

The Paying Taxes methodology

Paying Taxes records the taxes and mandatory contributions that a medium-size company must pay in a given year as well as measuring the administrative burden of paying taxes and contributions. The project was developed and implemented as part of the *Doing Business* project by the World Bank and IFC in cooperation with PwC. Taxes and contributions measured include profit or corporate income tax, social contributions and labour taxes paid by the employer, property taxes, property transfer taxes, dividend tax, capital gains tax, financial transactions tax, waste collection taxes, vehicle and road taxes, and any other small taxes or fees.

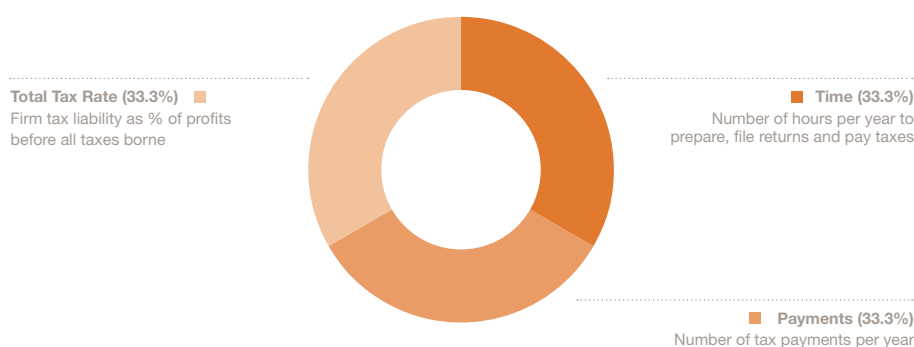
As for previous years, the overall paying taxes ranking included in this report continues to use a simple average of the percentile rankings for each of the sub-indicators. These rankings are set out in Appendix 4.

This year the rankings in this report differ from those used by the World Bank Group in the *Doing Business 2012* report where a change in the ranking methodology is being piloted to address various issues that have been raised through discussions with stakeholders. The *Doing Business* project has applied a threshold to the ranking for the Total Tax Rate to seek to mitigate the effects of low Total Tax Rates.

Paying Taxes measures all taxes and contributions that are government mandated (at any level—federal, state or local) and which apply to the standardised business and have an impact in its financial statements. In doing so, Paying Taxes goes beyond the traditional definition of a tax. As defined for the purposes of government national accounts, taxes include only compulsory, unrequited payments to general government. Paying Taxes departs from this definition because it measures imposed charges that affect business accounts, not government accounts. The main difference relates to labour contributions. The Paying Taxes measure in *Doing Business* includes government-mandated contributions paid by the employer to a required private pension fund or workers' insurance fund. The indicator includes, for example, Australia's compulsory superannuation guarantee and workers' compensation insurance. It should be noted that for the purpose of calculating the Total Tax Rate (defined below), only taxes borne are included. For example, value added taxes are generally excluded (provided they are not irrecoverable) because they do not affect the accounting profits of the business—that is, they are not reflected in the income statement. They are, however, included for the purpose of the compliance measures (time and payments), as they add to the burden of complying with the tax system.

Figure A1.1: Paying taxes: tax compliance for a local manufacturing company

Rankings are based on three-sub indicators



The Paying Taxes study uses the *Doing Business* case scenario to measure the taxes and contributions paid by a standardised business and the complexity of an economy's tax compliance system. This case scenario uses a set of financial statements and assumptions about transactions made over the course of the year. Tax experts from a number of different firms in each economy (including PwC) compute the taxes and mandatory contributions due in their jurisdiction based on the standardised case study facts. Information is also compiled on the frequency of filing and payments as well as time taken to comply with tax laws in an economy.

The timeline summarises the annual process for collecting the Paying Taxes data.

The methodology for the Paying Taxes indicators has benefited from discussion with members of the International Tax Dialogue and other stakeholders, which has led to a refinement of the survey questions on the number of hours required to pay taxes and the collection of additional data on the labour tax wedge for further research.

To make the data comparable across the economies included in the study, a number of assumptions about the business and the taxes and contributions made by the business are used.

Assumptions about the business

The business:

- is a limited liability, taxable company. If there is more than one type of limited liability company in the economy, the limited liability form most common among domestic firms is chosen. The most common form is reported by incorporation lawyers or the statistical office.
- started operations on 1 January 2009. At that time the company purchased all the assets shown in its balance sheet and hired all its workers.
- operates in the economy's largest business city.
- is 100% domestically owned and has five owners, all of whom are natural persons.
- at the end of 2009, has a start-up capital of 102 times income per capita.

- performs general industrial or commercial activities. Specifically, it produces ceramic flowerpots and sells them at retail. It does not participate in foreign trade (no import or export) and does not handle products subject to a special tax regime, for example, liquor or tobacco.
- at the beginning of 2010, owns two plots of land, one building, machinery, office equipment, computers and one truck. It also leases one truck.
- does not qualify for investment incentives or any benefits apart from those related to the age or size of the company.
- has 60 employees—four managers, eight assistants and 48 workers. All are nationals, and one manager is also an owner. The company pays for additional medical insurance for employees (not mandated by any law) as an additional benefit.

Figure A1.2: Timeline summarising the annual process for collecting the Paying Taxes data



In addition, in some economies reimbursable business travel and client entertainment expenses are considered fringe benefits. When applicable, it is assumed that the company pays the fringe benefit tax on this expense or that the benefit becomes taxable income for the employee. The case study assumes no additional salary additions for meals, transportation, education or others. Therefore, even when such benefits are frequent, they are not added to or removed from the taxable gross salaries to arrive at the labour tax or contribution calculation.

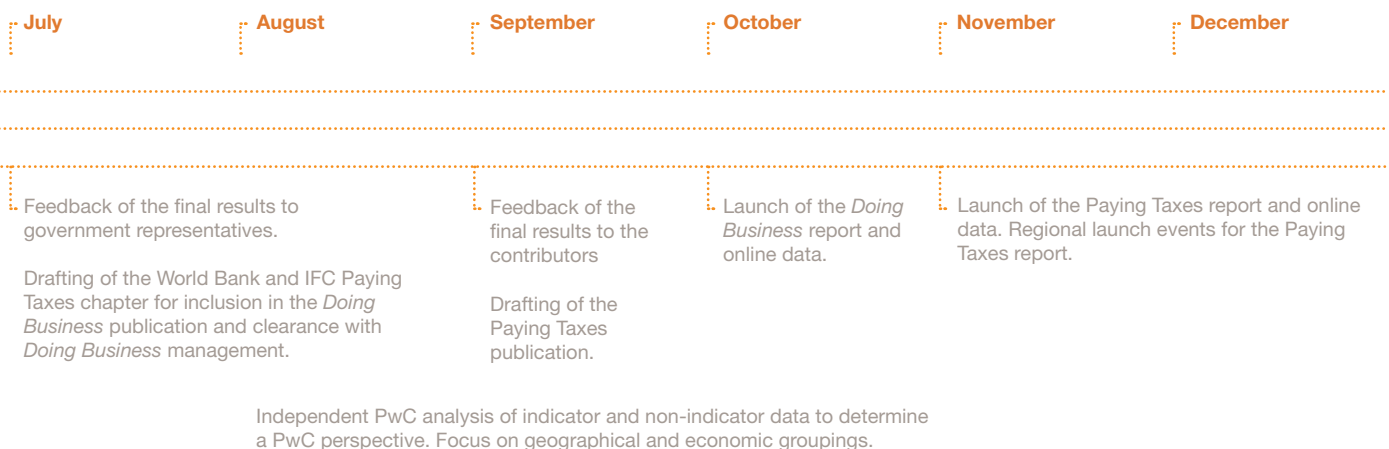
- has a turnover of 1,050 times income per capita.
- makes a loss in the first year of operation.
- has a gross margin (pre-tax) of 20% (i.e. sales are 120% of the cost of goods sold).
- distributes 50% of its net profits as dividends to the owners at the end of the second year.
- sells one of its plots of land at a profit at the beginning of the second year.
- has annual fuel costs for its trucks equal to twice income per capita.

- is subject to a series of detailed assumptions on expenses and transactions to further standardise the case. All financial statement variables are proportional to 2005 income per capita. For example, the owner who is also a manager spends 10% of income per capita on travelling for the company (20% of this owner's expenses are purely private, 20% are for entertaining customers and 60% for business travel).

- The number of times the company pays taxes and contributions in a year is the number of different taxes or contributions multiplied by the frequency of payment (or withholding) for each tax. The frequency of payment includes advance payments (or withholding) as well as regular payments (or withholding).

Assumptions about the taxes and contributions

- All the taxes and contributions recorded are those paid in the second year of operation (calendar year 2010). A tax or contribution is considered distinct if it has a different name or is collected by a different agency. Taxes and contributions with the same name and agency, but charged at different rates depending on the business, are counted as the same tax or contribution.



What does Paying Taxes measure?

Tax payments

The tax payments indicator reflects the total number of taxes and contributions paid, the method of payment, the frequency of payment, the frequency of filing and the number of agencies involved for this standardised case study company during the second year of operation (table A.1.1). It includes consumption taxes paid by the company, such as sales tax or value added tax. These taxes are traditionally collected from the consumer on behalf of the tax agencies. Although they do not affect the income statements of the company, they add to the administrative burden of complying with the tax system and so are included in the tax payments indicator.

The number of payments takes into account electronic filing. Where full electronic filing and payment is allowed and it is used by the majority of medium-size businesses, the tax is counted as paid once a year even if filings and payments are more frequent. For payments made through third parties, such as tax on interest paid by a financial institution or fuel tax paid by a fuel distributor, only one payment is included even if payments are more frequent.

Where two or more taxes or contributions are filed for and paid jointly using the same form, each of these joint payments is counted once. For example, if mandatory health insurance contributions and mandatory pension contributions are filed for and paid together, only one of these contributions would be included in the number of payments.

Time

Time is recorded in hours per year. The indicator measures the time taken to prepare, file and pay three major types of taxes and contributions: the corporate income tax, value added or sales tax, and labour taxes, including payroll taxes and social contributions. Preparation time includes the time to collect all information necessary to compute the tax payable and to calculate the amount payable. If separate accounting books must be kept for tax purposes – or separate calculations made – the time associated with these processes is included. This extra time is included only if the regular accounting work is not enough to fulfil the tax accounting requirements. Filing time includes the time to complete all necessary tax return forms and file the relevant returns at the tax authority. Payment time considers the hours needed to make the payment online or at the tax authorities. Where taxes and contributions are paid in person, the time includes delays while waiting.

Table A1.1: What do the paying taxes indicators measure?

Tax payments for a manufacturing company in 2010 (number per year adjusted for electronic and joint filing and payment)

Total number of taxes and contributions paid, including consumption taxes (value added tax, sales tax or goods and service tax)

Method and frequency of filing and payment

Time required to comply with 3 major taxes (hours per year)

Collecting information and computing the tax payable

Completing tax return forms, filing with proper agencies

Arranging payment or withholding

Preparing separate mandatory tax accounting books, if required

Total Tax Rate (% of profit before all taxes)

Profit or corporate income tax

Social contributions and labour taxes paid by the employer

Property and property transfer taxes

Dividend, capital gains and financial transactions taxes

Waste collection, vehicle, road and other taxes

Total Tax Rate

The Total Tax Rate measures the amount of taxes and mandatory contributions borne by the business in the second year of operation, expressed as a share of commercial profit. Paying Taxes 2012 reports the Total Tax Rate for calendar year 2010. The total amount of taxes borne is the sum of all the different taxes and contributions payable after accounting for allowable deductions and exemptions. The taxes withheld (such as personal income tax) or collected by the company and remitted to the tax authorities (such as Value Added Tax, sales tax or goods and service tax) but not borne by the company are excluded. The taxes included can be divided into five categories: profit or corporate income tax, social contributions and labour taxes paid by the employer (in respect of which all mandatory contributions are included, even if paid to a private entity such as a required pension fund), property taxes, turnover taxes and other taxes (such as municipal fees and vehicle and fuel taxes).

The Total Tax Rate is designed to provide a comprehensive measure of the cost of all the taxes a business bears. It differs from the statutory tax rate, which merely provides the factor to be applied to the tax base. In computing the Total Tax Rate, the actual tax payable is divided by commercial profit. Data for Norway is shown in figure A1.2 to illustrate the calculation.

Commercial profit is essentially net profit before all taxes borne. It differs from the conventional profit before tax, reported in financial statements. In computing profit before tax, many of the taxes borne by a firm are deductible. In computing commercial profit, these taxes are not deductible. Commercial profit therefore presents a clear picture of the actual profit of a business before any of the taxes it bears in the course of the fiscal year.

Commercial profit is computed as sales minus cost of goods sold, minus gross salaries, minus administrative expenses, minus other expenses, minus provisions, plus capital gains (from the property sale) minus interest expense, plus interest income and minus commercial depreciation. To compute the commercial depreciation, a straight-line depreciation method is applied, with the following rates: 0% for the land, 5% for the building, 10% for the machinery, 33% for the computers, 20% for the office equipment, 20% for the truck and 10% for business development expenses. Commercial profit amounts to 59.4 times income per capita.

The methodology for calculating the Total Tax Rate is broadly consistent with the Total Tax Contribution framework developed by PwC and the calculation within this framework for taxes borne. But while the work undertaken by PwC is usually based on data received from the largest companies in the economy, *Doing Business* focuses on a case study for a standardised medium-size company.

Table A1.2: Computing the Total Tax Rate for Norway

Type of tax (tax base)	Statutory rate r	Statutory tax base b Nkr	Actual tax payable $a = r \times b$ Nkr	Commercial profit* c Nkr	Total Tax Rate $t = a/c$
Corporate income tax (taxable income)	28.0%	20,612,719	5,771,561	23,651,183	24.4%
Social security contributions (taxable wages)	14.1%	26,684,645	3,762,535	23,651,183	15.9%
Fuel tax (fuel price)	NKr 4 per litre	74,247 litres	297,707	23,651,183	1.3%
Total			9,831,803		41.6%