

# *Tax Component of the Investment Reform Index*

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# Discussion points

- Objectives of the tax component of the *Investment Reform Index* (IRI).
- Tax topics addressed under the IRI.
- Assessment approach under the IRI.
- Benefits of working with the OECD.
- Structure of ‘tax indicators’.
- Some examples.

# Objectives of tax component of IRI

- Main objective of the tax component of the IRI --assist countries in tax policy and tax administration reforms to encourage investment, employment, and economic development.
- Peer assessment of ‘indicators’ on policy performance (focus on tax policy development, and tax policy).
- Disseminate ‘tax knowledge’, including comparative analysis of alternative tax systems/designs, tax models, experience of policy makers with different approaches.
- Provide technical assistance on a range of tax topics.

# Tax topics addressed under IRI

- Five tax-related topics addressed under the IRI:
  1. Fiscal position and budget planning.
  2. Taxation and investment.
  3. Taxation and employment.
  4. Taxation of small & medium-size enterprises (SMEs).
  5. Taxation of multinational enterprises (MNEs).

# Assessment approach

- Two-step assessment approach:
  - 1) Assessment of *tax policy development*.
  - 2) Assessment of *tax policy and options for reform*.
- Assessment of ‘tax policy development’:
  - For a given topic, are key (central) questions being addressed and analyzed?
  - Are ‘standard’ frameworks used to assess policy? (including revenue, efficiency, equity implications)
  - Does analysis use taxpayer-level (micro) data?

# Benefits of working with OECD

- OECD discussions on taxation:
  - Senior tax officials of 30 member countries meet regularly to discuss common challenges, alternative approaches.
  - Broad participation in OECD *Global Forum on Taxation*, ‘outreach’ programme, range of tax seminars/workshops.
- Benefits of dialoguing with OECD on taxation:
  - Access to reports on discussions of policy makers of key challenges, policy considerations, experiences.
  - Access to technical assistance, including ‘tax models’ to analyze revenue and distributional effects of tax policy.
  - Neutral player encouraging regional dialogue on taxation.

# Structure of tax indicators

## *Review of sub-topics*

- **Fiscal position and planning:**
  - Forecasting of aggregate tax revenue for each main tax.
  - Consideration of fiscal balance.
- **Taxation and investment:**
  - Sectoral analysis of tax burden on corporations.
  - Analysis of tax impediments to domestic investment.
  - Comparative analysis of tax depreciation systems.
  - Transparency (tax expenditure reporting) and cost benefit assessment of corporate tax incentives for investment.
- **Taxation and employment:**
  - Micro analysis of taxation of wage income, income equality.
  - ‘Tax wedge’ analysis of tax impediments to employment.

# Structure of tax indicators

## *Review of sub-topics (continued)*

- **Taxation of small and medium-size enterprises (SMEs):**
  - Analysis of tax burden on firms by asset size.
  - Analysis of tax impediments/distortions) to SME investment.
  - Analysis of tax impediments to equity financing of SMEs.
  - Analysis of tax arbitrage by SME owners.
  - Analysis of treatment of risky investment in SMEs.
  - Assessment of tax compliance costs, alternative tax policy approaches, alternative tax administrative approaches.
  - Assessment of taxpayer assistance and education services to reduce SME tax compliance burden.

# Structure of tax indicators

## *Review of sub-topics (continued)*

- **Taxation of multinational enterprises (MNEs):**
  - Analysis of tax burden on MNEs (cross-border investment).
  - Analysis of tax distortions to cross-border investment (FDI).
  - Analysis and treatment of thin capitalization of corporate tax base.

# IRI Assessment of *'Fiscal Position and Budget Planning'*

- IRI assesses a country's ability and practice in identifying / prioritizing public expenditures, forecasting tax and non-tax revenues, fiscal balance, feedback on choice over tax mix, appropriate tax burden on investment and employment.
- Assessment of models and data :
  - GDP-based tax revenue estimation models (each main tax).
  - Historical tax revenue data, non-tax revenue data, National Accounts income, expenditure, balance of payments data.
- Assessment of analysis :
  - Are GDP-based tax revenue forecasting models in place and regularly used to forecast revenues for each main tax?

# IRI Indicators for Forecasting aggregate tax revenues

1. The Ministry of Finance does not maintain aggregate tax revenue forecasting models to enable forecasting of tax revenues, to inform tax and expenditure policy making. No current plans for implementation.
2. The Ministry of Finance does not maintain aggregate tax revenue forecasting models to enable forecasting of tax revenues, but is currently taking steps towards implementation within one year.
3. The Ministry of Finance has implemented a GDP-based tax revenue forecasting model for one or more taxes, but not for all main taxes (contributing 5 per cent or more to total tax revenues).
4. A GDP-based tax revenue forecasting model is maintained by the Ministry of Finance for each main tax.
5. Level 4 plus the requirement that forecasts of total tax revenue, for each main tax, differ from actual total tax revenue by less than 10 per cent.

# IRI Assessment of *'Taxation and Investment'*

- Assessment of models and data :
  - Corporate income tax (CIT) micro-simulation model, METR model, depreciation calculator model.
  - Corporate tax return data (stratified sample), survey data. Corporate and shareholder-level tax parameter data.
- Assessment of analysis :
  - Sectoral analysis of tax burden – estimation of CIT payments at firm level; total CIT payments in current year, forecast years; average tax rates (ATRs) by firm asset size, industry and location; tax revenues foregone by incentives.
  - Analysis of tax impediments to domestic investment – measurement of METRs on domestic corporate profits.

# IRI Indicators for Sectoral analysis of taxation of corporate profit

1. The Ministry of Finance does not maintain a **CIT micro-simulation model** enabling sectoral analysis of corporate tax revenues and the effective tax rate on corporate profits. No current plans for implementation.
2. The Ministry of Finance does not maintain a CIT micro-simulation model, but is currently taking steps towards implementation within one year.
3. The Ministry of Finance maintains a CIT micro-simulation model. The model is routinely used to analyze tax revenue implications of tax reform.
4. Level 3 plus the requirements that a) underlying corporate tax return data are checked to identify entry/transcription errors; b) CIT model is updated each year (involving transcription of new tax return data each year).
5. Level 4 plus the requirement that a) estimates of total corporate tax revenue for sample year differ from actual corporate tax revenues by less than 2%; b) forecasted corporate revenues from micro-simulation model are cross-checked with forecasts from GDP-based corporate tax revenue model.

# IRI Indicators for Analysis of tax impediments to investment

1. The Ministry of Finance does not maintain a **marginal effective tax rate (METR) model** to enable analysis of tax impediments (distortions) to investment. No current plans for implementation.
2. The Ministry of Finance does not maintain a METR model, but is currently taking steps towards implementation within one year.
3. The Ministry of Finance maintains a METR model, used to analyze tax distortions to investment and implications of tax reform proposals.
4. Level 3 plus the requirement that the METR model is based on actual capital stock weights (i.e. those that reflect the national economy, based on National Accounts data), and is disaggregated across machinery and equipment, buildings, inventory and land.
5. Level 4 plus the requirement METR results are explained in summary reports in a non-technical way (for the non-tax expert) and are represented in graphical form to illustrate to policy makers the various factors explaining results.

# IRI Indicators for Analysis of tax depreciation systems

1. The Ministry of Finance does not undertake comparisons of depreciation systems in neighbouring countries/countries regarded as main competitors for investment. No current planning for undertaking such comparisons.
2. The Ministry of Finance does not undertake comparisons of depreciation systems, but is gathering information to enable comparisons within 1 year.
3. The Ministry of Finance regularly (e.g. annually) undertakes cross-country comparisons of capital depreciation systems, taking into account the number of depreciable capital asset classes, depreciation methods and rates.
4. Level 3 plus the requirement that comparisons take into account whether depreciation claims are mandatory or discretionary, interaction of claims with loss carry-forward rules, and the operation of recapture provisions.
5. Level 4 plus the requirement that a **depreciation calculator model** in place and used to measure, and compare across countries, the present-discounted value (PDV) of maximum tax depreciation allowances by depreciable capital asset type and industry.

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*Thank you*