

INTERNATIONAL FINANCE CORPORATION

**BUSINESS TAXATION PRODUCT
EVALUATION**

FINAL REPORT
Executive Summary

September 18, 2014

MAIN ABBREVIATIONS AND ACRONYMS

ABI	Administrative Barriers to Investment
ADB	Asian Development Bank
AFR	Africa Region
BEE	Business Enabling Environment
BL	Business Lines
BT	Business Taxation
CCS	Compliance Cost Saving
CIC	Investment Climate Department
DB	Doing Business
DFID	Department for International Development
DPO	Development Policy Operations
EAC	East African Community
EAP	East Asia & Pacific Region
ECA	Europe & Central Asia Region
ETC	Extended Term Consultants
ETR	Effective Tax Rate
FCAS	Fragile and Conflict-Affected States
FDI	Foreign Direct Investment
FIAS	Foreign Investment Advisory Service
GST	General Sales Tax
GTT	Global Tax Team
IBRA	Indicator-based Reform Advisory
IMF	International Monetary Fund
IPP	Investment Policy and Promotion
ITD	International Tax Dialogue
KM	Knowledge Management
LIC	Low Income Countries
LMIC	Lower Middle-Income Countries
MENA	Mediterranean & North Africa Region
MSME	Micro, Small and Medium Enterprises
PDS	Project Data Sheet
RBA	Risk-based Audit
STC	Short Term Consultants
TAAS	Technical Assistance and Advisory Services
TCC	Tax Compliance Certificates
TCCS	Tax Compliance Cost Surveys
TIN	Taxpayer Identification Number
TL	Trade Logistics
TMEA	TradeMark East Africa
UNDP	United Nations Development Program
VAT	Value Added Tax
WBG	World Bank Group

EXECUTIVE SUMMARY

This evaluation reviews *IFC advisory activities in the field of Business Taxation* (BT). IFC's work on BT can be divided into three components: core tax, transfer pricing, and tax transparency. The evaluation *focuses on the 'core tax' component*, which encompasses analytical work and advisory services aimed at fostering enterprise creation and inclusive growth through the improvement of tax policy and administration on a variety of themes (e.g. simplification of income tax policy and administration, tax legal and appeals reform, risk-based audit systems, etc.). The other two components are excluded from the exercise due to their recent introduction and, therefore, limited amount of evidence available for analysis.

Business Taxation Program

Recent Evolution. Preceded by a series of preparatory studies on the effects of taxation on business activities, the *BT Program was launched in July 2007*. The first three fully dedicated BT projects were approved in Fiscal Year (FY) 08-09. At the same time, BT components were included in other Investment Climate (IC) projects. Operations developed rapidly in subsequent years, with two more waves of dedicated BT projects approved in FY10-11 and FY13-14, plus a number of other smaller BT operations included in multi-component projects. Expenditure on BT activities grew from US\$ 4.3 million in FY11 to some US\$ 8.3 million in FY13, with BT becoming the *second largest 'product' within the Investment Climate Department* (CIC) after Business Regulation. The growth in operational work was accompanied by an increase in the size of the Global Tax Team (GTT), currently consisting of about a dozen staff, and by the development of a number of analytical and operational tools that have been used extensively by BT projects.

Strategic Approach. As spelled out in the FIAS Strategy for FY12-16, the *mission of the BT Program* is to support reforms that “*expand the tax base, are revenue neutral or positive, improve the transparency and efficiency of tax administration, and reduce the overall burden of the tax system on the private sector*”. These objectives are to be achieved through the streamlining of business-related tax instruments, the reduction in the cost of complying with tax policies and procedures, the elimination of discretion and legal ambiguity, and the removal of barriers to the formalization of small businesses. The BT Program's specific *private sector focus* has allowed the IFC to carve a niche in the broad taxation reform field, complementing the work done by other international financial institutions (IFI) and donors.

Work Streams and Instruments. BT work is structured around six main work streams or ‘reform areas’, namely: (i) *general BT reform*, aimed at improving the overall legal and/or institutional framework for business taxation; (ii) *tax administration simplification*, seeking to reduce tax compliance costs for businesses; (iii) *small business tax reform*, involving the design of tax regimes to better suit the needs of micro, small, and medium-sized enterprises (MSME); (iv) *tax incentives reform*, intending to eliminate discretion in the granting of incentives as well as to reduce the cost for the treasury in terms of foregone revenue; (v) *tax audits reform*, aimed at improving the effectiveness of tax audits and inspections while at the same time ensuring that businesses are treated fairly; and (vi) *reform of tax appeals mechanisms*, seeking to ensure that taxpayers' justified grievances are effectively addressed while avoiding the risk of condoning tax fraud.

Activities and Tools. BT reform work requires the combination of different activities and the deployment of various tools, including: (i) *analytical tools*, aimed at collecting information to orient operational work and consisting of various types of surveys, such as the Tax Compliance Cost Surveys (TCCS), investor motivations surveys and profitability surveys; (ii) *advisory services on policy and operational matters*, involving legal and institutional reviews, inventories of laws and regulations, the mapping of administrative processes, the design of risk-based assessment systems, and the development of IT solutions for the payment of taxes and filing of tax returns; and (iii) *reform implementation support*, including training and capacity building activities and the design and implementation of communication and taxpayer awareness campaigns.

Knowledge Management Activities. BT operational work is supported by *product development activities* financed under Knowledge Management (KM) projects. These initiatives include: (i) the design of specific BT interventions in various reform areas, with the development of various tools and approaches; (ii) the production of guidance materials to be used in operational BT work; (iii) the participation in tax reform forums and conferences; (iv) the organization of events for tax practitioners; and (v) the training of staff to build capabilities in BT reform. Other KM projects involve *analytical work on selected themes* (e.g. tax incentives reform) and/or on the *development of specific approaches to BT reform* (e.g. the development of e-payment and e-filing solutions).

Business Taxation Portfolio

Basic Features. The evaluation focuses on **39 projects**, including: (i) 28 client-facing operational projects; (ii) four initiatives involving diagnostic work ('preparatory' projects); and (iii) seven KM projects. These operations were approved between **FY06 and FY13**. Two thirds are completed, while the remaining are at different stages of implementation (with one project still at the concept note stage and others expected to continue until FY16). The total value of BT-related activities within these projects is about **US\$ 36.4 million**, of which 80% for operational initiatives and 20% for KM and preparatory projects.

Project Configuration. The *size of BT operations varies considerably*, ranging from a minimum of US\$ 40,000 to a maximum of US\$ 5.1 million, with an average of about US\$ 1 million. **Sixteen projects are fully dedicated BT operations**. In the other cases, BT activities are part of multi-product projects, accounting for between 10% and 50% of total budgets. In multi-component projects, the BT product is typically associated with Business Regulation and/or Indicator-Based Reform Advisory. The majority of BT projects have *some linkages with previous or parallel IC operations*; several projects are follow-ups of previous operations (although not always concerned with BT), while others are part of broad regional initiatives.

Clients. BT projects typically work with *revenue/tax authorities and/or with ministries of finance*, with some variations due to local specificities. With regard to the few projects working at both national and sub-national levels, counterparts also include *local authorities or government entities in charge of regional or local affairs*.

Geographies. *Africa and Europe & Central Asia (ECA)* are the main regions of operations, with 13 and 10 projects respectively. The first operations in Latin America & the Caribbean were approved only in FY13 and, due to their recent launch, are not covered by this evaluation. Overall, BT operations are mainly implemented in *low income and IDA countries*. Emphasis on poorer countries has increased overtime, paralleled by a growing focus on African countries. Most of the projects were implemented at the *national level*, with only two initiatives implemented at the sub-national level.

Delivery Model. BT initiatives were carried out by *both IFC staff and consultants*, with IFC staff playing a comparatively greater role in the case of fully dedicated BT projects. Consultants, both individuals and firms, are extensively employed for fact finding and diagnostic work, including the implementation of various surveys. About three quarters of operational BT projects were *managed locally*, and the majority could count on a permanent/semi-permanent in-country presence of BT specialists. Project teams are supported by *GTT staff located at headquarters* as well as by *Regional Product Leads* posted in all the regions.

Evaluation Findings

Strategic Relevance. Countries assisted by the BT Program present a wide range of conditions, from highly dysfunctional to sufficiently business friendly environments, with weaknesses in only selected areas. The diversity of country conditions is *well reflected in the orientation of BT operations*. While BT initiatives adopt a common reform approach, operational aspects and tools were customized to reflect country needs and specific objectives. For instance, in the area of tax audits, a simplified version of risk-based audit (RBA) systems was developed, which made it possible to introduce RBA also in countries with limited capabilities. In the early days,

some projects were overly ambitious, trying to address too many reform issues simultaneously, but project design has improved overtime and the ***majority of initiatives are now well focused***, targeting a limited number of reform areas. BT operations were well coordinated with those of other IFI/donors. More than two thirds of BT operational projects were ***joint IFC-World Bank (WB) operations*** and BT teams closely coordinated with WB projects in several cases for the provision of complementary actions. BT initiatives also ***cooperated extensively with the International Monetary Fund (IMF)***, often providing joint advice to governments and/or assisting governments in fulfilling conditionalities for IMF financing.

Effectiveness of Operational Projects – Outputs. BT operations ***perform well in terms of output delivery***, with several projects exceeding targets by a wide margin. Performance is not significantly affected by the characteristics of projects, such a size, vintage, linkages with other IC products, etc. Instead, more noteworthy are the differences across regions, with projects in ***ECA and South Asia*** performing better than those in other regions. The review of selected operational and analytical documents produced by a sample of a dozen projects suggests that the ***quality of outputs is high*** and that the advice provided by BT operations is ***aligned with international best practices***.

Effectiveness of Operational Projects – Outcomes. Performance in terms of development outcomes is also positive, although ***there are differences across reform areas***. Results are quite positive in the areas of general BT reform, tax administration simplification, tax audits and tax appeals. Initiatives in tax incentives and MSME taxation are also mainly successful, but results are more difficult to achieve as a result of opposition to reform from vested interests. As in the case of output delivery, performance is largely unrelated to project features, whereas there are differences across regions, with ***ECA projects*** performing much better than the average. It is important to note that this assessment of development outcomes only partly relies on the analysis of monitoring and evaluation (M&E) indicators due to the ***paucity of observations*** (e.g. data on the number of firms benefitting from reforms are rarely tracked by projects) and the ***limited ability of indicators to capture results***, especially in reform areas others than tax simplification.

Effectiveness of KM Projects. KM activities play an instrumental role in supporting the development of the BT Program, contributing to the establishment of the ***necessary ‘infrastructure’***, in terms of analytical and operational tools and staff capabilities, as well as to the facilitation of relationships with other players active in BT and potential clients. Training sessions allowed the GTT to grow organically, which in turn, allowed for an ***expansion of the portfolio*** and for the coverage of a progressively ***wider range of themes***. The active participation in tax reform forums and conference activities and the hosting of events for tax practitioners facilitated the good level of cooperation with IFI/donors usually observed at the operational level, also allowing for the creation of linkages with potential clients. However, KM projects have devoted limited attention to the theme of ***results measurement*** and this did not help in improving the ability of M&E indicators to effectively capture the results of BT operations.

Impact. A comprehensive assessment of impacts is difficult because of the scarcity of solid evidence, which mostly refer to just one category of impacts, namely the ***compliance cost savings (CCS)*** accruing to private businesses. Data on CCS are available for a dozen completed operations, which cumulatively achieved cost savings of about US\$ 59 million per annum. Average CCS per project are about US\$ 4.5 million, but there are major variations, with some projects achieving outstanding results (about US\$ 16 million in Georgia and India respectively) and others displaying a much less positive performance. The bulk of CCS originate from tax simplification reforms concerning high frequency transactions (e.g. 1.5 million transactions simplified as a result of the introduction of e-payments in Armenia), although some positive results are also achieved in the areas of tax audits and tax appeals. Evidence regarding other impacts is scarcer and not homogenous. Survey results and interviews with stakeholders suggest that reforms promoted by BT operations had a positive impact on ***taxpayers’ perceptions*** of the tax system, with an ensuing positive influence on the overall investment climate. Evidence of impact in terms of the ***broadening of the tax base***, a key objective of BT operations, is usually inconclusive, as the growth in the number of registered taxpayers recorded in various countries is also affected by other factors. Similar considerations refer to ***impact on tax revenue***, the evolution of which also depends on a

variety of factors other than the BT reforms supported by IFC. There are, however, a couple of cases in which tax incentives reforms resulted in a significant reduction in the loss of tax revenue for the treasury (e.g. US\$ 3.6 and US\$ 16 million per year in, respectively, Sierra Leone and Yemen).

Sustainability. Information on developments subsequent to project completion is not systematically available, but *prospects are generally positive*. In several countries, governments have demonstrated a sustained commitment to reform and the process ignited by BT projects is continuing. Sustainability is enhanced by *successive BT operations*, providing assistance over a protracted period of time (e.g. in some Central Asian countries support to BT reforms has been ongoing since the mid-2000s). There are, however, some examples of *policy reversal* (e.g. restrictions on the use of self-printed invoices in Vietnam), a reminder of the high political sensitivity of tax reform.

Efficiency. Project expenses were usually on or below budgets, with only a couple of cases of significant cost overruns. Under spending was often the result of negative external events (e.g. project in Yemen suspended because of deteriorating country conditions), but *there were also cases of genuine savings*. Operational costs account for the bulk of project expenditure, with only a marginal incidence of administrative costs. Cost savings are usually associated with a more *intensive use of less expensive local staff and consultants*, which also assisted in reducing travel expenses. The *costs of analytical and operational tools frequently utilized by BT projects are reasonable* and sometimes lower than those of comparable complexity and size (e.g. the cost of TCCS is typically in the US\$ 40 – 80,000 range, compared to US\$ 80 – 200,000 for generic SME surveys). Regarding the value for money, cost effectiveness ratios range from more than 1:10 for a few highly successful initiatives, to much lower values, sometimes below 1:1, for the majority of projects. *The average cost effectiveness ratio is a rather modest 1:5*. However, due to data limitations, these ratios capture only part of the impacts achieved by BT operations, and, therefore, *underestimate the ‘true’ value for money*.

Appropriateness of M&E Indicators. Some recent changes in the M&E framework for IC activities are expected to have a positive influence on BT operations. In particular, the introduction of reach indicators should encourage a more systematic measurement of the *number of beneficiaries* of BT reforms, an aspect frequently overlooked by BT projects in the past. Despite these improvements, the M&E framework remains fundamentally geared towards the measurement of effects of *simplification measures* on private firms, which seriously limits the ability of assessing the performance of operations focusing on *other aspects of the BT reform agenda*. With regard to outcome indicators, the key issue is that results of interventions aimed at achieving ‘discrete’ changes in the policy and institutional setting (such as the setting up of a tax appeal body) are captured only by *generic and non-descriptive indicators*, merely counting the number of entities implementing the recommended changes. The mismatch between the expected results of BT reforms and the ability to effectively measure these results is even greater in the case of impact indicators. In fact, while BT reforms are meant to achieve a wide range of benefits in various areas (increase in tax revenue, expansion of tax base, improved efficiency of tax administration, etc.), the M&E framework currently envisages *only one impact indicator*, again focused on the results of simplification work.

Conclusions and Recommendations

Overall Assessment. The overall assessment of the BT Program is positive. Obviously, not all the projects were equally successful and there are certainly margins for improvement. Nevertheless, it is quite remarkable that, over a relatively short period of time, the *BT Program has become an important player in the area of taxation reform*, covering a range of very relevant themes and achieving some important results. The assistance provided displays a good balance between analytical rigor and practical feasibility and is *generally highly appreciated by client institutions*. This view is shared by tax practitioners at the WB and IMF, who emphasize the *complementarity of the BT Program with the work of other IFI/donors* and the value added of IFC activities in the area of BT reform.

Recommendations on Strategic Approach. The range of themes covered by the BT Program is quite broad and there are no evident gaps in the assistance provided. As the debate on tax reform in emerging countries evolve, new themes of potential interest emerge. However, a possible expansion of the current menu of interventions should *prioritize themes that are closely related to the work already done*, so as to capitalize on existing analytical skills and operational expertise. *Close cooperation with other IFI/donors*, sometimes resulting in the provision of largely integrated ‘assistance packages’, was extremely beneficial and should *remain a key feature of the BT Program in the future*. Obviously, close cooperation with other players makes the attribution of results much more difficult, which in turn may raise *concerns regarding the ability to ‘demonstrate’ the achievement* of individual BT operations. While certainly legitimate, these concerns *should not constitute a deterrent to the launch of ‘joint initiatives’*, and special arrangements for the tracking of results should in case be found.

Recommendations on Project Design and Management. The design and management of BT projects have proved broadly adequate and no major innovations appear necessary. Regarding project design, *it is important that BT operations retain a focused approach*, avoiding excessively complex project configurations that may lead to a sub-optimal use of resources. Similarly, *efforts to maximize synergies with other IC products should continue*. In particular, while work on DB indicators is of limited immediate relevance for the Program, BT operations should capitalize on the visibility and convening power of the DB reform agenda to push their proposals forward. On the operational front, *efforts should be made to further increase the share of projects with a permanent in-country presence*. In countries where it is reasonable to expect difficulties in the relocation of IFC staff and/or in the recruitment of high caliber tax consultants, the issue should be squarely addressed, namely through the budgeting of appropriate resources for a sufficient in-country presence.

Recommendations on Specific Analytical and Operational Tools. The BT Program has developed a comprehensive set of analytical and operational tools able to assist reform work on a wide range of reform themes. In general, no major innovations appear necessary, although some operational changes aimed at increasing cost effectiveness may be envisaged. This is particularly the case of TCCS, by far the most commonly used tool. TCCS implemented in the early stages of project implementation have proven to be very useful, effectively contributing to orient operational work and/or to create consensus around reforms. The merit of conducting these ‘early’ surveys obviously needs to be carefully assessed on a case-by-case basis, but in general *the deployment of ‘early’ TCCS appears quite appropriate*, especially for ‘first generation’ projects. TCCS implemented at later stages are used to assess the impact of implemented reforms. Due to budget limitations, these ‘late’ surveys have been used sparingly, namely only by two projects (which, perhaps not entirely coincidentally, are also those posting the highest values for CCS). Given the need for BT operations to tangibly demonstrate their impact, *a wider use of ‘late’ TCCS could be envisaged*, at least for sequences of two or more projects, which would allow for the spreading of costs over a larger cumulated budget. In the case of both ‘early’ and ‘late’ surveys, *the replacement of TCCS with other tools does not seem to be a viable option* since results would not be sufficiently specific and/or cost savings would be limited. Instead, *consideration should be given to the possibility of reducing the samples surveyed*, although the relationship between cost and sample size is somewhat spurious due to the presence of other factors (some economies of scale, local cost conditions). The other surveys used by BT projects are highly specific instruments, serving very definite purposes. The deployment of such instruments is inherent to the very nature of BT interventions in certain reform areas and, therefore, *no changes in utilization can or should be envisaged*. Similar considerations apply to the mapping of administrative procedures, which are an *indispensable tool for the design of tax administration reforms*.

Recommendations on M&E Indicators. A peculiar feature of the BT Program is the extreme diversity of the results sought, encompassing benefits for both private firms and tax authorities and concerning different variables. If the results of BT operations are to be effectively tracked and measured, a higher degree of customization of the M&E framework appears necessary. Four areas of improvement with regard to outcome and impact indicators can be identified. The first concerns the introduction of an *additional outcome indicator aimed at better capturing institutional and policy achievements*. Based on a scoring system, the indicator could provide a more specific and granular assessment of the results of interventions targeting ‘discrete’ changes in the

policy and institutional setting. The second area of improvement involves the introduction of an ***impact indicator intended to measure the administrative cost savings for tax authorities***. Conceptually similar to the CCS indicator used for the private sector, this indicator would allow for a more comprehensive view of the results of tax administration simplification work, which has beneficial effects on both the private and the public sectors. The third possible improvement refers to the ***development of a BT-related variant of the CCS indicator***, so as to capture some benefits currently not measured, namely the cash flow benefits generated by reforms reducing the frequency of tax payments (typically in VAT). Finally, the fourth area of improvement concerns the ***development of an impact indicator to assess 'direct' effects of BT reforms on tax revenue***. While the influence of BT reforms on tax revenue is in general quite remote and difficult to measure due to the presence of a variety of intervening factors, there are specific situations in which the effect is sufficiently direct to be measured through indicators with an acceptable degree of approximation. Such specific cases most notably include: (i) the reduction in the tax revenue foregone resulting from the elimination of tax incentives; and (ii) the increase in tax collection associated with the deployment of improved audit methods and/or of improved methods for the selection of taxpayers to be audited.

Economisti Associati
Via Rialto 9
40124 Bologna
ITALY

Phone **+39 051 6569606**
Fax **+39 051 6486838**
E-mail **main@economistiassociati.com**