

Doing Business

Paying taxes

“In Sweden we pay taxes online. The corporate income tax, value added tax, labor contributions and property tax are filed on a single form. Doesn’t everyone do it that way?” asks Astrid, a Swedish business owner.

Not yet. In Papua New Guinea, Syria and Zimbabwe tax forms are brought in person to the tax office and “discussed” with a tax officer to make sure calculations are correct. To comply with regulations on taxes and contributions¹ in the Republic of Congo, a company must make 89 payments a year, spend 106 days and pay 65.4% of its profits. Meanwhile, the company has to fill out 50 pages of forms for corporate income taxes, 50 for labor taxes and contributions and 36 for consumption taxes. Only Belarus and Ukraine have a more burdensome tax system.

The ease of paying taxes can range from filing a

single online form in Sweden to making 124 payments a year in Belarus. Investors make their choices accordingly. Countries with more payments have fewer formal businesses per capita and lower rates of business entry (figure 8.1).² In Brazil, for example, the Simples program, which eases tax requirements for small businesses, increased business registrations in the retail sector by 13 percent compared with the year before the program started.³

Countries that make it easier to pay taxes and contributions also have higher rates of workforce participation, and lower rates of unemployment, among women.⁴ The reason is simple: a burdensome tax system disproportionately hurts smaller businesses, especially in the services sector, and this is where most women work. In Colombia, where women outnumber men almost 2 to 1 among the unemployed, small businesses have to pay 82.4% of their

FIGURE 8.1

More burdensome taxes and contributions, fewer formal businesses

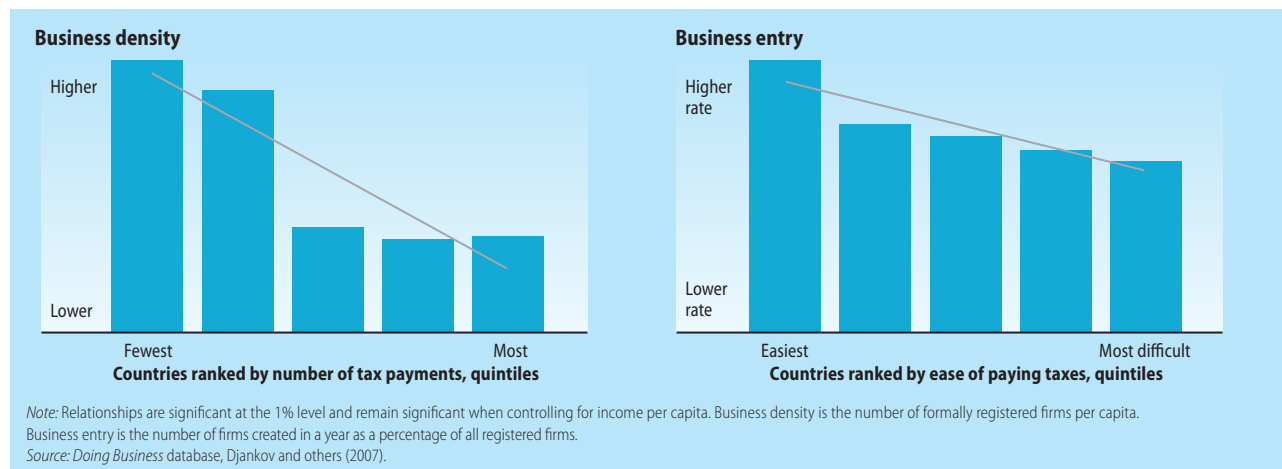


TABLE 8.1

Where is it easy to pay taxes—and where not?

Easiest	Rank	Most difficult	Rank
Maldives	1	Panama	169
Singapore	2	Jamaica	170
Hong Kong, China	3	Mauritania	171
United Arab Emirates	4	Bolivia	172
Oman	5	Gambia	173
Ireland	6	Venezuela	174
Saudi Arabia	7	Central African Republic	175
Kuwait	8	Congo, Rep.	176
New Zealand	9	Ukraine	177
Kiribati	10	Belarus	178

Note: Rankings are the average of the country rankings on the number of payments, time and total tax rate. See Data notes for details.

Source: Doing Business database.

Who is reforming?

Thirty-one economies made it easier to pay taxes in 2006/07. Reducing the corporate income tax rate was the most popular reform, done in 27 economies (table 8.2). Moldova, Mongolia, Sierra Leone, Syria, Turkey and Uruguay made major revisions in their tax codes. Colombia, Israel, the Kyrgyz Republic, South Africa, Uruguay and Uzbekistan reduced the number of taxes paid by businesses by consolidating or eliminating taxes. Azerbaijan, Bulgaria, Colombia, Lesotho, Malaysia, the Netherlands, Turkey and Uzbekistan simplified the process of paying taxes by introducing or expanding electronic filing and reducing the frequency of payments.

Bangladesh, the Dominican Republic, Hungary, Venezuela and Zimbabwe increased the tax burden on businesses. Bangladesh raised its corporate income tax from 37.5% of profits to 40%. Only Comoros and São Tomé and Príncipe have higher corporate income tax. The Dominican Republic passed a law requiring companies to submit paper receipts every month. Hungary introduced a temporary 4% tax on profits (the solidarity tax) and increased employers' labor contributions by 3.5 percentage points—both with the aim of reducing the budget deficit. Venezuela introduced 3 new taxes. Zimbabwe increased the road tax and the tax on check transactions. It also introduced a new corporate tax form to accompany each quarterly payment. That increased the time for tax compliance by 40 hours a year.

Bulgaria was the top reformer in 2006/07: it reduced the corporate tax from 15% to 10% and employers' labor taxes by 7 percentage points (table 8.3). And online filing is now widely used for corporate income tax and social security contributions.

commercial profits, make 69 tax payments a year and spend 47 days to comply with all tax requirements. This is changing, thanks to a new tax law enacted by the congress in late 2006.

There is good news: paying taxes is now easier, especially in Eastern Europe and Central Asia, which had the most reforms in 2006/07. Revenues are growing as well. For example, the Czech Republic saw its tax revenue rise by 2% after reducing the corporate income tax between 2004 and 2005.⁵ This is part of a longer global trend—the tax burden on businesses has decreased every year since 1985.⁶ A few places—much of Africa, some countries of the former Soviet Union and several Latin American countries—have yet to catch on (table 8.1).

Turkey was the runner-up in reforms. It reduced the top rate for corporate income tax from 30% in 2005 to 20% in 2006 and introduced a new corporate tax code. Turkey also reduced the tax on interest from 18% to 15% in 2006 and simplified other taxes, such as the property tax and the tax on check transactions. And it improved e-filing, reducing the time businesses need to comply with tax regulations by 31 hours.

Eastern Europe and Central Asia accounted for about a third of the reforms in 2006/07. Besides Bulgaria, 8 countries reduced the corporate income tax and 6 reduced social contributions paid by employers. Uzbekistan reduced the corporate tax from 15% in 2005 to 12% in 2006 and 10% in 2007. It gradually reduced labor contributions from 33% in 2004 to 24% in 2007. And it expanded the single tax payment regime for small

TABLE 8.2

Reducing tax rates—the most common reform in 2006/07**Reduced profit tax**

Azerbaijan, Bulgaria, Colombia, Côte d'Ivoire, Greece, Israel, Kazakhstan, Kyrgyz Republic, Lesotho, FYR Macedonia, Malaysia, Mauritius, Mexico, Moldova, Mongolia, Netherlands, Portugal, Slovenia, South Africa, Spain, Syria, Trinidad and Tobago, Tunisia, Turkey, Uruguay, Uzbekistan, West Bank and Gaza

Reduced labor taxes or contributions

Albania, Bulgaria, Israel, Kyrgyz Republic, Mexico, Moldova, Netherlands, Romania, Seychelles, Slovenia, South Africa, Uzbekistan

Simplified process of paying taxes

Azerbaijan, Bulgaria, Colombia, Lesotho, Malaysia, Netherlands, Turkey, Uzbekistan

Revised tax code

Moldova, Mongolia, Sierra Leone, Syria, Turkey, Uruguay

Eliminated taxes

Colombia, Israel, Kyrgyz Republic, South Africa, Uruguay, Uzbekistan

Source: Doing Business database.

TABLE 8.3
Major cuts in corporate income taxes in 2006/07

Region	Changes in corporate income tax rate (%)
Eastern Europe & Central Asia	Azerbaijan 24 to 22
	Bulgaria 15 to 10
	Kyrgyz Republic 20 to 10
	FYR Macedonia 15 to 12
	Moldova 18 to 15
	Slovenia 25 to 23
	Turkey 30 to 20
Uzbekistan 15 to 12	
Sub-Saharan Africa	Côte d'Ivoire 35 to 27
	Lesotho 35 to 25
	Mauritius 25 to 22.5
	South Africa 12.5 to 10 ^a
Latin America & Caribbean	Colombia 35 to 34
	Mexico 29 to 28
	Trinidad and Tobago 30 to 25
	Uruguay 30 to 25
OECD high income	Greece 29 to 25
	Netherlands 29.6 to 25.5
	Portugal 27.5 to 26.5
	Spain 35 to 32.5
Middle East & North Africa	Israel 31 to 29
	Syria 35 to 28
	Tunisia 35 to 30
	West Bank and Gaza 16 to 15
East Asia & Pacific	Malaysia 28 to 27
	Mongolia 30 to 25

a. Data are for the secondary company tax, paid on top of the corporate income tax.
Source: Doing Business database.

businesses. Moldova is taking the most ambitious step: reducing the corporate income tax from 15% to 0% in 2008 after already lowering it from 18% in 2006. FYR Macedonia committed to reducing the corporate income tax from 15% in 2006 to 12% in 2007 and 10% in 2008.

In Eastern Europe the main motivation for simplifying taxes is joining and being competitive in the European Union. That creates pressure on Western European countries to simplify taxes too. The Netherlands reduced the top rate for corporate income tax from 31.5% in 2005 to 29.6% in 2006 and 25.5% in 2007. It also reduced 3 of the labor contributions. And it introduced e-filing for social security contributions, greatly simplifying the process of paying taxes.

Six countries reformed in Africa. Sierra Leone reduced a cascading sales tax—a sales tax that must be paid on raw materials and cannot be deducted upon sale of the final product—from 15% to 10%. Next year it is likely to complete the process of replacing this tax with a value added tax. Four other African countries lowered their profit tax, and 2 reduced labor contributions. But Africa is still the region with the highest tax rates—with

TABLE 8.4
Who makes paying taxes easy—and who does not?

Payments (number per year)			
Fewest		Most	
Maldives	1	Venezuela	70
Sweden	2	Jamaica	72
Hong Kong, China	4	Dominican Republic	74
Norway	4	Kyrgyz Republic	75
Singapore	5	Montenegro	88
Afghanistan	6	Congo, Rep.	89
Kiribati	7	Romania	96
Latvia	7	Ukraine	99
Mauritius	7	Uzbekistan	118
New Zealand	8	Belarus	124
Time (hours per year)			
Least		Most	
Maldives	0	Czech Republic	930
United Arab Emirates	12	Azerbaijan	952
Singapore	49	Vietnam	1,050
Luxembourg	58	Bolivia	1,080
Oman	62	Armenia	1,120
Switzerland	63	Nigeria	1,120
New Zealand	70	Belarus	1,188
St. Lucia	71	Cameroon	1,400
Ireland	76	Ukraine	2,085
Seychelles	76	Brazil	2,600
Total tax rate (% of profit)			
Lowest		Highest	
Vanuatu	8.4	Eritrea	84.5
Maldives	9.1	Uzbekistan	96.3
United Arab Emirates	14.4	Mauritania	107.5
Kuwait	14.4	Argentina	112.9
Saudi Arabia	14.5	Belarus	144.4
Zambia	16.1	Central African Republic	203.8
West Bank and Gaza	17.1	Congo, Dem. Rep.	229.8
Botswana	17.2	Sierra Leone	233.5
Samoa	19.8	Burundi	278.7
Lesotho	20.8	Gambia	286.7

Source: Doing Business database.

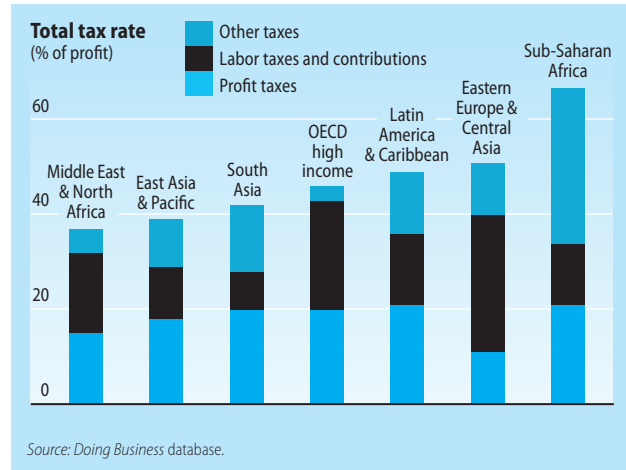
the Central African Republic, the Democratic Republic of Congo, Sierra Leone, Burundi and Gambia each requiring businesses to pay more than 200% of their profits (table 8.4).

In Latin America and the Caribbean, Trinidad and Tobago made the biggest reduction in the total tax rate by cutting the profit tax by 5 percentage points. Uruguay passed a new tax law that eliminates 15 taxes, simplifies the social contributions and reduces the profit, personal income and value added taxes. Colombia eliminated the system of adjustment for inflation, simplifying tax computation.

Four economies in the Middle East and North Africa made their tax law more business friendly. While the main focus of reforms was reducing the profit tax, some countries went beyond that. Israel eliminated the stamp duty. Syria developed a large-taxpayer unit to make it easier for large businesses to pay taxes.

Only 2 countries reformed in East Asia and Pacific, the region with the second lowest tax rate (figure 8.2). Mongolia put in place new laws for the corporate income, value added and personal income taxes, including a new flat tax for individual income. Malaysia reduced the profit tax by 1 percentage point (with another 1 percentage point reduction planned by 2008) and simplified online tax filing.

FIGURE 8.2
Business taxes lowest in Middle East & North Africa



What to reform?

Tax reforms are usually controversial, attracting intense political debate. The choice is often perceived as being between lower taxes with more votes but potentially less government revenue—and higher rates with discontented voters but potentially smaller fiscal deficits. In reality there is often no tradeoff between revenues and votes. Since 2005, 90 reforms in 65 economies have pointed to the 4 most successful reforms:

- Introduce online filing.
- Combine taxes.
- Simplify tax administration.
- Reduce tax rates and broaden the base.

Of those 65 economies, 4 improved their tax system every year: Albania, Bulgaria, Mexico and Moldova. Eighteen others reformed twice: the Czech Republic, Estonia, Ghana, Greece, Hungary, India, Israel, Latvia, Lesotho, Lithuania, Morocco, the Netherlands, Pakistan, Senegal, Sierra Leone, Spain, Turkey and Uzbekistan.

Introduce online filing

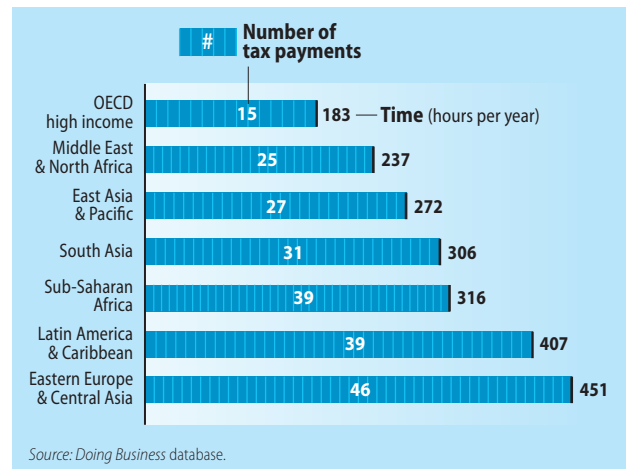
A quarter of the world's countries have electronic filing and payment of business taxes. That means no need for paper documents—and no need for personal interaction with tax officers. A third of the world's countries now use electronic payment such as bank transfer—and half use payment by check. In Mozambique the tax authority favors check payments by clearing them faster than bank transfers. But this choice has not been incident free: some checks were deposited in accounts belonging to tax officers.

Combine taxes

Almost 50% of countries have more than one labor tax or contribution, 27% more than one tax on profits and 41% more than one tax on property. If the base is the same (salaries, profits or property value), why not just combine these? Having multiple taxes increases the bureaucratic burden for both the taxpayer and the tax administration. Poland has the highest administrative costs of tax collection among OECD countries, at 2.62% of revenue.⁷ The reason? A business has to make 41 tax payments a year, including 4 different labor taxes. Many countries in Eastern Europe and Central Asia have a similar burden (figure 8.3). In contrast, tax administration in Sweden costs only 0.59% of revenue, since all business taxes can be paid online.

Several countries have joint tax payments. Bosnia and Herzegovina combines 3 labor contributions—and

FIGURE 8.3
Compliance most burdensome in Eastern Europe & Central Asia



Uruguay 4—in one monthly payment. In Portugal companies can pay 2 taxes on profits together.

Simplify tax administration

More than half of countries require special accounting books for tax purposes. Two-fifths have more than one law per type of tax. So businesses spend a lot of time complying with tax regulations (figure 8.4). Making the tax rules for businesses complex is unlikely to bring more revenue—quite the opposite. Countries that don't require special books have 10% more revenue (as a percentage of GDP) on average than countries that do. And having a clear tax law increases tax revenue by 6% on average.⁸

Clarity on audit rules can make a big difference. While the vast majority of countries have a system of self-assessment for calculating taxes, only about 16% use risk analysis as the basis for their tax audits. Yet tax audits are a big opportunity for bribes. Using clear rules (and even statistical analysis) to determine who and how to audit can reduce this opportunity and increase tax revenue. Indeed, countries with audits based on risk analysis have higher tax revenue as a percentage of GDP—18% higher on average—despite having lower tax rates.

The reason is that businesses have fewer incentives to hide revenues. One example: a 2007 study of transition economies finds that businesses that report frequent tax audits are also 17% less likely to borrow from banks. Instead, they resort to informal lenders. That way the borrowed money stays out of the tax records.⁹

FIGURE 8.4
More complexity, more time paying taxes

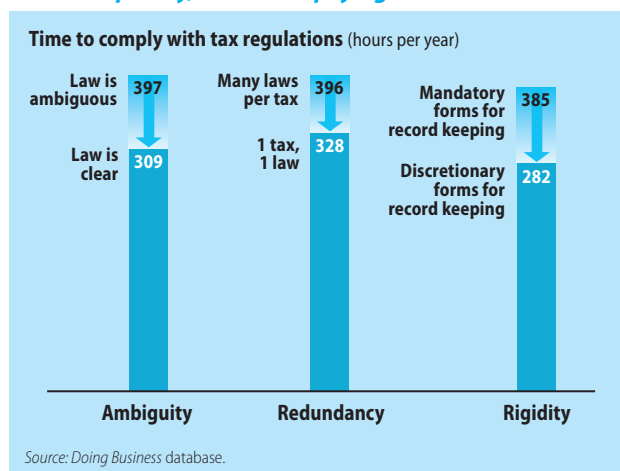
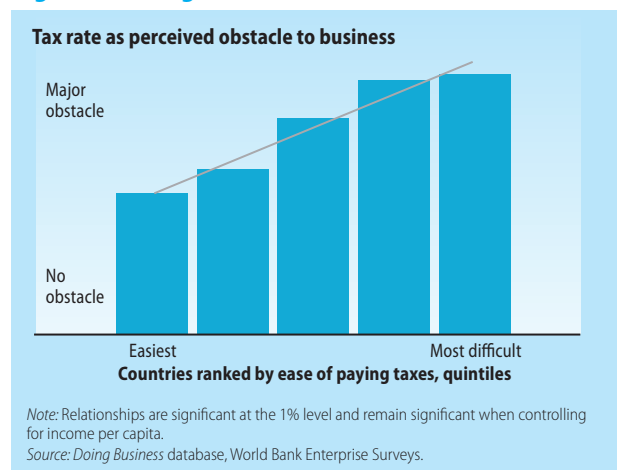


FIGURE 8.5
Higher tax rate, greater obstacle to business



Reduce tax rates and broaden the base

High tax rates can force companies into the informal sector (figure 8.5). In the Democratic Republic of Congo, with taxes as high as twice the commercial profit for a company with a profit margin of 20%, businesses have a strong incentive to evade taxes. Indeed, half the country's manufacturing activity is in the informal sector.¹⁰ Such countries can increase tax revenue by lowering rates and persuading more businesses to comply with the new tax system. Even countries with a smaller informal sector can gain from this strategy. Greece saw its corporate tax revenue grow from 4% of GDP to 5% after reducing the corporate tax rate in 2005.

Notes

1. *Doing Business* measures taxes and contributions paid by a standardized business. The indicator includes taxes as defined by the system of national accounts (compulsory unrequited payments to general government) as well as government-mandated contributions such as compulsory payments to the employee social security where the statutory incidence is on the employer. See Data notes for details.
2. Djankov and others (2007).
3. Monteiro and Assunção (2006).
4. Alesina and Ichino (2007) and Azmat, Guell and Manning (2006).
5. World Bank, World Development Indicators database.
6. Slemrod (2004).
7. OECD (2007).
8. World Bank, World Development Indicators database.
9. Safavian and Wimpey (2007).
10. Schneider (2005).