private sector to support tax system reforms.

Companies

Companies contribute to the societies in which they operate in a number of ways. In terms of public finances, it is not just taxes on corporate profits that support public expenditure, but also other taxes made possible by the economic activity they generate – such as value-added taxes and personal income taxes. There is now pressure from some stakeholders that they comply with the spirit and letter of relevant tax laws, and in many cases this means an expectation around both tax payments and the disclosure of relevant financial information.

A potential barrier to companies also contributing their expertise and resources to improve the local business environment in the developing world may be that the benefits of improvements will be shared with all other businesses (the free rider problem). However, evidence suggests that these barriers can be overcome.[53] Acting collectively to provide support and capacity building can diminish the problem, also providing an opportunity to strengthen relationships. The reputational benefits of providing support can also be significant, and promoting a clear, public CSR strategy can ensure these reputational benefits are captured by the firm or firms actually providing the support.

How can companies better support tax reform in developing countries?

A number of tax administrations in the developing world are looking for financial and expert support in reforming and strengthening their tax systems. Some corporates are interested in supporting these types of reforms but find that it is not always easy to know how to offer their support in a way that isn't misinterpreted. These corporate stakeholders often have interests very closely aligned with those of the governments and donors, as it is in their shared interests for countries to have well-functioning tax and public finance systems – where the infrastructure is properly managed, people have money to spend and invest, and corruption is minimised. They also have expertise and financial resources that can be applied to help tax reform including the drafting and strengthening of tax policy, legislation and administration.

Companies' involvement with governments of developing countries has historically been sensitive due to issues such as perceived conflicts of interest, criticism for interfering in developing countries' tax affairs, and accusations of corruption and bribery. These barriers are not insurmountable, and as we describe below, companies are already beginning to overcome some of these obstacles in innovative ways, acknowledging the positive impact that they can have if involved in the right way.

[52] OECD 2016c.
[53] Porter and Kramer 2002.

The table below outlines the main barriers and potential solutions to cooperation on tax administration and policy. The list is by no means exhaustive, but it highlights the extent to which companies may be deterred from making a valuable contribution, as well as the ease with which some of these barriers may be overcome.

Barriers

	Procedural barriers	Lack of access	The free rider problem	Mutual lack of understanding
Barriers	Internal rules and/or legislation designed to prevent conflicts of interest may prevent corporates from being involved.	No natural forum or platform for engaging on issues of tax development may exist.	Companies may be reluctant to support tax development in a context where non-contributors also benefit.	Businesses, governments, NGOs and international financial institutions may not understand each other sufficiently.
Potential solutions	• Revise internal risk procedures to allow cooperation by putting in place appropriate safeguards (e.g. clear codes of conduct, rigorous relationship checking, understanding the details of services proposed and parties involved/impacted, and examining and documenting the nature of the relationship between entities for the delivery of the services). • Implement processes/ standards for cooperation developed by international organisations such as the OECD (e.g. on Responsible Business Conduct) or the Business and Industry Advisory Committee (BIAC) framework for stakeholder engagement.[54]	• Build relationships with the help of facilitators or business advisers. • Set up fora for dialogue and cooperation with representatives of different parties, including NGOs, tax authorities and other corporates. • Work with, or through, international financial institutions and the international community.	• Facilitate collaboration between corporates, to encourage a collective approach across an industry, or even more widely. • Ensure that the reputational benefits of the company supporting tax development are realised (e.g. through the publication of a clear CSR strategy).	• Frequent and constructive multi-stakeholder policy dialogue to improve understanding and build trust between stakeholders. • Formal submissions (written and verbal) on potential tax changes. • Secondments of tax staff from companies to tax authorities (and vice versa), with appropriate safeguards.

[54] BIAC 2006.

Barriers

Lack of trust
Stakeholders may not trust one another sufficiently to cooperate on issues of tax development.

Corruption
Companies may be deterred from working with governments due to real or perceived corruption within the bureaucratic or political levels.

The perception of lobbying
Businesses may be deterred from providing support in case it is perceived by stakeholders as a lobbying exercise.

Costs to the business
The cost of providing support for tax development may be prohibitive. This includes financial costs, staff time and management resource.

Potential solutions

Lack of trust

- Improve corporate transparency and consider what voluntary disclosure can be made in order to build trust.
- Ensure any interactions with the authorities around tax development, and the company's intentions, are publically disclosed.
- Assess and address the developmental impacts of tax behaviour.

Corruption

- Ensure all interactions and arrangements with the government are made on a fully transparent basis.
- Cooperate with international organisations or other independent bodies to mitigate the risks.
- Provide technical assistance to support the government in the fields of governance and anti-corruption.
- Ensure strong procurement procedures to protect the company from problematic conflicts of interest arising through its interactions with government tax bodies.

The perception of lobbying

- Transparent public disclosure of the aims and outcomes of cooperation around tax and development issues.
- Payment by results approaches can – if well executed – provide a mechanism for aligning incentives between the provider of a service/ program and the contracting authority. These contracts involve a "success fee", which is subject to the realisation of pre-defined objectives related to the project.
- Work with, or through, international organisations or wider industry groups.

Costs to the business

- For some companies this may be a perceived, rather than actual, barrier, as the improvements to the business environment and flow-on implications for the company's operations can far outweigh the costs of providing support.
- Companies may be able to provide support in ways that alleviate their main pressure points – i.e., providing opportunities for staff secondments where financial support is not possible.
- Companies can encourage others to participate through the sharing of best-practice cooperation examples and the impact these have had on the firms themselves.

This demonstrates that the barriers to corporates supporting the development of sound, well-functioning tax systems are not insurmountable, and a number of these potential solutions are already being utilised by companies and tax administrations around the world. As a final point, we highlight two of the key tools being used to overcome these constraints below.

A number of industry groups have been set up to overcome these obstacles in a collective way. One example of this is the Africa Industry Tax Association (AITA), a group of multinational corporations with significant operations in Africa. This group was formed as a structured, collective platform for engaging with African governments and revenue authorities on issues around tax policy, systems and administration, and has an active working relationship with the African Tax Administration Forum (ATAF). These groups may even be formally incorporated into the consultation processes of other stakeholders as is the case with the Business and Industry Advisory Committee to the OECD (BIAC), a group of multinational businesses who operate as a trusted partner to the OECD and other international institutions. Groups like these can be a powerful tool for promoting dialogue and building trust between governments and industry around tax affairs, mitigating the free rider concern and reducing the perception of lobbying for the advancement of company-specific benefits.

Blended finance is another collaborative approach to overcoming these barriers. It is defined by the World Economic Forum and OECD as "the strategic use of development finance and philanthropic funds to mobilize private capital flows to emerging and frontier markets".[55] At its core it is a way to channel private investment into sectors where the development needs are the greatest, by combining it with development finance and philanthropic funds to mitigate risk and ensure commercial returns. International financial institutions are already operating models like this as a way to mobilise resources for their global programmes, including specific funds established to assist with tax development. Both these approaches – as well as the tools and approaches listed above – are available to companies and governments looking to overcome the constraints to greater cooperation around issues of tax development.[56]

Concluding remarks

Governments worldwide are looking to their tax systems to generate the funds necessary to support vibrant, inclusive societies, but many countries remain unable to harness the revenues needed to provide even basic needs for their populations. Tackling corruption, improving the tax system, and making it easier for companies and individuals to pay their taxes are important roles of government, while companies are expected to pay their tax when and where it is due.

In addition to the taxes that a company pays, there is potential for companies to work in cooperation with governments and other stakeholders in support of broader development goals as well, including a role in the worldwide development of strong tax systems. The potential barriers to this cooperation, if addressed properly, need not prevent the experience, influence and resourcefulness of the private sector from playing their part in fulfilling these important goals.

Tackling corruption, improving the tax system, and making it easier for companies and individuals to pay their taxes are important roles of government, while companies are expected to pay their tax when and where it is due.

[55] OECD and World Economic Forum 2015.
[56] Examples include a series of multi-donor funds operated by the World Bank, and the IMF's Tax Policy and Administration Topical Trust Fund, launched in 2011 to help meet increased demand for technical assistance from developing countries in the area of revenue policy and administration (see IMF 2016b).

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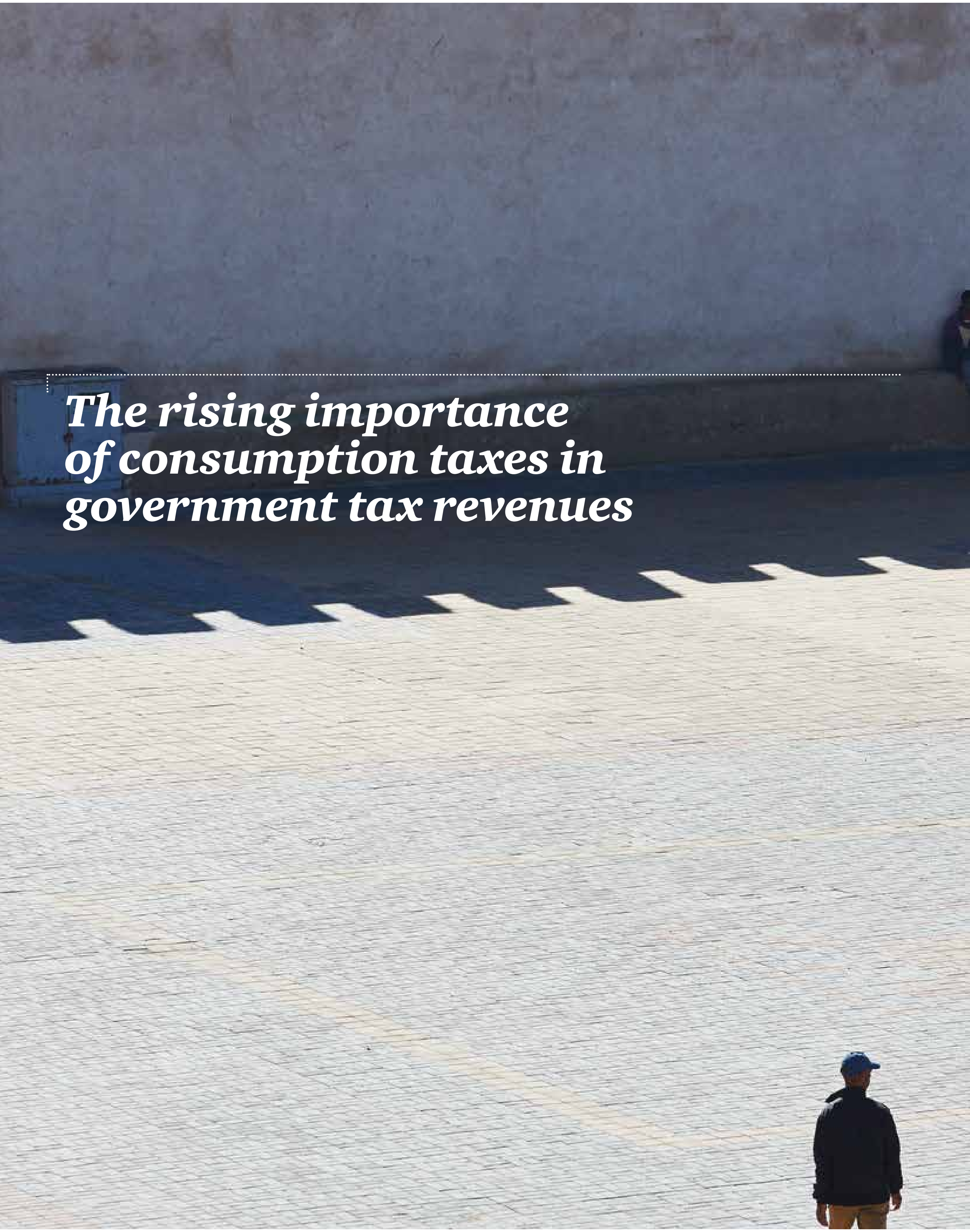

The rising importance of consumption taxes in government tax revenues

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Executive Summary

- Corporate income tax as a percentage of governments' tax revenues is continuing to fall at the same time as tax revenues from indirect taxes such as value-added tax (VAT)[57] are increasing. This reflects a global trend of governments focusing on the certainty of revenues from VAT and using indirect taxation to achieve objectives beyond just raising tax revenue.

- The number of countries around the world with a VAT system is increasing. VAT in the OECD countries now accounts for around 20%[58] of total tax revenues, a 70% greater share than in the mid-eighties.[59]

- Comparing VAT systems across the world shows that there is a clear tension between the need to reduce the possibility of non-compliance and ensuring that the burden of administration on taxpayers does not impair businesses' competitiveness. There is some evidence to suggest that more recently implemented VAT systems in OECD countries have higher levels of compliance. This is because a single VAT rate is used with a broader VAT base with few exemptions. More research is needed to explore this further.

- Technology is playing an increasingly important role in the creation of efficient indirect tax systems and in improving their effectiveness by reducing the cost and administrative burden for both taxpayers and tax authorities. Examples of this will be seen next year in India where they will introduce a new goods and services tax and in Spain which will increase the use of 'real time' VAT reporting.

- Post-filing interactions with tax authorities for VAT can complicate the compliance process and increase costs for business. The new *Paying Taxes 2017* post-filing index enables a comparison of these processes around the world.

[57] We have used VAT (value-added tax) to cover similar consumption tax systems such as goods and services tax (GST). The US system of sales and use taxes is not a VAT (as not collected on the value added at each stage and is essentially collected at a single stage (retail)) however it remains a tax on consumption and not income.
[58] OECD (2015), "*Revenue Statistics: Comparative tables*", OECD Tax Statistics (database).
[59] OECD (2014), *Consumption Tax Trends 2014 – Fig 1.3.*

The EU member states, as well as a number of countries in Africa, America and Asia-Pacific currently have VAT systems. The Gulf Cooperation Council (GCC) countries in the Middle East are also looking to implement VAT over the next few years, and India is still on track to implement a new GST system to replace its current multiple VAT and sales tax systems early in 2017.

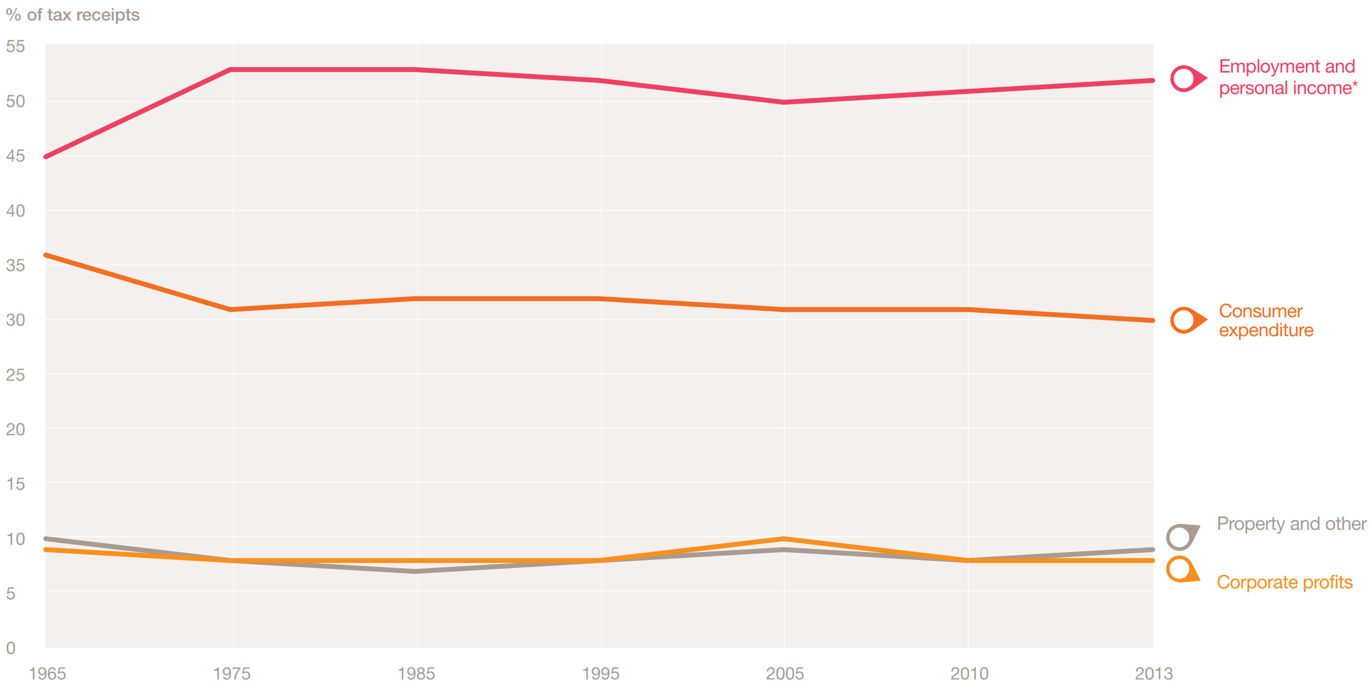
Consumption taxes, primarily in the form of value-added tax, goods and services tax (GST) as well as sales and use tax (SUT), have grown to be a major source of tax revenues for governments across the globe as they begin to appreciate that taxing consumption provides a more certain tax revenue stream than taxing income or profit. Governments worldwide are looking to raise more of their taxes from indirect taxes, which from a business perspective should be more neutral than direct taxes. See Figure 58 which shows that almost 30% of tax revenues are raised from indirect taxes (VAT raising around 20% and other indirect taxes such as excise duties making up the balance) versus tax revenues from corporate profits at around 10%.[60]

VAT is now the most common form of consumption tax used around the world with a growing number of countries moving from a sales tax to a VAT system. With 162 economies in the *Paying Taxes 2017* study employing VAT today,[61] it is attracting an increased focus from governments as it is viewed as an efficient and effective method of providing tax revenues that governments need without stifling business growth. Whereas high rates of corporate income tax (or a very extensive tax base) can discourage investment and provide an incentive to shift income to lower tax jurisdictions, VAT is generally neutral in terms of business location decisions (except where VAT recoveries take too long or are impossible to achieve).

162
economies
in the Paying Taxes 2017 study employing VAT today.

Figure 58

Tax Structures in OECD economies – % of tax receipts categories by revenue source



Source: OECD Revenue Statistics, 2015 * personal income tax and social security contributions

[60] OECD (2015), "Revenue Statistics: Comparative tables", OECD Tax Statistics (database).
[61] The OECD records 164 economies with VAT systems in its 2014 edition of Consumption tax trends. This includes economies that are not in the *Paying Taxes 2017* study.

What are the differences between the types of consumption taxes, VAT, GST and SUT?

VAT and GST are designed to be a tax on final consumption. They are collected throughout the supply chain through a staged collection process. VAT and GST are levied on the supply of goods and services, as well as on the importation of goods and services. As a general principle, VAT and GST are imposed at every stage of the economic process and allow deduction of taxes on purchases by all but the final consumer, subject to some exceptions. The net effect of this is to spread the collection of the tax as buyers, suppliers, and consumers contribute only the incremental value they have provided in the supply chain under a credit or debit system where VAT/GST incurred on purchases is offset against the VAT/GST due on sales.

The EU member states, as well as a number of countries in Africa, America and Asia-Pacific currently have VAT systems. The Gulf Cooperation Council (GCC) countries in the Middle East are also looking to implement VAT over the next few years, and India is still on track to implement a new GST system to replace its current multiple VAT and sales tax systems early in 2017.

In comparison to mature VAT systems, such as in the EU, where newer VAT systems have been introduced, for example in Australia, New Zealand and Singapore, these countries apply VAT at a single rate of tax to a broad base of consumer spending, with few exemptions, and as a result are characterised by having a higher degree of compliance (and by implication a reduced cost of compliance for the taxpayer, i.e., the business) and sustained revenue raising.[62] The EU VAT model has been part of the tax landscape in Europe since the first VAT Directive was adopted on 11 April 1967, and is characterised by having a far narrower tax base (due to the high use of exemptions and zero-ratings) which renders the EU VAT system more complex for business and tax administrations and increases the costs of compliance for both. It should be noted however that the *Paying Taxes 2017* study's simple fact pattern is not able to provide support for this position; further work will be undertaken to investigate this.

Whilst a VAT system requires all parties in the supply chain to collect and remit (a part of) the tax, this indirect tax system is often viewed as less open to fraud than retail sales taxes such as SUTs, for example, as in the US, which are collected in their entirety at the point of sale on the last sale in the supply chain (i.e., the retailer to consumer). In this regard, although both VAT and SUT are designed to tax the final consumption of a wide range of products, in practice, SUT places reliance on either the final supplier or end consumer remitting the entirety of the tax. To reduce the 'cascade' effect of such taxes, an exemption certification is often required through the supply chain. As a result of the non-compliance risks associated with the sales tax system, this can result in the tax revenue being at risk if either party is unaware of or does not fulfil its reporting obligations particularly in the case of the final transaction with the end consumer. The US is currently the only OECD country which employs SUTs as its principal tax on consumption.

[62] The Anatomy of the VAT – Michael Keen IMF paper 13/111.

The spread of VAT/GST systems globally

The number of VAT systems in the *Paying Taxes 2017* study has continued to increase, rising from 153 economies in 2010 to 162 economies in 2015.[63] Some of these are a new tax and some a replacement for other narrower forms of consumption tax. Some examples of how VAT systems are developing include China's accelerated transition from business tax to a VAT system from 2012 which was substantially completed in 2016, the introduction of VAT in Malaysia on 1 April 2015 (which replaced its Sales and Services Tax system), and Egypt's transition to a full VAT system in September 2016. VAT in the OECD countries now accounts for around 20% of total tax revenues, a 70% greater share than in the mid-eighties.

With the new GST expected to be implemented in India in April 2017 and the introduction of VAT in the GCC countries expected to occur in 2018, the number of countries with a VAT based system will continue to rise in the coming years. This will present a number of challenges as businesses operating in these markets adapt to a new tax system and consider the need to introduce automated tools to help them comply.

This need for "bedding-in a new VAT system" is evidenced in the *Paying Taxes 2017* study by the introduction of VAT in The Bahamas in January 2015, where the time to comply for the case study company in dealing with consumption taxes increased the most by 157 hours as businesses adjusted to a new tax regime and the inherent additional processes. Similarly, Malaysian businesses' time to comply for consumption taxes also increased by 58 hours and demonstrates the many challenges businesses can initially face when tax authorities change existing tax regimes.

There is also a rising number of countries with existing VAT based systems which have raised their standard rate at least once since 2010 (in the period 2008-2010, 13 countries out of the then 27 member states in the EU increased their rates)[64] due to financial consolidation pressures caused by the global financial crisis. This resulted in businesses being required to adapt their IT systems and prices in advance of these changes creating additional compliance burdens.

The VAT compliance burden

It is inherent in the way VAT is collected that businesses are unpaid tax collectors, as all parties in the supply chain are responsible for the extra VAT accounting required. This burden includes the cost of raising VAT invoices (in a VAT system) for each supply made, the cost of preparation and submission of VAT returns, and the frequent payment of the VAT due.

Variations in the time to comply (and the complexity of the compliance process) can even arise within a region where countries share the same underlying framework and compliance requirements. For example, in EU member states, where there is a common legal framework for the VAT system,[65] the time needed annually to comply with the VAT obligations varies in the *Paying Taxes 2017* study. The range is from 30 hours in Ireland to complete, submit and file a VAT return to 96 hours in Hungary. This may in part be explained by the difference in the level of information reported on the VAT return, where there is only a requirement to report VAT on sales and purchases and trade with other EU member states on the Irish VAT return, compared to up to 99 boxes to complete on the Hungarian VAT return. The amount of information and data on a VAT return may not just reflect the complexity of the system itself but in addition the use to which tax administrations put the data collected, e.g. desk based reviews and risk analyses.

24hrs

It is interesting that the global average time to comply with consumption taxes in the Paying Taxes study has fallen from 123 hours in 2004 to 99 hours in 2015, for the case study company.

[63] *Paying Taxes 2017.*
[64] The Anatomy of the VAT – Michael Keen IMF paper 13/111.
[65] Directive 2006/112/EC

Whilst the complexity of the legislative regime has to be absorbed by businesses and the actual time taken to comply will vary with the size of the organisation, it should be welcomed that an increasing number of tax authorities are implementing ways to reduce the compliance and administration costs falling on business.

It is interesting that the global average time to comply with consumption taxes in the *Paying Taxes 2017* study has fallen from 123 hours in 2004 to 99 in 2015 while the number of payments sub-indicator for 'other' taxes (which includes consumption taxes) has fallen from 16.1 to 12.5. These falls reflect the introduction and increased use of electronic filing and payment systems and also changes to the frequency of filing returns and the supporting information required.

In the most recent year of the study, 2015, the most significant reductions in the time to comply in relation to consumption taxes were seen in Brazil, Vietnam, Senegal, Algeria and Albania, while in Tajikistan the payments sub-indicator fell significantly by 5. All of these countries made changes to their tax systems to assist in making it easier to comply with their consumption tax obligations:

- Brazil has benefitted from the introduction of electronic systems which are being used more widely for preparing, filing, and paying VAT. Albania has also introduced an on-line platform for the submission of VAT returns.
- Improvements to supporting accounting software have been seen in Senegal and Algeria. Albania has also enabled accounting software to be integrated with the online platform mentioned above.
- In Tajikistan taxpayers now have the ability to maintain and file VAT invoices electronically.
- In Vietnam it is now possible to file VAT returns on a quarterly basis.[66]

There is also a rising number of countries with existing VAT based systems which have raised their standard rate at least once since 2010.

[66] Note however, the burden of compliance must be balanced with the neutrality of the VAT system when determining the frequency of filing and the increased fraud risk.

The Paying Taxes 2017 study has shown this year that governments around the world continue to implement reforms to improve how easy it is to comply with VAT systems.

Post-filing information

VAT is attracting more attention from tax authorities across the world due to its potential to be a simple and efficient means of tax collection and an important source of revenue for governments. SUT has its limits as it is not, unlike VAT, self-controlling and this explains in part why most SUT rates are far lower than VAT rates. Tax authorities are, in addition, increasing and improving their audit procedures in order to ensure that the correct amount of tax is paid at the right place and at the right time.

Whilst businesses have an element of control over the preparation and submission of VAT returns depending on the effectiveness of their tax function and the optimisation of the VAT technology used, the interactions which can potentially take place with a tax authority, for example, following a VAT refund claim can significantly complicate the compliance process and increase costs for businesses. In this regard, it is common in a number of jurisdictions that businesses seeking a refund of VAT can expect to be subject to an audit. With this in mind the fourth sub-indicator, the post-filing index, has been introduced to the *Paying Taxes 2017* study this year which in part looks at VAT and dealing with a VAT refund claim.

VAT refund mechanism

It is common for the majority of VAT registered businesses to be in a VAT payment position. There are however occasions where businesses may be in a VAT repayment position. This can arise for a variety of reasons ranging from businesses being involved in export transactions where zero-rating or exemption from charging VAT is available or when companies make one-off large capital investments resulting in input taxes on purchases exceeding the tax on sales for one or several periods.

The mechanism by which VAT is refunded is an essential part of the VAT system. It is interesting to note, however, from the analysis carried out in *Paying Taxes 2017* that of the 162 economies identified which had a VAT system in 2015, only 93 gave the facility for a VAT refund under the case study company scenario where VAT is payable on the purchase of capital equipment.

In 22 of the 162 economies which have VAT, taxpayers are required to carry forward the excess input tax for at least two months before a cash refund can be requested. In these 22 economies the average period of time needed before a request can be made for a cash refund is nearly five months, ranging from two months in Bulgaria, Seychelles and Tonga to twelve months in Vietnam.

In general, the ability to receive a VAT refund is challenging or, non-existent in certain countries in Africa, Asia Pacific, South America, Central America and the Caribbean. This primarily arises either because:

- the ability to claim a refund is restricted to specific categories of taxpayers such as international businesses involved in export transactions; or
- there is no mechanism to refund the VAT.

7.9 hrs
is the average time it takes the case study company to comply with a VAT refund in high income economies compared with
26.9 hrs
in low income economies.

Where a business is unable to obtain a VAT refund, there is a clear cost to the business. Our practical experience of this is that the cost can be so significant as to make transactions uncommercial and thus, business will often move, stop or change the transaction they carry out in a country where VAT recovery is potentially a problem or impossible.

On average, the *Paying Taxes 2017* study finds that the EU performs the best on the post-filing index which includes 7.4 hours as the average time needed to comply with VAT refund requirements and 14.7 weeks to receive the refund.[67] This can be attributed to the existing legal framework in place and the work undertaken by the EU Commission to both simplify the VAT system and ensure refunds are processed in a timely manner – even to taking legal action. Also of note is that the EU is one of the few regions which allows non-resident businesses (both other EU Member States and non-EU territories) to recover VAT incurred there (in certain circumstances).

Notwithstanding that 46% of the economies in the EU do not systematically undertake an audit as part of the VAT refund request procedure, the time to comply and the time to obtain the VAT refund are lower than the global average. This can be contrasted with the position in the Central America & the Caribbean region where, on average, it takes the longest time to obtain a VAT refund with businesses having to spend 19.6 hours on compliance and waiting 34.7 weeks to receive the refund.

Austria is shown to have the most efficient VAT refund system: the likelihood of receiving a VAT audit is low for our case study company in Austria and the time frame in which a VAT refund can expect to be received is also the shortest across all countries (approximately 3.2 weeks). This may, in part, be attributable to the Austrian Ministry of Finance being one of the first tax authorities to use a standard audit file format (Standard Audit File for Tax (SAF-T)) for the electronic exchange of reliable accounting data from organisations to a national tax authority.

When comparing the VAT refund process across the levels of economic development around the world, on average it takes less time to comply with a VAT refund in high income economies where it takes 7.9 hours for the case study company compared with 26.9 hours in low income economies. Furthermore, it takes 15.6 weeks to receive the refund in high income economies compared with 28.3 weeks in low income economies.

Some conclusions, and what next

Indirect taxation is increasingly being seen by governments as a cost effective way to raise taxation and has (as compared to corporate taxation) less of an impact on business performance and the relative attractiveness of a location.

The *Paying Taxes 2017* study has shown this year that governments around the world continue to implement reforms to improve how easy it is to comply with VAT systems, but there continues to be a wide variety of complexity in VAT systems even between neighbours. There is also a general correlation between the efficiency and speed of the repayment of refund claims and a country's general level of economic development.

There appears to be a correlation between a broad based single rate system and the level of compliance by business, with newer systems often inherently less complex thereby being easier to comply with. However further research is required to provide evidence of this as it is currently beyond the scope of the *Paying Taxes 2017* study scenario due to its simple fact pattern.

Overall the aim should be to have simple systems which make the best use of information technology to minimise compliance times and the data elements required to find the right balance between reducing the burden of data provision requirements and the opportunity for fraud. There are many questions to consider as VAT systems evolve and governments seek to find the right balance – is all data collected by authorities actually effective in the fight against fraud? Is some data more important than others? Does a high quantity and frequency of data collection increase or reduce fraud in a country? What kind of automation and technology introduced by tax authorities will help reduce the time to comply and can it help in reducing fraud? Over the coming months we will be conducting further research to address these questions.

[67] Please note that these averages are for the EU only. *Paying Taxes 2017* refers to EU & EFTA which includes Iceland, Norway, Switzerland and San Marino.

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