

INDONESIA

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TAXATION AND ECONOMIC DEVELOPMENT

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1. INTRODUCTION

Indonesia's fiscal adjustment and tax administration reform strategies emerged in the early 2000's against the backdrop of the East Asian financial crisis. The factors had a significant role in shaping the tax administration reforms:

1. The macro-fiscal situation;
2. The structure of the tax regime;
3. The weak state of the DGT's operations.

1.1. The macro-fiscal situation

The 1997 Asian financial crisis afflicted Indonesia more severely than most economies and served as a major catalyst for reforming Indonesia's tax administration. Real GDP contracted by 13 percent in 1998, and by July 1998 the Rupiah had depreciated by about 80 percent from the previous year, while inflation had accelerated to about 70 percent per annum. The situation deteriorated further as a run on the banking system left many banks insolvent. While progress had been made in restoring macroeconomic stability by mid – 1999, the early gains began to unravel in 2000 and 2001. Slippages in reforms and an increasingly uncertain political climate contributed to renew downward pressure on the Rupiah, and new inflationary pressures emerged.

To achieve economic stability and growth, the Indonesian authorities formulated an economic reform program in 2000. The program envisaged restoring the growth rate to 5-6 percent over the medium term, restricting inflation to below 5 percent annually, and achieving fiscal sustainability. Under this program, public debt, which had shot up from 25 percent of GDP before the crisis to about 100 percent of GDP in 2002, was to be reduced to 65 percent of GDP by 2004.

In this context, the authorities designed a fiscal adjustment program that aimed at achieving a balance between supporting economic recoveries and making progress toward the public debt objective. Given the fragility of the emerging recovery in early 2000, it was considered important to maintain fiscal stimulus in 2000 while planning for early fiscal consolidation. Hence, the government's medium-term macroeconomic framework targeted a gradual reduction in the central government deficit.

With oil production projected to decline, increasing the buoyancy of non-oil and gas tax revenue was to become a key element in Indonesia's fiscal adjustment

strategy. With the economy slowly recovering from a major economic and financial crisis, the authorities sought to generate as much revenue as possible through improvements in tax administration rather than to rely exclusively or mainly on tax changes for increasing the tax yield.

Year 2002 would become a pivotal year for tax administration reform in Indonesia. That year's budget targeted a sizable reduction in the deficit which would require, among other things, increasing non-oil tax revenue by 1.2 percentage point of GDP. About one-half of the revenue increase was to be generated through tax administration improvements. To achieve the targeted increase, the government called upon the DGT to identify specific administration reforms to higher order economic objectives would prove crucial for locking in the political commitment needed to implement the DGT's reform agenda.

The government's economic reform program during the early 2000's also attached great importance to improving the investment climate as a key to achieving its growth and employment objectives. With a number of studies and surveys indicating that problems in tax administration were among the top impediments to doing business in Indonesia, tax administration reform came to be seen as crucial for reasons beyond its potential for generating revenue. As a result, the DGT's reform strategy was eventually broadened to include measures aimed at simplifying the compliance requirements of the tax system, promoting integrity among tax officers, accelerating refunds to taxpayers, and a number of other investment-enhancing initiatives.

In this way, the government's macro-fiscal objectives propelled tax administration to a prominent position in Indonesia's economic policy agenda, which triggered a series of tax administration reforms that began in late 2001 and have continued since. Before turning to the details of the tax administration reform strategy, the paper first describes the state of Indonesia's tax system and tax administration in 2000.

1.2. The Structure of the Tax System

Prior to the Asian financial crisis, Indonesia had taken steps to improve the tax system by introducing a modern VAT and income tax. By, 2000, the overall design of the tax system was generally regarded as sound, but its yield was low and the tax laws included a number of features that unnecessarily complicated

administration. As such, some aspects of the tax policy regime made the challenges of administering the tax system that much greater for the DGT.

1.2.1. The overall yield of the tax system was low.

The overall burden on Indonesia's tax system in 2000 was relatively light compared to that of other countries in the region. Specifically, the ratio of tax revenue to GDP in Indonesia (excluding oil and gas tax revenues) was 9.9 percent. Indonesia's low tax burden reflected several weaknesses, including the narrowness of major tax bases, relatively low taxation of petroleum, tobacco and certain forms of income, and a high rate of noncompliance among taxpayers. Correcting these weaknesses would be essential to mobilizing the revenue that Indonesia's fiscal adjustment program required.

Income taxes (both corporate and individual) in Indonesia comprised 4.3 percent of GDP (excluding oil and gas income tax revenue) which is noticeably lower than the average of 6.0 percent of GDP among selected non-OECD Asian countries (in Indonesia, income tax revenue from the oil and gas sector is classified as oil and gas revenue instead of tax revenue. In 2001, oil and gas income tax collection is estimated to have been around 1.1 percent of GDP). In these countries, corporate income tax accounts for about two-thirds of total income tax collections and personal income tax the remainder. In Indonesia, because of the means of presenting the data by nature of collection rather than corporate or personal income taxpayers, it is not possible to determine the relevant breakdown. However, a rough allocation of components of income tax revenue (excluding oil and gas revenue) suggests a similar breakdown (or a somewhat lower reliance on personal income tax) as that of non-OECD regional comparators.

General consumption taxes in Indonesia were equivalent to 3.4 percent of GDP compared to the regional average of 3.2 percent for non-OECD comparators. In Indonesia, the general consumption tax category includes VAT and luxury tax, with the latter applying to an extensive list of goods. If the luxury taxes were reclassified to the excise tax category, then the general consumption tax would have yielded about 3.0 percent of GDP, in line with the average for non-OECD regional comparators.

Excise taxes comprise only 1.1 percent of GDP in Indonesia, compared to a regional average of 2.7 percent. The lower share of excises in Indonesia

compared to the region was largely accounted for by the omission of petroleum from Indonesia's excise regime. Indonesia does not impose an excise tax or luxury sales tax on gasoline and other petroleum products, which represents a significant source of revenue for many other countries in the region. Excise taxes, both on domestic and international transactions, are collected by Indonesia's customs administration.

International trade taxes in Indonesia also yielded less than the regional average. This appears to have reflected a combination of weak enforcement, widespread exemptions, and generally low tariff rates.

Property taxes were slightly above the non-OECD regional average. However, compared with OECD countries in the region, this tax yielded little revenue mainly due to its policy design. With a 0.5 percent tax rate and a standard property assessment at 40 percent of market value, the effective rate is 0.2 percent of assessed property value, which is low.

1.2.2. Some features of the tax system were unnecessarily complex

The tax laws included a number of provisions, relating to both income and consumption taxes, which presented difficulties for taxpayers to comply with and for the DGT to enforce. Tax simplification, therefore, offered significant advantages for taxpayers and the DGT alike, and would become a key element in Indonesia's tax administration reform strategy.

Income taxes

The personal income tax had several positive features that simplified compliance and tax administration, including the widespread withholding of tax at source and a simplified regime for individual entrepreneurs. However, many of these advantages were offset by the government's decision in 2001 to require most individual taxpayers (even employees with only a single source of income) to file an annual tax return. This requirement dramatically increased the number of tax returns that had to be filed beyond the capacity of the DGT to process and enforce.

The corporate income tax law also had a number of features that complicated administration and provided scope for abuse. Chief among these was the reintroduction of tax privileges in 1996 (under Government Regulation 45) which provided tax holidays to newly incorporated firms "operating in certain

industries” for up to 10 years. Tax holidays and other tax incentives present serious administrative challenges to a tax agency as they introduce the possibility for taxpayers to transfer profits from operations that do not qualify for the holiday to those that do. Such schemes are also an invitation to corruption as government officials commonly have wide discretion in their administration.

Value Added Tax (VAT)

The general design of the VAT in 2000 provided a number of advantages for administration. These included a single positive rate of 10 percent, the limitation of zero-rating to exports, the use of the invoice/credit method (accrual) to calculate the VAT liability, and a simplified regime for small taxpayers. Along with these desirable features, however, the VAT also contained a number of undesirable features that significantly complicated administration. The most serious of these problems involved a legal provision that requires all refund claims to be audited, regardless of the taxpayer’s compliance history, prior to payment and approved (or disallowed) within 12 months. This requirement led to lengthy delays in processing refund claims which caused major cash flow problems for businesses, particularly to exporters who were regularly in a refund position for the VAT. It also created problems for tax administration by requiring the DGT to allocate a disproportionate amount of audit resources to examining refund claims and, as a result, leaving insufficient resources for auditing other, potentially more significant issues.

An additional problem involved the VAT-free status of Batam Island, which was difficult to enforce and created risks of significant revenue leakage. Other complications with the VAT involved the separate registration thresholds for goods and services, separate VAT reporting by each branch of an enterprise, and the excessive use of “collectors” who were required to withhold 100 percent of the VAT from their suppliers.

Luxury Sales Tax (LST)

The LST added much complexity to the tax system but produced little revenue. The tax provide for approximately 350 tariff codes, which ally to both domestic and imported goods, with more than half of the codes containing either taxable and nontaxable products or products taxable at different rates.

The taxable status of a product depended on one of several factors including its price, packaging, quality, or output capacity. Distinguishing among these various factors and applying the correct rate made compliance extremely difficult for the DGT to achieve or verify.

1.3. The State of Tax Administration

In 2000, Indonesia's tax administration was beset by many weaknesses. Poor legal and governance frameworks, shortcomings in organizational and staffing arrangements, ineffective taxpayer services and enforcement programs, and outdated information systems combined to severely reduce the DGT's effectiveness and efficiency in collecting taxes. These weaknesses resulted in large amounts of foregone tax revenue due to noncompliance by taxpayers and also raised the cost of doing business in Indonesia. Addressing these problems would become central to the DGT's reform strategy and to advancing the government's fiscal adjustment program.

1.3.1. Poor Legal and Governance Frameworks

In Indonesia, the legal framework for tax administration is contained in two sets of laws; the rules that apply to all taxes are set out in the general law on tax administration and arrears collection. While the rules that apply to a particular tax are provided for in each substantive tax law. Deficiencies in this framework meant that tax officers lacked many powers common to modern tax agencies while taxpayers lacked a number of basic protections. The deficiencies included a weak penalty regime, inadequate access to taxpayers records (particularly banking records), and the absence of key powers for enforcing the collection of tax debts. From the taxpayer's perspective, the tax laws led to lengthy delays in processing refunds, did not offer sufficient protections from receiving large arbitrary tax assessments (which often became the basis for negotiating the tax liability), the objection and appeals processes was viewed as biased in favor of the DGT, and certain tax offences could lead to imprisonment without trial. Together, these problems contributed to an environment of mutual suspicion and distrust between tax officers and taxpayers.

1.3.2. Shortcomings in Organizational and Staffing Arrangements

The DGT's had a number of serious staffing problems. During the 1990s and into the 2000s, the DGT had insufficient numbers of staff signed to the key functions of strategic planning, audit and taxpayer services. For example, in 1996 the DGT had only about 1,800 skilled auditors, equivalent to about 7 percent of its staff, whereas effective tax administrations commonly assign up to 30 to 40 percent of their staff to the audit function. Such misallocations of staff constrained the DGT in carrying out key management and operational functions.

1.3.3. Ineffective Enforcement and Taxpayer Service Program

In 2000, The DGT had considerable difficulty in enforcing taxpayers' basic obligations under the tax laws: only a very small fraction of the taxpayer population was registered with the DGT and, among those who were, many failed to file their tax return on time, did not fully pay their tax liabilities, and underreported substantial amounts of taxes. These problems reflected weaknesses in the DGT's enforcement programs, particularly in the audit and arrears collection areas. Similar problems existed in the directorate's taxpayer services function, staffed with tax officers who had little training and lacked a service-oriented attitude, and provided taxpayers with only the most basic types of services and assistance.

1.3.4. Outdated Information Technology Systems

While the DGT had introduced computer technology to all levels of the organization by the mid-1990s, the quality of its information systems remained very low in 2000. The main deficiency was that separate, nonintegrated systems were used to administer each tax, thereby making it difficult to get a consolidated picture of taxpayers' overall account status with the DGT. In addition, the information systems provided few automated tools to help front-line staff in carrying out their operational responsibility and practically no electronic services to taxpayers. Management oversight was severely compromised by the lack of reliable information that could be used to evaluate the effectiveness and efficiency of the DGT's core enforcement and taxpayer services programs.

2. THE TAX ADMINISTRATION REFORM STRATEGY

This section describes the tax administration reform strategy that DGT formulated beginning in late 2001 and has continued to implement, with refinements and additions along the way, ever since.

2.1. Analytical Framework

In designing tax administration reform strategies where increasing revenue is a key objective, it is important to understand the linkages between a tax agency's administrative programs and the tax yields.

2.1.1. The "Tax Gap" Concept

The analysis of how tax administration improvements can increase tax revenue is anchored in the concept of the *tax gap*. The tax is generally defined as the difference between, on the one hand, the amount of tax revenue that would have been collected had all taxpayers fully complied with their obligations under the tax laws and, on the other hand, the amount of tax revenue that was actually collected by the tax administration. The difference, or gap, between potential and actual tax collections consists of taxes that were legally due but not paid by taxpayers as a result of noncompliance.

The tax gap has three main components: non filing, underreporting, and underpayment. The non filing gap represents the amount of taxes not paid by taxpayers who have an obligation to file a tax return, but do not file on time. The underreporting gap is the tax owed by taxpayers who file tax returns on time, but do not report the full amount of tax they owe. The underpayment gap is the amount of foregone revenue resulting from taxpayers who fail to fully pay on time the amount of tax owed.

The gap provides a useful organizing principle for designing a tax administration reform strategy within the context of a fiscal adjustment program. A tax agency has at its disposal various measures to increase actual tax collection relative to potential collection and, thereby, reduce the tax gap. Before turning to these measures it is important to first recognize that tax collections take two broad forms.

2.1.2. Forms of Tax Collection

A tax agency receives revenue in two ways: (i) taxes that are paid voluntarily by taxpayers and (ii) taxes that are collected from noncompliance taxpayers through some form of enforcement by the tax authorities. In all countries, these two forms of collection account for vastly different shares of tax revenue and respond differently to a tax agency's administrative programs.

Voluntary Collections

Voluntary collections consist of those taxes that are paid by taxpayers without requiring any direct form of enforcement on the part of the tax authorities. These collections commonly occur when taxpayers self-assess a tax return and voluntarily pay the declared tax liability. In all countries, voluntary collections account for a much larger proportion of tax revenue (usually far more than 90 percent) than enforced collections. A tax administration can increase voluntary collections by putting in place measures that raise the rate of voluntary compliance among taxpayers.

Because of the large share of voluntary collections in tax revenue, relatively small increases in taxpayers' compliance rates can generate substantial increases in tax revenue. However, it may take time for a tax agency's measures to increase voluntary collections since these measures work through changes in taxpayers' compliance rates which often take a while to adjust. The difficulty in measuring compliance rates is one of the reasons why fiscal analysts are often reluctant to program tax administration gains into their revenue.

Enforced Collections

Enforced collections are those taxes that a tax agency collects through some form of enforcement action that is taken against noncompliant individuals and businesses. Examples include revenue recovered from taxpayers who are failed to file a tax return on time, underreported their taxes, or owed tax arrears. Revenue from enforced collections normally accounts for a relatively small share of a country's tax revenue (commonly far less than 10 percent).

Because of its small share in total tax collections, enforced collections must increase at a high rate in order to have a significant impact on the tax yield. *Nevertheless, enforced collections have the potential to increase quickly,*

since these collections do not require adjustments in taxpayers' compliance patterns, but instead result directly from a tax agency's own enforcement actions. Since most tax agency's have the capacity to measure the amount of revenue recovered through enforcement, fiscal analysts can estimate more precisely the potential for tax administration measures to increase enforced collections than voluntary collections.

2.1.3. Tax administration Instruments and Their Linkages to the Tax Yield

A tax agency has two broad sets of instruments for reducing the tax gap: *compliance facilitation* and *compliance enforcement*. These two sets of instruments affect the tax yield in different ways through their impacts on voluntary collections and enforced collections.

Compliance Facilitation Affects the Tax Yield by Increasing Voluntary Collections

Compliance facilitation entails those tax administration measures that make it easier for taxpayers to comply with their obligations under the tax laws. Common examples include simplifying the tax laws, streamlining administrative procedures and information reporting requirements, and improving taxpayer services. By reducing the cost of compliance, compliance facilitation creates incentives for taxpayers to voluntarily pay their taxes. To the extent that taxpayers respond positively to these incentives, their voluntary compliance rate will increase and voluntary collections will rise.

Compliance Enforcement Affects the Tax Yield by Increasing Both Voluntary

Compliance facilitation entails those tax administration measures that make it easier for taxpayers to comply with their obligations under the tax laws. Common examples include simplifying the tax laws, streamlining administrative procedures and information reporting requirements, and improving taxpayer services. By reducing the cost of compliance, compliance facilitation creates incentives for taxpayers to voluntary pay their taxes. To the extent that taxpayers respond positively to these incentives, their voluntary compliance rate will increase and voluntary collections will rise.

Collections and Enforced Collections

Compliance enforcement involves a tax agency's measures for detecting and redressing noncompliance by taxpayers. Common examples include identifying potential registrants, detecting underreported tax liabilities, and recovering delinquent tax returns and late tax payments. Compliance enforcement measures can have a direct effect on the tax yield by increasing enforced collections. They can also have an indirect effect on the tax revenue by discouraging taxpayers from engaging in noncompliance and thereby increasing voluntary collections.

2.2. Overview of the Reform Strategy

Indonesia's tax administration reforms were guided by two primary objectives in the fiscal adjustment strategy: increasing the tax yield and promoting the investment climate. In pursuing these objectives, the DGT formulated both short and medium term reform strategies whose main features and their rationale are summarized below.

2.2.1. The Short Term Reforms

In late 2001, the DGT developed a short term reform strategy in close coordination with the MOF which, at the time, was formulating the country's fiscal adjustment program. In designing the short term strategy, priority was given to those tax administration measures that could have an immediate impact on both the tax yield and the investment climate as well as jump start the process of modernizing the DGT. The latter was seen as crucial for further increasing tax collection and improving the investment climate over the medium term.

The scope of the short term strategy was constrained by the DGT's limited implementation capacity. At the time, the DGT had little experience in managing a comprehensive reform program and had little time to produce results. Consequently, the short term strategy was restricted to a small number of reforms that the DGT could effectively manage and which could generate quick results. This approach of focusing on a few major initiatives and piloting their implementation wherever possible has been a constant theme in Indonesia's tax administration reform strategy since 2001.

The DGT short term strategy was built around three initiatives: (i) a “revenue generation program” which included a number of measures aimed at tightening the enforcement of the tax laws. The rationale for this initiative flowed from the analytical framework that was presented in the previous subsection which demonstrated that stepped-up enforcement could yield potentially large increases in tax revenue in the short term; (ii) the establishment of a special tax office within the DGT to administer the largest taxpayers. Since these businesses were not only large taxpayers but also large investors, it was felt that this initiative could have significant short term impacts on both tax revenue and the investment climate; and (iii) the introduction of an electronic system for processing tax payments to replace the existing system, which was slow, costly, and vulnerable to “leakage”. This initiative, which was already on the drawing board in 2001, could enhance tax collections by accelerating the processing of tax payments and guarding against illicit paper based payment advices, a common problem at the time.

2.2.2. The Medium Term Reforms

As the short term reforms were being implemented during 2001 and 2002, it became apparent that a broader set of tax administration reforms would be required to further increase tax collections and promote the business climate over the medium term. To achieve these goals, the DGT would have to address its most fundamental weaknesses, including those involving the legal and governance frameworks for tax administration, organizational and staffing arrangements, taxpayer services and enforcement programs, information systems and technologies, and human resource management policies. Given the deep seated nature of these problems, a medium term perspective was needed for their improvement.

In early 2003, the DGT designed a medium term reform plan, which was intended to be implemented over the next three years. In broad terms, the plan provided for a continuation of the short term strategy and added to these reforms several major new initiatives. More specifically, the medium term plan comprised the foundation statements and the following ten initiatives:

- 1) Increasing the number of taxpayers administered by the large taxpayer office (LTO) and extending the LTO reforms to another region that also administered large businesses;

- 2) Establishing model tax offices for administering small and medium sized taxpayers, and gradually extending these models to all offices throughout Indonesia;
- 3) Continuing the revenue generation initiative;
- 4) Simplifying each major tax, beginning with the value added tax;
- 5) Revising the legal framework for tax administration;
- 6) Enhancing the capacity of the DGT's audit function;
- 7) Developing a balanced set of performance measures for the DGT's core tax administration processes;
- 8) Introducing new human resource management policies;
- 9) Designing a comprehensive information technology master plan;
- 10) Creating an internal investigation unit to investigate misconduct by tax officers.

Although the medium term plan would be refined in subsequent years to include additional measures, such as reorganizing DGT Headquarters and creating Data Processing Center, the ten above mentioned initiatives would continue to form the core of the reform strategy through 2007.

3. IMPACTS OF THE REFORMS

This section analyzes the impact that the reforms have had on two key objectives in Indonesia's fiscal adjustment strategy: (i) increasing non-oil and gas tax revenue; and (ii) improving the investment climate. The available evidence suggests that the reforms had a strong, positive impact on the tax yield and a positive, though difficult to quantify, effect on the investment climate.

3.1. Impact on Revenue

Prior to the 1997/98 Asian crisis (non-oil) tax collection in Indonesia was on a slow but steady downward trend. In the five years prior to the 1997/98 Asian crises, Indonesia's tax yield averaged 10.5 percent of GDP and then declined and eventually bottomed out at 9.6 percent in 2000. A similar downward trend in collection is also observable as a ratio of non oil GDP. The decline mostly came from lower DGT collections.

In breaking with pre-crisis and crisis trends, the tax yield increased over the period of the tax administration reforms. From 2001, the year preceding the introduction of the reforms, to 2006 the non oil and gas tax to GDP ratio rose from 9.9 to 11. Over this period, DGT collections rose by 1.2 percentage points of GDP while collections from DG Customs decreased by 0.1 percentage points of GDP. The buoyancy in DGT collection was generated by three taxes: income tax (0.6 percentage points of GDP), VAT (0.5 percentage points of GDP), and land tax (0.3 percentage points); luxury and sales tax collection partly offset this good performance, as it declined by 0.2 percentage points of GDP. In the five reform years beginning in 2001, the average tax yield increased to 11 percent of GDP.

The increased tax buoyancy could have resulted from a mix of: (1) tax policy changes, (2) structural economic changes, and (3) tax administration improvements. Before assessing the likely revenue impact of the latter, we briefly review the revenue impact that the former two factors could have had.

Tax Policy Effect

During the tax policy reform period with objectives and necessities not only to secure the increasing government revenue, to create certainty of law, to create transparency, but also to develop a taxation system that neutral, simple, stable, and more fair, The DGT's tax law has been passed by Parliament in 2007 for Law on General Provisions and Procedures (Law No. 28/2007) and in 2008 for Law on Income Tax (Law No. 36/2008)

Structural Economic Effect

Changes in Indonesia's economic structure were more significant since the economy was recovering from a major economic and financial crisis. This is likely to have affected tax collection through several channels. For corporate income tax, the Asian crisis is likely to have materially impacted revenue collection up to 2002 due to the slow winding down of loss carry forward provisions and of tax relief for the restructuring of businesses completed in the tax years 2000 to 2002. For personal income tax, the labor market strengthened significantly from its trough during the Asian crisis which impacted both the base (less unemployed individuals) and the salary of each worker. Hence, improved income tax buoyancy is expected. Similarly, VAT buoyancy should also be up due to a recovery in domestic consumption. The land and building taxes rely heavily on collections from mining resources and other natural resources rather than developed real estate. Due to

booming commodity prices over the reform period, improved tax elasticity is expected.

Tax Administration Effect

The DGT's tax administration reforms are estimated to have accounted for over half of the 1.2 percentage points of GDP increase in tax collection over the reform period. The evolution of the above compliance indicators confirms the results stemming from the analysis of VAT collection, namely that DGT's reforms improved overall tax compliance which led to a significant boost in tax buoyancy. Assuming that the impact of DGT reforms on revenue collection is the same for income tax and the VAT, then tax administration reform would account for 0.35 percentage points of GDP out of the 0.6 percentage points of GDP increase in income tax from 2001 to 2006. Combined with the revenue improvement in the VAT, the revenue generated by the DGT reforms would be over 0.6 percentage points of GDP. From this perspective, the contribution of the tax administration reforms to the overall fiscal adjustment effort during 2001 – 2006 was significant.

3.2. Impact on the Investment Climate

The tax administration reforms appear to be a necessary but not sufficient factor in improving the investment climate in Indonesia. Although tax administration has been, and continues to be, a major impediment to investment in Indonesia, taxpayers' satisfaction with the pilot DGT offices is very high. Reforms that achieved particularly good results, as perceived by large taxpayers, are the governance framework and the accelerated refunds. Reforms that remain incomplete include tax simplification and revisions to the tax administration laws. Those that are not functioning as originally intended include the DGT's the audit and appeals processes and the ministry of finance's internal investigation unit.

Improving the investment climate remains crucial to meeting Indonesia's poverty reduction and employment objectives. Since investors continue to view tax administration as a major obstacle to the business environment, the DGT will need to make further progress in this area. A judicious strategy would be for the DGT to extend nationally those investor-friendly reforms that have proven to work well at the pilot offices and to redouble efforts on those reforms that so far have fallen short of expectations.

4. LESSONS AND CONCLUSION

Since 2002, Indonesia's tax administration reforms have made significant contributions to the country's fiscal adjustment program and have also placed the DGT on a reform path that has continued through 2009. From this perspective, the reforms can be considered to have been successful in achieving their objectives. Yet despite the broadly positive results, it is nevertheless clear that some reforms have been implemented more fully than others and, in a number of important areas, much further progress is still needed. In this final section, the paper identifies the key success factors and major impediments to reform along with the main conclusions that may be drawn from Indonesia's experience in reforming tax administration within the context of a fiscal adjustment program.

4.1. Key Success Factors

Several factors have contributed significantly to the success of the tax administration reforms over the last several years. As the DGT continues to move forward with its reform agenda, it will be important to preserve these key success factors, which have included:

Direct linkages with the fiscal adjustment program

Strong pressure to increase revenue from non-oil and gas resources, coupled with the limited agenda for tax policy reform, focused the government's attention on tax administration reform as an integral element in its strategy for achieving fiscal sustainability. The linkage of the tax administration reforms to the government's high level policy objectives was crucial for ensuring that sufficient amounts of resources (political, budgetary and staffing) were made available to support the reform effort. It also made the reforms more consequential to DGT officials, who initially were not necessarily convinced of the reform program's benefits.

Strong political support

From the outset, the reforms received strong support from the Minister of Finance and other senior government officials. This support was manifested in a number of ways, both big and small. Most importantly, the Minister of Finance allocated adequate resources to the reforms, monitored developments to ensure that the reforms remained on track, and intervened in a timely manner to overcome obstacles. Less obviously, but equally important, the minister and other senior government officials made significant efforts at explaining the reforms to the media

and taxpayer population, encouraging the DGT staff to implement the reform agenda, and recognized and rewarded good performance. These efforts are continuing.

Appointment of capable staff to lead the reforms

Among the most important decisions that the authorities had taken at the beginning of the reform program was to appoint a capable group of DGT officials to lead the reforms. These staff was highly motivated, open to new approaches in tax administration, and possessed strong leadership skills. They worked long hours on designing and implementing the reforms while at the same time holding down their regular operational positions. Their dedicated efforts were truly impressive and provide yet another example of the close relationship that exists between efforts and results in tax administration reform.

Achievable targets to deliver early results

To avoid the DGT from becoming overwhelmed by a comprehensive reform program that exceeded its implementation capacity, the initial phase of reforms in 2002 was purposely restricted to a relatively small number of priority initiatives that the DGT could effectively manage. This approach allowed early successes to be registered, which built confidence within the DGT to take on increasingly more challenging reforms. In this way, the modestly ambitious reforms that commenced in 2002 catalyzed commitment and enthusiasm for the more ambitious reform program that was to follow.

Phased implementation

Wherever possible, new initiatives were tested at one or more pilot sites before being rolled out nationally. For example, new organizational structures, human resource management policies, and IT initiatives were first piloted in the Large Taxpayer Office. This approach facilitated better control and monitoring during the implementation stages and allowed teething problems to be dealt with more expediently. Once the success of these initiatives had been confirmed, including through feedback from taxpayers, the reforms were duplicated at the medium taxpayer office and are now being extended to at all small taxpayer offices as an integral part of the DGT's modernization strategy.

Private sector stakeholders' involvement

From time to time, the DGT met with representatives of the business community to update them on progress with the tax administration reforms and to solicit feedback on proposals. The DGT also made great effort to invite business representatives to significant events, such as new office openings offices or new initiative launches. Apart from providing valuable feedback that assisted in the design and implementation of modernization initiatives, involving the private sector business community also secured its support for the reforms, which had further positive impacts on the political support for the project.

Appropriate use of policy conditionality and technical assistance

The policy conditionality that accompanied the financial assistance from international agencies helped to catalyze Indonesia's tax administration reforms. Similarly, the Indonesian authorities made excellent use of technical assistance from these agencies at each stage in the reform process. When combined with strong political commitment for reform by governments, the experience from Indonesia shows that policy conditionality and technical assistance can play an important role in advancing tax administration reform.

4.2. Major Impediments

In addition to factors that helped the tax administration reforms succeed, there were also a number of constraints that have impeded the reform effort over the years. The success of the reforms going forward depends critically on the steps that the Indonesian authorities take to ease these constraints, which include:

Political constraint

Despite strong political support for the reforms from some key officials, there were a number of critical areas where interests at both the executive and administrative levels within government, as well as powerful interests outside government, were not always aligned with the reforms and inhibited, at times, the implementation of some key initiatives. This was particularly the case with the efforts at overhauling the DGT's audit program, which to date have produced few results despite being crucial to the tax administration reform strategy. Similarly, the initiative to register additional numbers of high income taxpayers was hindered by the refusal of many third parties, such as professional associations, to provide details about their members to the DGT. When faced with this situation, the DGT itself was reluctant

to adopt a firm stance, instead opting to seek legal clarification that was rarely decisive.

Legal and procedural constraint

Legal constraints sometimes obstructed progress on the implementation of reforms. Some reforms required legislative amendment, which inevitably caused long delays. Other delays resulted from the requirement for the DGT to issue a formal decree, signed by the Director General, to effect changes in instructions regarding operational methods and procedures. For example, the introduction of the “*gold card scheme*”, which was designed to speed up the VAT refund process, not only required decrees for operational instructions, but also required each taxpayer to be named in a decree as being awarded gold card status. The extensive requirement for issuing DGT decree and the lack of managerial empowerment severely restricted the pace at which detailed operational matters could be reformed.

Organizational constraint

Operational pressures meant that most key players responsible for designing the reforms were also expected to continue carrying out their regular operational duties, which made it difficult to maintain enthusiasm for the reform program over a prolonged period. From this perspective, a more productive arrangement may have been to create a full-time modernization team and to relieve the staff assigned to this team from other responsibilities. Similarly, the DGT’s policy of mandatory rotation of staff and managers every two years – though largely an anti corruption measure – greatly impedes the development of expertise as managers are frequently rotated into areas in which they have little or no experience. Finally, the reform effort was further complicated by fragmented implementation responsibilities at headquarters: for example, despite the establishment of a dedicated headquarters team to improve compliance with tax filing obligations, little progress was achieved on this initiative because critical elements were also required to be performed by other departments at headquarters.

Measurement and incentive constraint

Traditionally, the DGT had relied on the annual revenue collection target as the main measure for judging and rewarding the performance of its regional and district directors. This reliance on a narrow measure of performance, however, created perverse incentives for all sorts of inappropriate practices – including arbitrary audit

assessments and delaying the processing of refunds – in order to achieve by the revenue generation program – which established targets for each of the DGT's enforcement programs – demonstrates that substantial gains in tax administration can be realized by setting meaningful and reasonably ambitious performance measures, and holding staff accountable for their achievement.

4.3. Conclusions

Several conclusions may be drawn from the Indonesia's experience in reforming tax administration. Some conclusions reaffirm lessons learned from tax administration reform in other countries, while other conclusions offer new insights. These include:

- ◆ Since 2002, Indonesia's tax administration reforms have been successful in advancing the country's fiscal adjustment program. The tax administration reforms had a strong, positive impact on the tax yield and a positive, though difficult to quantify, effect on the investment climate.
- ◆ Linking tax administration reform to a government's wider fiscal adjustment program can both assist fiscal adjustment and improve tax administration. Given the gestation period for designing and implementing tax administration reforms, the sooner such reforms can be incorporated into an adjustment program the better.
- ◆ Tax administration reform can help increase the tax yield by raising additional amounts of enforced and voluntary tax collections. Programming these gains should be based on a coherent framework with realistic estimates for increasing collections that are linked to concrete administrative measures for bringing about the targeted increases.
- ◆ In the short-term, enforced collections may provide a substantial source of additional tax revenue. However, because these collections typically account for a relatively small share of tax revenue, very high growth rates are required to have an appreciable impact on the tax yield. The Indonesian experience demonstrates the practical difficulties of achieving high growth rates in enforced collections year after year.
- ◆ Over the medium-term, increasing voluntary collections (by raising taxpayers' compliance rates) is the key way that tax administration can help sustain and expand the tax yield. Therefore, tax agencies should be encouraged to

measure tax compliance, identify reasons for non compliance, and develop appropriate compliance – enhancing strategies.

- ◆ Tax administration reform can be a necessary (but not a sufficient) condition for improving a country's investment climate. A tax agency can help boost the investment climate through measures that lower compliance costs faced by taxpayers and promote integrity among tax officers. Indonesia achieved promising, initial results by piloting the careful vetting of tax officers, providing sufficiently high salaries, establishing clear standards of conduct that were effectively communicated to taxpayers and tax offices, and accelerating the processing of tax refunds.
- ◆ The good results that have been achieved in improving Indonesia's tax administration were due, in part, to a reform strategy that focused initially on a few key initiatives. This approach allowed early successes to be registered in the short-term and helped build confidence within the DGT to take on increasingly more challenging reforms over the medium-term.
- ◆ Strong political commitment was critical to the success of Indonesia's tax administration reforms. This commitment was most evidenced by the government's willingness to place tax administration reform high on its reform agenda, allocate resources (staff, budgetary, and technical assistance) to support the reforms, and appoint capable staff to lead the reform effort.
- ◆ Technical assistance and policy conditionality can play an important role in helping tax agencies to design and implement reform programs. However, ownership of the reform process by a country's tax agency is indispensable for sustaining the reforms over time.
- ◆ There remains ample scope for Indonesia to increase the tax yield and stimulate the investment climate through further improvements in tax administration. In this regard, the strategic plan that the DGT's new management formulated in 2006 provides a sound basis for strengthening revenue collection and promoting fiscal adjustment over the coming years. These preliminary 2009 tax collection estimates vindicate these reform efforts.



Taxation and Economic Development

***Directorate General of Taxes
Republic of Indonesia***

Outline



- ❖ Administrative Tax Reform
- ❖ Policy Reform
 - Law on General Provisions and Procedures
 - Law on Income Tax
 - + Objective and Necessities of New Law
 - + Significant Changes Toward Competitive Tax Scheme
- ❖ International Issues

ADMINISTRATIVE TAX REFORM



Areas Being Reformed

- Organizational Structure
- Business Process with the Utilization of Information and Communication Technology
- Human Resources Management



To support Good Governance

REFORM in Organizational Structure



CONCEPT :

- Debureaucratization
- Taxpayer Segmentation based on size
- Functional-Based Organizational Structure
- Customer Oriented – Account Representative (Consultation and Compliance Monitoring)
- Tax Audit and Objection are strictly separated
- New function of Internal Audit and Change Program

IMPLEMENTATION :

- Establishment Of Large Taxpayers Office (LTO), Medium Taxpayers Office (MTO), and Small Taxpayers Office (STO) , High Wealth Individual Taxpayers Office (HWI)
 - Restructuring Of Headquarter
 - Piloting Data Processing Center (DPC)
-

Improvement in Business Process



CONCEPT :

- Information and Communication Technology oriented
- Simple and Easy to understand
- Cost Effective
- Built-in Control

IMPLEMENTATION :

- e-Filing, e-Payment
 - IT System (SIDJP) Improvement :
 - Taxpayer accounting
 - Tax Forms Improvement and Simplification
 - Improvement in SOPs and Reporting System
-

Policy Reform



- Law on General Provisions and Procedures (Law No. 28/2007)
- Law on Income Tax (Law No. 36/2008)

Law on General Provisions and Procedures (Law No. 28/2007)



IMPORTANT CHANGES:

- Shorter statute of limitation from 10 years to 5 years
- Revising criteria for refund tax audit
- Omitting payment obligation in dispute case
- Clarity on taxpayer right and obligation

Law on Income Tax (Law No. 36/2008)



OBJECTIVES AND NECESSITIES

- to secure the increasing government revenue
 - to develop a taxation system that :
 - neutral,
 - simple,
 - stable,
 - and more fair
 - to create certainty of law
 - to create transparency
-

SIGNIFICANT CHANGES



Taxable Income:

Included:

- ascertain about farm in-farm out
- income from sharia business;
- surplus of Bank of Indonesia (Bank Central);
- interest on bonds received or accrued by an investment fund company;

Not Included:

- Zakat and compulsory religious donation;
 - requirement to have a business active for taxpayers that receive inter-corporate dividend is deleted;
 - scholarships;
 - a surplus of education non-profit organization;
 - distribution of profit received or accrued by a member of a limited partnership;
-

SIGNIFICANT CHANGES



Deductible expenses included:

- scholarships, apprenticeships and training expenses;
- donation for national disaster; for research and development; for sport enhancement; and in the form of education facilities
- costs of social infrastructure development;

SIGNIFICANT CHANGES



Tax Rate and Personal allowance

- Corporate Income Tax rate that previously consists of three 3 layer (10%, 15%, and 30%) become flat tax rate 28% in 2009 and to 25% starting tax year 2010.
- Reduction 5% for the highest individual tax rate (35% to 30%), remove the tax rate layer (10%), and expand a layer of income bracket of Rp 200 million to Rp 500 million.
- Individual income tax rates are as follows:

Taxable Income Tax Brackets	Tax Rate
Rp 50.000.000,00 or less	5%
Rp 50.000.000,00 - Rp 250.000.000,00	15%
Rp 250.000.000,00 - Rp 500.000.000,00	25%
Over Rp 500.000.000,00	30%

SIGNIFICANT CHANGES



Tax Rate and Personal allowance

- The amount of personal allowance is as follows:

Rp15.840.000	for an individual Taxpayer
additional Rp1.320.000	for a married Taxpayer;
additional Rp15.840.000	for married Taxpayers' spouse (in a joint tax return);
additional Rp1.320.000	for each dependent family member with a maximum of three dependents

SIGNIFICANT CHANGES



Incentives

- 10% tax on dividend received by individual resident tax payer
 - 5% reduction of corporate income tax for listed resident company with certain requirement
 - SME enterprises (gross income until Rp 50.000.000.000) receives reduction of the rate by 50% from general rate
 - Debt redemption for small debtor is excluded from taxable object
(Debt up to Rp. 100 million for micro-credit and up to 5 million for other debtors)
-

INTERNATIONAL ISSUES

Anti Tax Avoiding Rule



- A taxpayer who purchase shares or other assets through the a special purpose company can be deemed as the real party to the transaction (not SPV transaction);
 - The sale or transfer of shares of a special purpose company in tax haven countries that have an affiliation with an entity in Indonesia, could be deemed as the sale or transfer of shares of an entity;
 - Income received by the employee in other country related to services in Indonesia shall be deem as Indonesia source of Income and taxable in Indonesia.
-

INTERNATIONAL ISSUES

TRANSFER PRICING



- Process rules for Transfer Pricing based on International best practice
 - Process Advance Pricing Agreement
-

INTERNATIONAL ISSUES



Treaty Policy

- G-20 Issues
 - Exchange of Information
 - Tax Haven Country List
 - Transparency
 - Bank Secrecy
 - Mutual Agreement Procedure
 - Tax Information Exchange Agreement
-



***THANK
YOU***

Iran

The Effects of Tax Policies on the Economic Growth

Islamic republic of Iran

Alireza Tarahomi Harandi

Abstract

This paper analyses the effects of tax policies on the economic growth of Iran. Specifically following hypothesis will be evaluated:

“In the short-run, tax policies have no effects on real gross domestic product, but may affect the gross domestic product in the long-run”.

Using system dynamic approach, it is tried to examine the relationship between all economic sectors and variables of financial sector in order to measure the effects of various policies on GDP.

The main results of this study indicate that in Iran in the short-run (less than three years), the effects of the tax policies on the real GDP is zero. But in the long-run (more than three years), its effects on GDP is negligible.

For example, in the long-run twenty percent decrease in tax, will have about 0.05% effect on the real GDP.

Moreover, according to many studies, the effect of monetary policies on the economic growth is little. Therefore, the monetary policies can not achieve the long-run objectives of the economic growth.

So, the fiscal policies should be targeted. In order to achieve the long-run economic growth, the appropriate tax policies can be considered as the best way to encourage private sector to invest in the economy.



The Effect of Tax Policies On The Economic Growth

**Islamic Republic of Iran
Iranian National Tax Administration**

October 2009

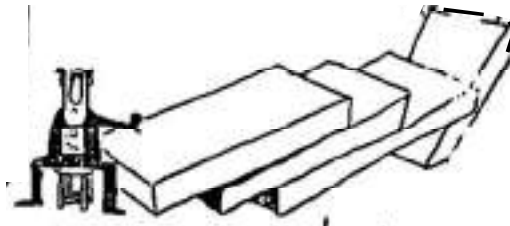
How tax policy affects on economic growth?

Indigenous economic growth models:

$$\hat{Y}_i = \hat{\alpha} k_i + \hat{\beta} m_i + \mu_i$$

Y: the product of an economy which known as GDP,
K: amount and efficiency of capital and
M: the amount and skill of labor force.

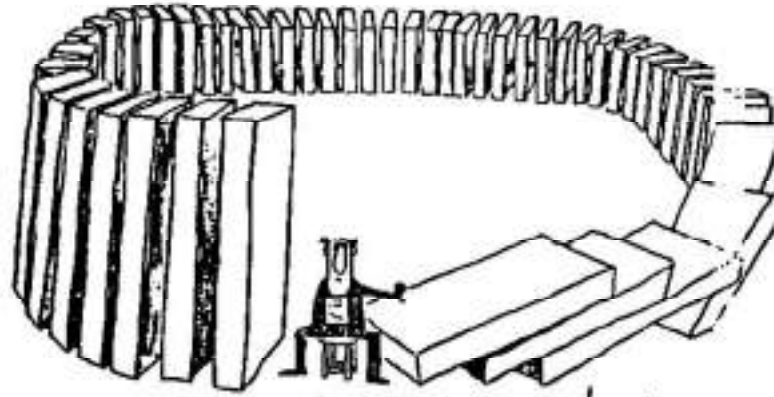
The policy makers of the economy may achieve results different from what they expected, by implementing policies, without regarding the economic systems with a macro view.



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But if we look at the whole system, the result of this work can be seen.



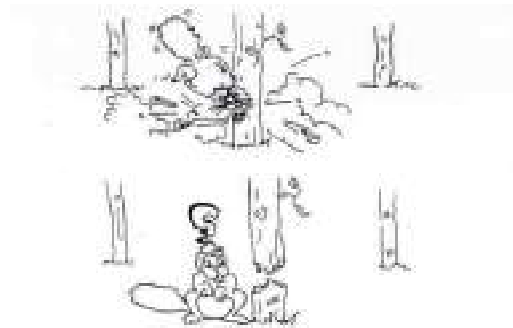
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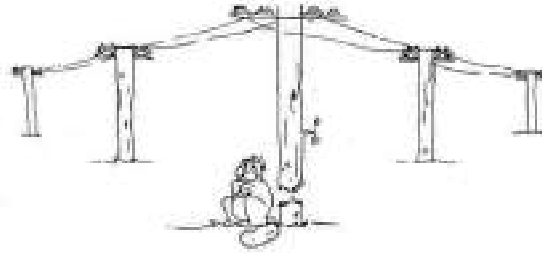
Understanding the whole system is the pre requisite to solve any problem. The appropriate result may not be achieved if the relationship between the elements of the system is not clear for the policy makers.



Why in the most cases the results of the policy making and the actions are not as our expectations?



Before adopting the appropriate policy, the results can be well predicted, if the elements and the different sections of the system can be clearly illustrated.

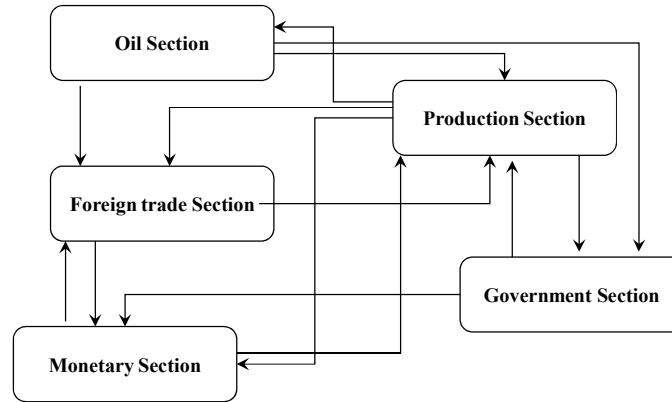


The Era of the Systems Knowledge

“The concept of the system has been increasingly recognized as a scientific view towards the world since 40’s. Therefore the era of the systems began. Although concept is not a new one, its organizing role is new.

Ludwig von Bertalanfi

Using system dynamic approach to understanding of the elements of the system and the relationship among its factors:



In order to show the relationship between the variables in the system dynamic approach, the following figures are used:

a) Stocks

In the dynamic modeling, the stock is a structure for restoring something which potentially can influence the other elements of the system.

The first type of variables are usually shown by the symbol (□)

b) Flows

In the dynamic modeling, the flows consists of activities, which lead to changes of the size of stocks during the time. The flows are divided into inflows and outflows.

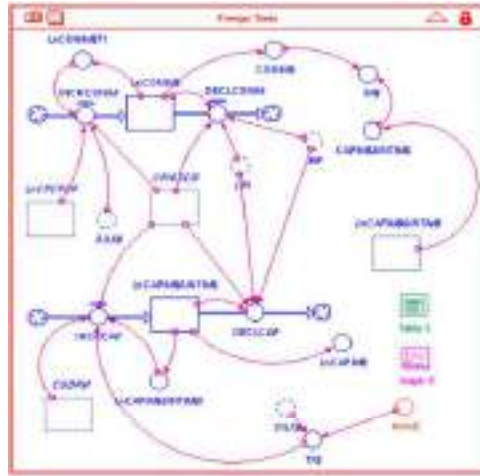
These variables are usually shown by the symbol ($\overline{\circ}$)

c) The converters of the system

The converters are variables which may play different roles. Their most important functions in the system models is to determine a rate, at which the flows changed. In fact the size of inflow and outflow tap which flows on the structure will be modeled using this structure.

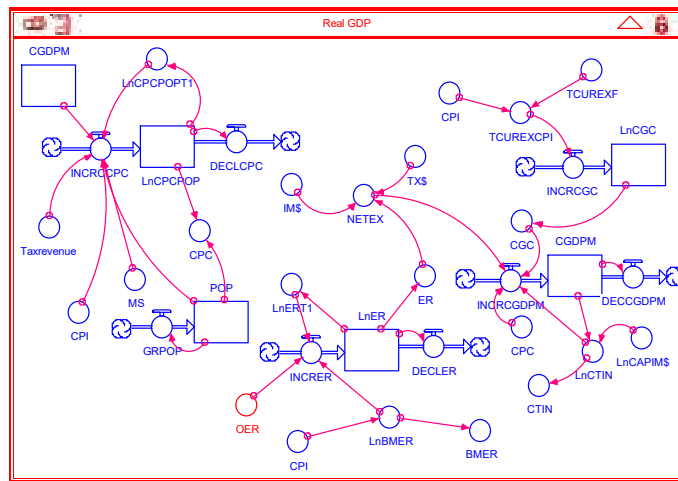
These variables are usually shown by the symbol (\circ)

the Foreign Trade Section and the relationship between its elements



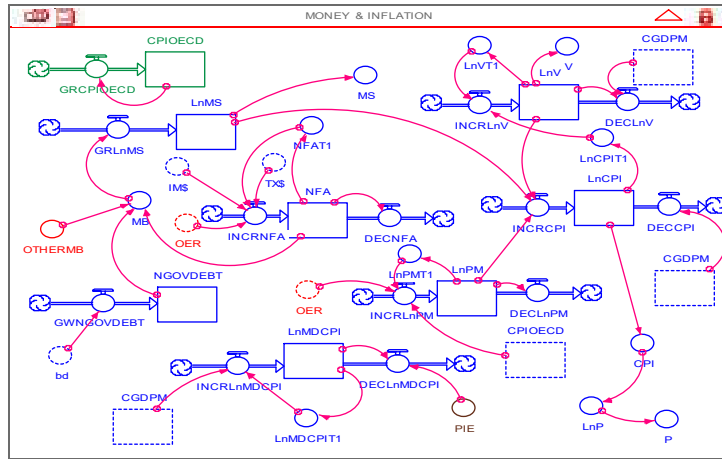
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The relationship between GDP Section elements



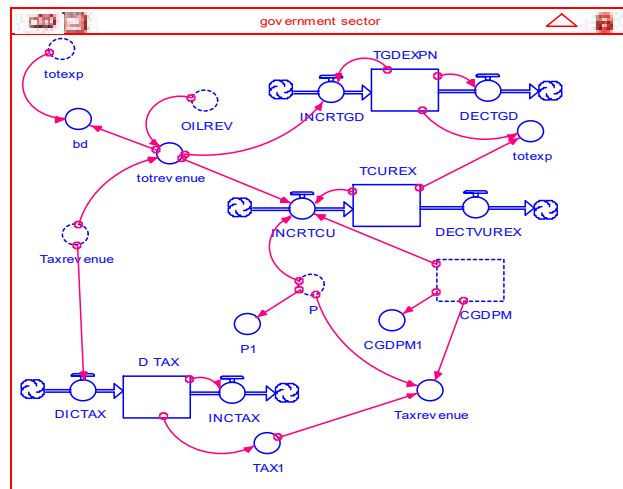
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The Monetary Section and the relationship between its elements



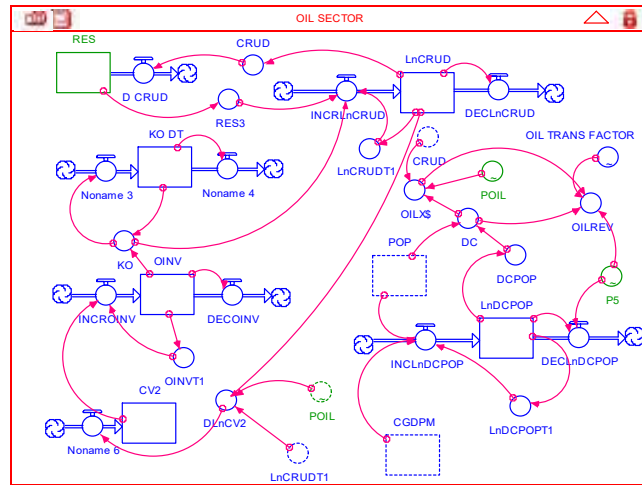
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The Government Section and the relationship between its elements



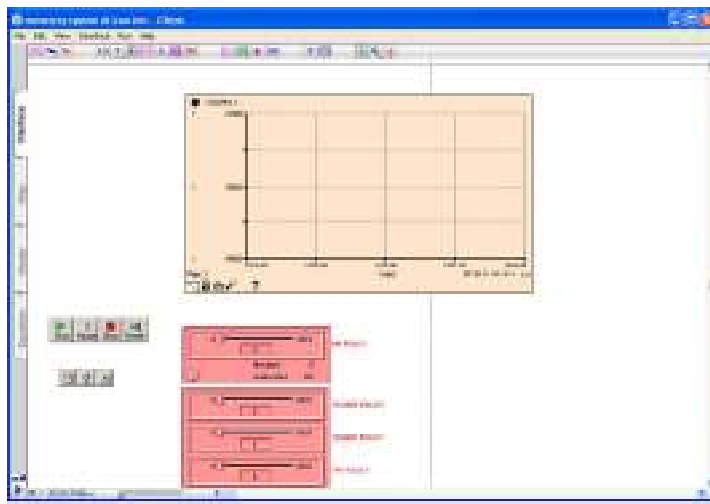
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The Oil Section and the relationship between its elements



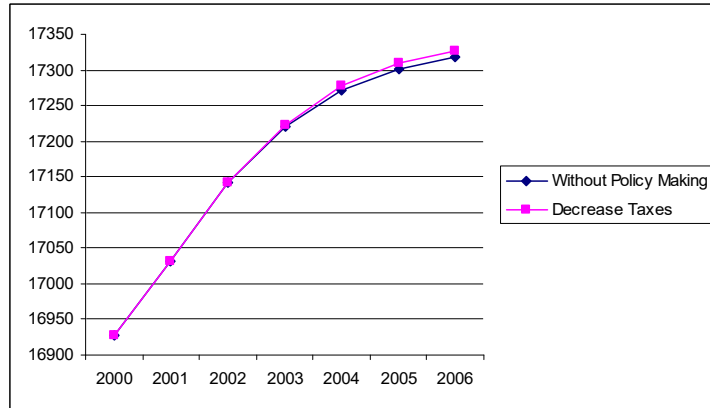
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using statistical methods, after illustrating different sections of the system of the economy of Iran and the relationship between its elements, the effects of the variables on each other will be specified and the credit of the model will be tested. Then appropriate needed tools for policy making will be designed to analyze the tax reduction policy.



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Therefore, the whole system can be implemented without enforcing the policy. The trend of GDP growth can be seen in the graph and then the effect of the adopted policy on the GDP will be analyzed.



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Therefore, following a reduction of 20% in tax, the GDP will be changed accordingly (following table)

Percentage Change After Implementing the Policy	20% Reduction in Tax (in billion RI)	Without Policy Making (in billion RI)	Year
	GDP2	GDP	
0.00	16928	16928	2000
0.00	17031	17031	2001
0.00	17142	17142	2002
0.01	17223	17221	2003
0.03	17277	17271	2004
0.05	17309	17301	2005
0.05	17327	17319	2006

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In Iran in the short-run (less than three years) the effects of the tax policies on the real GDP is zero. But in long-run (more than three years), its effects on GDP is negligible.

In order to achieve the long-run economic growth, the appropriate tax policies can be considered as the best way to encourage private sector to invest In the economy.

Some article of direct taxes act that encourage private sector to invest in Iran economy

Article 92:

50% of salary tax of employees working in less developed regions, as per the list prepared by the state organization of management and planning, shall be spared.

Article 132:

80% of the income from producing and mining activities, which is derived and declared by producing and mining enterprises of cooperative or private sector for whom exploitation licenses are issued, or with whom extraction and sale contracts are concluded, from the beginning of the year 1381 onwards by relevant ministries, shall be exempt from the tax set forth in the article 105 here of for a term of 4 years beginning from the date of exploitation or extraction. As regards the less developed regions, the exemption shall apply to 100% of the income for a term of 10 years

Article 133:

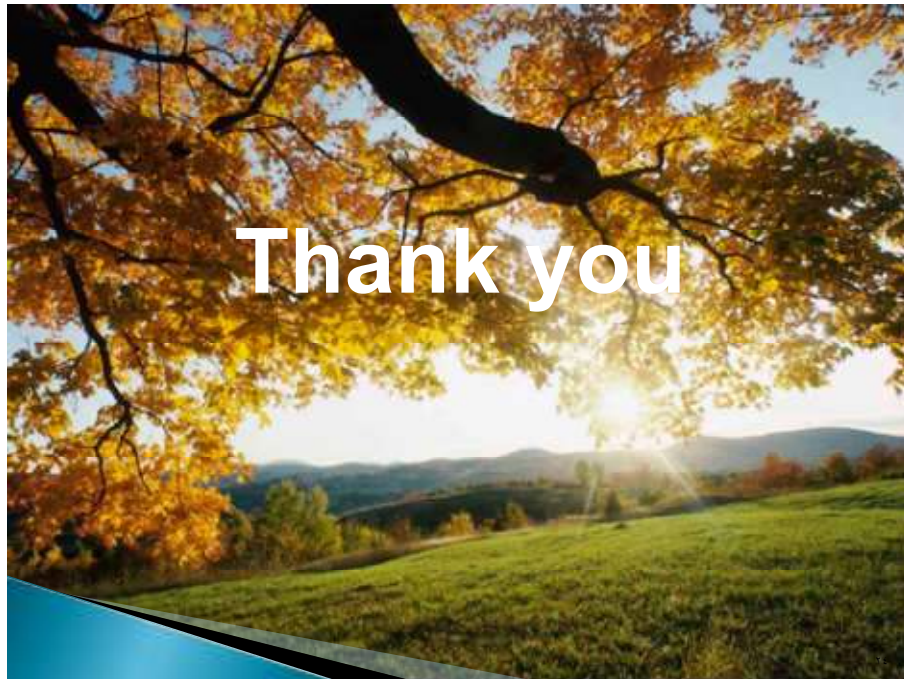
100% of the income derived by rural, tribal, agricultural, fishermen, workers, employees, students and pupils cooperative societies and their unions shall be exempt from taxation

Continue

Article 138:

any part of the declared profit of private and cooperative companies that is used in the same year for development, reconstruction, renovation or completion of existing industrial or mining units of those companies, or for setting up of new industrial or mining units, shall be exempt from 50% of the applicable tax set forth in the article 105 of this Act.

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Jordan

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Summary of the Study

The main objective sought by the study is to demonstrate the importance of the role played by income and sales tax in Jordan in the field of economic development and its impact on investment in Jordan, as well as the nature of fiscal policy in Jordan and the extent of participation in the formulation of plans and programs of economic development, in addition to impeding the realization of more achievements on the level of overall development.

The showing of the great importance of incentives, exemptions and tax legislation to stimulate domestic and foreign investment enables a state to use taxes to build effective strategies in creating an optimal investment environment, particularly through direct access to the views of investors and their needs, and therefore draw policy to attract such investment and guidance in service plans and economic development programs.

The results of the study showed the important role of the income and sales tax Department policy and the success in attracting investments, whether domestic or foreign, which turns out to have a great impact on the investment decision for an investor, which means that this person should be given much attention in the policies that adapted by competent authorities in the field of motivation and polarization and the rival model in the region to attract domestic and foreign investment.

Has been shown through studies and analysis conducted by the income and sales tax department and through the competent directorates to explore the views of internal and external partners (taxpayers), in its desire to provide the best possible service to get the best satisfaction possible, all studies have indicated that the tax incentives provided by tax departments are determined the options of the investor primarily in identification his investment and are therefore of great importance for tax policy in Jordan. The new tax policy in the Income and Sales Tax Department seeks to find a new development strategy .

plans to adopt a new discipline, realize the objectives efficiently and effectively, so that the work within the triangle of growth, development and prosperity, and break the cycle of frustration and dependency and underdevelopment, and thus work with other state institutions in translation the direction of the country's Supreme Commander in making

Jordan a model economic developmental model in the region and the world and serve the overall economic development programs.

Introduction

This study addresses the issue that was most urgently needed and most effective in influencing economic development, which has plans and programs of national economic development as well as a valuable tax policy reforms in Jordan and placed on top of its priorities, namely, the theme of economic development, in light of the recent transformation of the world has witnessed during the last decade of the last century, it became necessary for countries, especially the small ones to draw a new national vision in various areas, which achieves its national goals and go beyond the obstacles and overcome challenges that have arisen with modern concepts and institutions, such as globalization and the World Trade Organization and others.

The tax administration is a fundamental pillar in building the national economy and it is the main engine and without it can not be achieving satisfactory growth rates in gross domestic product.

The construction of an integrated visualization of the nature of the challenges facing the tax administration and economic management and demonstrates the opportunity, and work to develop a scientific view on the relationship between income tax and sales and opportunities for economic management to view and diagnose the challenges facing the local economy, and the formulation of a national strategy that enables the economic management to discharge its duties, is deemed to be the most important challenge to stabilize the national economy, to get out with a vision of scientific strategy and an integrated process emphasizes the importance of economic management as an essential component of the components of our national economy, and its association with political and social stability and security in the State and society, and to maintain the social fabric for the welfare of the citizens.

This is therefore a strategic vision aimed mainly to achieve economic and social development, and helps activate the relations of the local economy with the Arab world and globally.

Strategic vision seeks to protect the homeland, from which may arise as a result of the challenges of attracting foreign investments, which are usually distinct from the local ones by technical competence and the large capital investment, through the mechanisms and tools available that are in line with agreements that the developing countries participate in.

The economies of developing countries facing a state of underdevelopment and economic stagnation, which varies from country to country depending on the circumstances and possibilities and the diversity of sources of funding, scarce resources and limits, it does not have a fixed or specific sources of funding as it is totally dependent on external influences, either positively or negatively (Kalbouna 1999) .

And therefore efforts should be directed towards the promotion of the new approach to fiscal and economic philosophy that has consistently stressed the importance of liberalization of the economy and market constraints and other obstacles and develop new sources of revenue to fill the different gaps in the process of economic development, and strengthening the capacity to attract capital to domestic economic management, the removal of economic constraints and procedural requirements for the establishment and administration of projects, and improving programs to overcome obstacles and move towards achieving the goals set according to economic plans.

Within this approach, the income and sales tax is seriously striving to create a work environment in order to improve and promote economic governance at the local and foreign levels.

And makes great efforts to find appropriate economic climate and a constant search for attractions through the development of many advantages and are able to compete with international standards.

The study of tax administration in Jordan will need a lot of attention, given that economic studies can not be taken as a science stand-alone, because of the close link between them and the taxes and other sciences, where we find that closely related to the economics science and financial management and other various financial science,

the economic management is considered to be one of the main tools that guide political and economic life in all countries. (Maharme, 2009)

Jordan has the potential and opportunities to attract more foreign investments, as well as it could switch to an ideal model in the region by creating a climate for economic management of competition and be a destination for Arab and foreign investments, if strategic plans and programs and sound economic have been adopted and activated by the tax administration capable of achieving the set objectives.

FIRST: The general features of the tax system in Jordan.

Tax in Jordan plays an important role in the national economy as it is one of pillars of the financial policy of the State which are used in guiding and controlling the economy, and the importance of taxes can be summarized as follows:

First: the abundance of revenue: one of the oldest and most important goals as this stands as the target of the source of funding for the expenses of the state's repeated and non-recurrent.

With the expansion of the Jordanian society, growth and the increasing need for many of the projects available to it by the state so-called public goods, such as defense, security, education, health and other projects, hence highlighting the role of taxation as a means of financing those expenditures, the greater the financial burden on the State the need for taxes arises, either through an increase of tax rates or expansion of tax base.

Secondly: a means for the stability of price levels.

Tax is one important means to achieve stability in the price level, if the economy is operating at full employment with rising demand, it will inevitably lead to higher levels of prices and hence inflation in prices and here the State intervenes to impose or increase taxes.

One of the most fundamental goals of imposing tax in Jordan is to transfer control of economic resources in the community from one category to another fairly, and just supposed to be transferred in ways that lead to less economic and social damage, but is also expected that these methods lead to the activation of access process to the various economic goals, the transfer process includes the following:

1. The transfer of purchasing power between private sector groups.

2. Transfer of control of resources between the key economic sectors.

And the importance of taxes as a funding and correcting tool patch from the obligatory nature (Compulsory Nature) that characterize it, the search for standards that judge the strength of the tax system and effectiveness has taken great importance, the process of developing these standards has been associated with

(The Theory of Economic Welfare) and the focus of the world's advanced economies is to achieve some goals that are the degree of achieving them is related to the degree of matching with the degree of the tax system (in those countries) with the standards used to judge the effectiveness and ability to help the economy to reach the optimum level of economic well-being desired, These objectives are as follows:

1. Corresponds to the upper limit of freedom of choice with the welfare of others.
2. Be achieved optimum levels of living with the resources and technologies available and in the light of the preferences of consumers and owners of productive factors.
3. Achieve an acceptable level of income distribution in the community.
4. Achieve full employment and economic growth.
5. Re-distribution of wealth among various economic sectors.
6. Distribution of the tax burden efficiently.

The organizers of the tax system of Jordan reached to the above criteria through which could judge the tax system and its effectiveness and its ability to achieve the set objectives to reach the optimal level of welfare, taxes have a number of neutral effects and of different ways, it may affect the preferences of individuals or production methods or the relatively desire between both work and leisure or consumption and savings.

This has been a national strategies and targets program of work going strongly towards the modernization and reformulation of the tax laws to conform to the curriculum and the new philosophy of income and sales tax in advancing economic development and attract investment and promote the well-being.

SECOND: The most important tax policies in Jordan related to economic development.

First: The tax policy is the most important components of financial policy, and where the goals are the most important frameworks that determine which policy and it is the economic expression of the aspirations of this policy, the objectives of tax policy in Jordan is to supplement the public treasury revenue necessary to finance public expenditure and to support economic development programs of the government and encourage savings and investment and positive impact on consumption and price stability, as well as achieving social justice and equality by contributing to the redistribution of incomes.

Fiscal policy in Jordan requires, emphasizing the balance between the tax authority and rights OF Taxpayers, which requires the Tax Department to provide tax services and the promotion of voluntary response to the payers, as well as the harmonization of the tax system and national development objectives, so the tax administration has begun setting its mission by translating them into procedural objectives and tasks into a specific action plan is the Department's work through direct contact with the investment activities and grant exemptions and facilities by type and location of investment activity.

Based on this concept, the Department achieved high growth rates in revenue during the past years that exceed economic growth rates, probably due to the following: --

1. Broadening the tax base by including targeted sectors were not committed to paying due taxes, such as collecting a flat tax from the transportation and import sector, and lowering the limit of sales tax registration to cover the largest possible number of registered.
2. Activation of the system information and investigation, which led to the reduction of tax evasion cases.
3. Introducing the principle of self-assessment boosted the confidence and credibility between the taxpayer and the department, and helped raise the level of voluntary

response, which led to a significant decline in the number of tax cases to the courts.

Finally, we find that the continuous development and improvement in tax legislation have helped create a better investment climate and contributed to greater transparency in dealing with taxpayers, which translates into strategies and programs pursued by the management of income and sales tax to development projects on the ground.

Second : an overview of developments in the tax systems:

Several amendments have been made to the Income Tax Act with a view to creating a favorable investment climate characterized by transparency and clarity while maintaining fiscal and monetary stability, and perhaps Jordan one of the first countries in the region, which introduced the concept of self-assessment, as part of the Provisional Law No. (34) for the year 1988. With regard to legislation on sales tax, Jordan has moved from the concept of tax levies and production to consumption tax and sales tax in its first phase in 1994, which included the importer, manufacturer, and sales tax in the second phase, which added the rest of the links of Commerce in 2001, and the legislative development of the sales tax always aimed to achieve equality and justice between taxpayers and to encourage investment and reduce the double taxation of all are in the comprehensive reform in the process of economic development and social development.

The aim of the Income and Sales Tax Department to supplement the state treasury with

income and to achieve the following: --

1. Manage the process of taxation and the verification and collection efficiency, effectiveness and follow-up actions related to it through the dissemination of knowledge culture.
2. Raise awareness of tax to the taxpayers, and introducing them to their rights and their duties.
3. Reduction of tax evasion.
4. Review, evaluate and update the tax policy in the area of income tax and general sales tax and VAT.

5. Create a tax efficient, effective and acts as a model to achieve targeted tax revenues and enhance the investment climate and provide optimum service to the citizens.
6. Raise the efficiency and effectiveness of the department to assess and collect a tax to achieve national objectives through the promotion of the philosophy of self-assessment and applying the method of sampling and to encourage voluntary response and awareness to address cases of tax evasion and to provide high quality services for citizens to achieve the best possible satisfaction through the application of Quality Assurance

THIRD: the most influential tax factors on economic development?

- Income and sales tax is an important and main resource to supplement the state treasury, and in economic terms is an important tool to guide the national economy, through the use of re-distribution of national income equitably among citizens, and to encourage investment in industrial and agricultural projects through the granting of exemptions and facilities for some of the projects that helps to increase GDP and increase employment opportunities and increasing the State's capacity to export and reducing import, also aims to encourage investment inflows and attract capital, whether foreign or domestic to invest in the Kingdom through the granting of exemptions and facilitating procedures and the enactment of appropriate legislation to attract these investments.
- Socially they contribute to the eradication of inequality through the redistribution of wealth as it is progressive in nature, characterized by its fairness because it is imposed on the basis of ability to pay represented by income.
- The economic development has a community dimension at the level of the developed world and developing both as a target sought by all countries by working to maintain appropriate levels of development so that all of society in the long run full employment without inflation or deflation .

As for developing countries, the objective of development is to increase the rates of growth in real national income ... Namely, to reduce unemployment and improve the citizen and their hopes for a dignified life in accordance with the standards of health, education and social and all that makes him a good person contributing to the progress of their homeland.

The development is one of the noble goals of building a better world serving the suffering humanity and it is thus must be a cultural change deals with components of the society as a whole to the extent that addresses the causes of poverty, and guarantee the right of the needy in the resources available in society and to provide social guarantees for them ... And providing health care if the illness..... And so on.

Most notably involved in the development process is a radical change in society by serving the causes of underdevelopment, and the doing of this change in the structure of society at all levels of economic and social development is the common denominator of all economic development experiences.

- The strategic vision of the Income and Sales Tax Department seeks to protect the homeland, from which may arise as a result of the challenges of attracting foreign investments, which are usually distinct from domestic investment, with technical competence and the large capital investment, through the mechanisms and tools available that are in line with international conventions in which the Kingdom of Jordan participates.
- In general, Jordan suffers from the problem of evasion of investors from income and sales tax and it is one of the factors distorting the economic and social system, because of their bad results both in terms of reduced tax revenue and deprive the state of doing a lot of public expenditures, and breach of equitable distribution of tax burden as a result of impunity of Some taxpayers, or in terms of creating division among the groups in society and the elimination of national unity, and the expansion of loop evasion characterized by a proliferation of fraud and the weakening of morality. (Penguin, 2000)

FOURTH: How can increase the effectiveness of the tax system as a tool for economic development

First: It is known that the taxes at the present time include many types varying of importance and its economic, social effects, and most important of these types is income tax, which has its own set of objectives can be summarized as follows (Maharme, 2009)

1. Financial targets.

2. Economic targets.

3. Social objectives.

1: financial goals.

One of the most important and main reasons for the imposition of taxes, especially direct taxes including income tax is to get revenue, so the state can cover current and capital expenses, and the increasing of the State's need for this type of revenue increase state requirements to do what is required in order to carry out the duties of defense and the provision of education at all levels and provide health care and social services and all other advanced services to the society, as a result of increasing awareness among communities and a sense of the need not to provide these services only, but also develops and presents them to the best and in a manner commensurate with the development of civilization and technology in this day and age, so the service will be given to them by their state is similar in terms of quantity and efficiency of the rest of the civilized countries that became obvious to any citizen of any State as a result of progress of communications technology that enables it to know the extent of progress in the provision of public services by the civilized nations of the world.

2: Economic objectives:

Economic situation in any country in the world a strong indication of the importance of this country and its strength and its impact on the rest of the world, the more the country has flourished economically as led to independence in its political and socio-economic, it is known that any country that its economy is subjected to jolt or crisis and by the size of the economic crisis faced is affected its independence and its ability to make decisions as a result of pressure exerted by international organizations such as the IMF and World Bank.

Therefore, it appears the concept of intervention in economic activity through the imposition of tax on certain sectors and the exemption of certain sectors which the State is in their need to help energize the economy, growth and prosperity, and encourage investment in these sectors, by exempting the sector from the tax exemption permanently or for a limited period of time be in beginning of the production project, such exemption as the permanent exemption of income from agriculture in Jordan and the tax exemption of certain sectors of industry, tourism from tax for a specified period and the exemption of export tax entirely to give them the ability to compete abroad and to provide the State in hard currencies.

3: Social objectives:

The state aims from imposing tax also to improve the distribution of income, and deduct part of the high-income and provide this the form of services to other categories of low-income and thus trying to mitigate or reduce the material gap between the different classes of the people, also the state aims from imposing consumption taxes to reduce unjustified excessive consumption, a phenomenon that prevails most societies.

Second: The income tax law allows exemption of any income provided for exemption under any other law, such as:

1. Law of free zones: the income of economic activities (industrial / commercial / services) projects operating in free zones are exempt from income tax.
2. Investment Promotion Act: As the projects operating under the investment laws have exemption from income tax by (25%, 50%, 75%) as per the development area where the projects are working
3. Development Areas Law: the organizations that registered and operating in the development areas in any of the mentioned sectors are subject to the income tax rate (5%), the organization has the right of exemption from income tax for export profits under the resolutions of the Council of Minister as well as exemption from social services tax and distribution tax.
4. Law of Special Economic Zone of Aqaba : the institutions are registered and operating in any of the mentioned sectors to the income tax rate (5%) only with the exemption of capital gains, agricultural gains from tax and the distribution tax and social services tax.
5. Income Tax Act allowed to exempt any income exempted under the conventions which the government held with any other party or company (concession agreements or strategic projects ...) where a number of agreements held with building and operating and manage companies, and contain many exemptions like the company that carried out the airport project and the company implementing the Disi project (for water) and companies that implement projects of electricity or companies carrying out oil projects.

6. Income tax law Allowed benefiting the companies operating in any of the above sectors from the provisions of the avoidance of double taxation where the text provided for an exemption of any income covered by the conventions from the tax and not accounting for taxing the company in two states.
7. The Income Tax Law states to exempt the income of companies that do not-for-profit whatever the nature of their business as long as it is registered as a not-for-profit and is committed to the provisions of the law.
8. Income Tax Law gives the power to the Council of Ministers, to exempt export profits where profits of exports of goods and services exempt from income tax since 1994 and until the year 2015 under the resolutions of the Council of Ministers.
many of the industrial and service companies has benefited from the exemptions contained in these resolutions, including companies operating in the Qualified Industrial Zones (QIZ) as the majority of its manufacturing and exporting to foreign markets, especially the U.S. market.

Third : Encourage investment in the sales tax law

Incentives provided by the sales tax law to investors:

A. Mandatory Legislative incentives:

1. Exempt goods and services listed in the table No. (3) Of the annexed to the sales law.
2. Subject to a zero rate goods and services listed in the table No. (2) annexed to the Act and those contained in the text of Article (22) and (21) of the Act.
3. Postpone the payment of tax on imports, making it easier to provide liquidity for investors
4. Goods and services that are imported from outside the Kingdom for the existing projects in cities and regions and free markets are not subject to the sales tax.
5. Goods and services that are exported outside the Kingdom of the existing projects in urban areas and free markets are not subject to the general sales tax.

6. As export sales (goods and services) are subject to the sales tax rate of zero where they can take advantage of the refund process of the tax paid on inputs of the production of exported goods.

7. Refund of sales tax paid on inputs of production of goods and services within three months from the date of application encouraged to provide liquidity to the payers according to the provisions of the law, regulations and executive instructions for the process of tax refund.

B. permissive Incentives and exemptions:

The articles of the law give the Council of Ministers the power to exempt any commodity or service or a person upon the recommendation of the Minister of Finance, in 2008 many of the exemptions for goods or services were issued under this authority.

The following is a summary of the profiling and the role of the income and sales tax and their contribution to the income tax and local and state revenues as a whole and the gross national product at current prices:

Table (1)

exemption of exports from income and service tax for the period, 2006-2008

Year	value of export exemption	financial impact of income tax payable * 15%	annual collections / million	ratio of the financial impact to the collections
	Million	million		
2006	87	13	1.647	8%
2007	30	45	1.971	2%
2008	36	54	2.3	2%

total	117	176	5.498	12%
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Figure (1) exemption of exports from income tax and social services tax for the period, 2006-2008

Accordingly, it can explore the effectiveness of the tax system of Jordan and its big role in guiding the overall economy in Jordan by stimulating economic activities for export, as well as to attract domestic and foreign investment, and work on the redistribution of economic development on various parts of the Kingdom, by giving various tax incentives by geographic area of investment so as to give the provinces far from the capital largest exemptions and so on, so that we can achieve comprehensive development in the Kingdom, and achieve well-being of all in justice.

FIFTH: Jordan's strategy to overcome such problems "

The management of the income and sales tax developed ambitious goals for the next ten years aims to reduce levels of unemployment, and the development of the national economy. Given the current composition of the workforce and the limited resources available, the only way to achieve those goals is encouraging to attract local and foreign investment in the industry, business services of labor-intensive export-oriented.

Jordan, however, faces a strong regional and international competition in attracting investments. (Maharme, 2009)

Therefore, improving the capacity of income and sales tax competitiveness, forces them to work for access to the class "special" on the scale of the expectations of investors in the business environment, and service businesses.

During the past four years, Jordan records- because of the balanced performance of the Department of income and sales tax - relatively good achievements in the development of certain economic sectors with high growth potential, driven in part by external factors, and Jordan has taken several steps to improve the business environment, but these steps are only partially successful in promoting competitiveness of the economy and sectors to attract more investors, provision of an advanced investment environment depends on the ability of government to formulate, plan and implement economic and investment policies in consistent and coordinated manner.

Therefore, the core of deepening economic development aims to institutionalize the process of decision-making for all matters relating to investment, trade and development projects in Jordan. These all for Jordan to become among the best investment environment that provides an advanced and competitive.

It is thus clear that the impact of taxes on economic development depends largely on the way how the income revenue is spent, so tax revenues are directed towards the transfer payments to reduce economic growth, on the other hand, income oriented services produced, on the financing of public projects will neutralize the negative impact of taxes and be prompt and tonic for the process of economic growth.

The department is also working to re-evaluate ongoing and comprehensive review of regulations and tax legislation in line with the investment requirements and provide advanced model in the region in the area of taxation.

A contingency plan and a strategy was adopted to activate the collection, especially in light of the global financial crisis experienced by the whole world and its impact on the Kingdom in particular, in light of the size of the amount estimated in the budget law as revenue must be collected, the department drafted a contingency plan and a strategy to increase the availability and the revenue and to achieve the desired goal aims to raise the collection efficiency of the department, by increasing the tax compliance of the taxpayers and an emphasis on the voluntary commitment and raise the efficiency of assessment and audit and the search for new methods of collection in accordance with the provisions of the articles of the law.

The strategy includes the following:

First: consider the organizational structure of the Department: the restructuring of some directorates of the department and the establishment of specialized directorate for the management of tax compliance and the creation of a reference for collection process by the Department in the district through the abolition of the Directorate of collection and the establishment of the Directorate of specialized debt management and implementation of compulsory enforcement

Second: administrative procedures: The study of current procedures and review some of them for several purposes including:

1. Simplification of procedures starting from a filing of self-assessment return / declaration and reduce the audit assessment and collect taxes from taxpayers, and correlating the size of the collection with the size of the assessment, ending with notice to notify charge / claim to the taxpayers.
2. Shorten the assessment and audit and collect taxes from taxpayers, and correlating the size of the collection with the size assessment.
3. Increase tax compliance and reduce the debt to facilitate procedures as installment..... Etc...
4. Take advantage of the administrative decisions of the Council of Ministers decisions as exemption from fines.

Third: Assessment and Audit:

1. Horizontal expansion (new taxpayers) the department has worked to expand horizontally to access to the new taxpayers who are not committed to refer to the department according to the order of priorities.
2. Activation of managerial assessment (initial) for the purpose of raising the level of performance and achievement, decided to release groups of assessments in the directorates and offices of the department to work

in accordance with the plans and timetables for such kind of assessment to those who did not commit to providing self-assessment returns or declarations and conduct a comprehensive field survey by directorates and offices of the department in accordance with the plans and schedules follow-up on a weekly basis.
3. Activate the various means of collection in particular:
 - To continue the adoption of the commercial banks in the Kingdom for the purposes of receiving tax returns and payments due and the adoption of electronic payment, both based on the Internet or by electronic smart cards.
 - Establish a Division of solvency in each directorate of the department with a view to further study the solvency of the taxpayers whom the department has due debts from them (defaulters) in terms of ownership of the funds of movable and immovable and coordination with ministries and official

departments to get on the letters that prove their ownership of these funds and update data related to them first hand.

SEXETH: What are the difficulties face the tax system in Jordan:

The importance of studying the difficulties faced by the tax system in Jordan, comes mainly from the vital role occupied by local revenue in the state budget in this country, which its economy, suffers from a chronic shortage and continuing in fiscal balances internal and external, and that can not be met by relying solely on domestic resources, which also increased the debt burdens of internal and external, and therefore there is urgent need to search for new methods of financing to become the starting point and framework for economic development.

Jordan is suffering from economic problems in the business sector at the moment and also the serious problem of poverty and unemployment, and therefore the only approach to address these problems is to stimulate economic growth and encouraging domestic and foreign investment.

The most prominent problems and challenges facing the Jordanian economy is a serious trade imbalance, as well as the negative impacts caused by the global financial crisis which has affected the modern world economy at the beginning of September 2008, as well as its implications for the region and on the Jordanian economy, add to that the challenge of fluctuating oil prices, and negative impacts of some trade agreements, and weak competitiveness of the economy of Jordan, and the small size of the domestic market and the weak capacity of legislation and laws on the development of Jordanian businesses, which means placing the burden of improving the competitive environment on amending the legislation relating to investment, in particular income and sales tax law.

The economic policies that have been applied in Jordan over the past years did not achieve its objectives for the reduction of poverty and unemployment, as the poverty and unemployment rates continue to be high compared with many surrounding countries and small economies that are similar to the Jordanian economy.

Jordan has realized the importance of investment and its important role in economic development, official statistics showed that investment projects benefiting from the Investment Promotion Law amounted to over three years (2006, 2007, and 2005) about \$ 7 billion in various economic sectors. (Jerusalem Center for Studies, 2008)

Also, the importance of attracting investment to Jordan, especially foreign ones comes in light of the efforts of the Jordanian state represented by its institutions of economic, to meet the economic challenges of maintaining a satisfactory rate of economic growth, as well as reduce the deficit in the trade balance and the general budget, in addition to creating more employment opportunities, which requires increased investments with high added value in the priority sectors, and work to combat the phenomenon of tax evasion and increase voluntary compliance among the citizens and the increase in taxes to meet the requirements of economic development.

SEVENTH : tax incentives are an effective mean to promote a climate of domestic and foreign investment as the experience of Jordan.

Tax incentives have a great impact in attracting domestic and foreign investment and there is a large role for income and sales tax in investment promotion and management of economic life in Jordan ,and can review, the following results: (Maharme, 2009)

1. That the services tax (income and sales) came in first place in achieving importance for investors, where the importance of income and sales services amounted to 89.6%, according to the results of coefficient alpha Kronbach of the paragraphs of variables, procedures and incentives of tax legislation (income and sales).

Consequently, we attached great importance to the investment decision-makers of the tax services they receive directly and substantially, and this type of service is a strategic dimension in the investment decision to take a decision to invest or reinvest. (Maharme, 2009)

2. Incentives and procedures of tax sales came second in terms of the relative importance to investor, which amounted to 87.4%, and therefore believe that investors attach great importance to the incentives and procedures of sales tax more than of incentives and procedures of income tax, the fact that sales tax is the most important and risky in tax transactions compared to income tax , fines items and audit procedures for sales are given priority on the procedures for income tax. (Maharme, 2009)

The aim of some of these studies to shed light on the reality of investment promotion institutions, which was represented by Free Zones and Industrial

Estates Corporation and Investment Promotion and Exports Development Foundation and its role in attracting foreign investment.

These studies have concluded many results the most important are summarized as follows:

- A - The favorable investment climate creates an atmosphere of confidence among investors, which prompted to set up his investment in comfort.
- B - The study confirmed that the economic infrastructure in Jordan needs great efforts to raise its competence to suit the needs of the investor.
- C - c. Economic environment consists of a set of factors that are components of macroeconomic The study pointed to the low performance of a number of these components.

It was also seeking to determine if both of the Investment Promotion Law No. (16) for the year (1995) and the Income Tax Law No. (14) for the year (1995) and the economic environment and political environment in Jordan affecting the investment promotion.

The study concluded many results some of them: both the Jordan Investment Promotion Law and the Income Tax Act affecting the promotion of investment besides, economic activity and the current political situation in Jordan affecting the promotion of investment within the country.

It is shown through studies and analysis conducted by the income and sales tax department and through the competent directorates to explore the views of internal and external partners (taxpayers), in addition to its desire to provide the best possible service to get the best satisfaction possible, all studies have indicated that tax incentives offered by the tax departments determine the options of the investor in first hand and direct his investment, and take the decision to invest or reinvest, and are therefore of great importance for tax policy in Jordan.

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MALAYSIA

COUNTRY WORKING PAPER BY MALAYSIA FOR THE 6th ATAIC TECHNICAL CONFERENCE 2009

Topic : Taxation and Economic Development

1. Introduction

- 1.1 Malaysia is a growing and relatively open market economy. In 2007, the economy of Malaysia was the 29th largest economy in the world by purchasing power parity with gross domestic product for 2007 was estimated to be USD357.9 billion with a growth rate of 5% to 7% since 2007. Malaysia experienced an economic boom and underwent rapid development during the late 20th century and has a GDP per capita of USD14,400 although being considered a newly industrialized country. Malaysia is also a member of trade organizations such as APEC, ASEAN and WTO.
- 1.2 Malaysia's economic development is one of the fastest and steady in global economic scenario. Malaysia GDP per capita has been estimated to be USD15,700 in fiscal year 2008. This is a clear indication of tremendous economic development in Malaysia. Malaysia's economy is a middle income country that has developed since 1970's. It was previously a mere raw materials producing economy, which has evolved now as a developing multi-sector economy. This growth bears testimony to impressive economic development in Malaysia.

- 1.3 Economic development of Malaysia is largely dependent on various factors. Malaysia GDP as per purchasing power parity was estimated to be USD397.5 billion in 2008. GDP as per official exchange for 2008 was USD214.7 billion. Real growth rate of Malaysia GDP of 2008 has been found to be about 5.5 percent.
- 1.4 Different sectors contribute individually for Malaysia's economic development. In financial year 2008, contribution of agricultural sector to Malaysia GDP was 9.7%, industrial sector contributed 44.6% and 45.7% came from service sector. Asian Development Bank (ADB), a Manila-based institution, shows Malaysia GDP to be 5.7 percent in fiscal year 2008.
- 1.5 Revenue collected by IRB is normally higher than the government's forecast. The revenue has increase tremendously from RM10.402 billion in 1990 to RM29.156 in 2000 and finally RM69.396 in 2007. The mark increase in revenue collection has a vital role in ensuring a continuous effort in developing the economy of the country.

2. What are the general characteristics of your country tax structure

- 2.1 Generally, all income of companies and individuals accrued in, derived from or remitted to Malaysia are liable to tax. However, income remitted to Malaysia by resident companies (other than companies carrying on the business of banking, insurance, air and sea transportation), non-resident companies and non-resident individuals are exempted from tax. Apart from income tax, there are other direct taxes such as real property gains tax and indirect taxes such as sales tax, service tax, excise duty and import duty.

Sources of income which are liable to income tax are as follows :

- Gains and profits from trade, profession and business
- Salaries, remunerations, gains and profits from an employment
- Dividends, interest or discounts
- Rents, royalties or premiums
- Pensions, annuities or other periodic payments

- Other gains or profits of an income nature not mentioned above.
- Chargeable income is arrived at after adjusting for expenses incurred wholly and exclusively in the production of the income. Specific provisions or reserves for anticipated losses or contingent liabilities are not tax deductible. No deduction for book depreciation is allowed although capital allowances are granted. Unabsorbed losses may be carried forward indefinitely to offset against future income.

2.3 Company tax - A company, whether resident or not, is assessable on income accrued in or derived from Malaysia. Income derived from sources outside Malaysia and remitted by a resident company is not subject to tax, except in the case of banking and insurance business and sea and air transport undertakings. A company is considered a resident in Malaysia if the control and management of its affairs are exercised in Malaysia. Places of control and management are considered on the basis of where meetings of the Board of Directors are held. A tax rate of 25% (w.e.f. YA2009) is applicable to both resident and non-resident companies. In the case of a company carrying on petroleum production, the applicable tax rate is 38%.

2.4 Personal income tax - All individuals are liable to tax on income accrued in or derived from Malaysia. The rate of tax depends on the resident status of the individual which is determined by the duration of his stay in the country (as stipulated under Section 7 in the Income Tax Act 1967). A resident individual is taxed on his chargeable income at graduated rates from 1% to 27% (w.e.f. YA2009) after the deduction of tax reliefs. However, an individual with chargeable income of less than RM 2,500 is taxed at zero rate. Generally, a non-resident individual is liable to tax at the rate of 27% and he is not entitled to any personal relief.

2.5 Real Property Gains Tax - Capital gains are generally not subject to tax in Malaysia. Real Property Gains Tax is charged on gains arising from the disposal of real property situated in Malaysia or of interest, options or other rights in or over such land as well as the disposal of shares in real property companies. For individuals who are citizens or permanent residents, gains from disposal of real property held after five years are

not subject to this tax. In addition, they also enjoy a one-time tax exemption on the gains arising from the disposal of one private residence. For non-citizens and non-permanent resident individuals, gains from disposal of real property within 5 years are subject to tax at a flat rate of 30%. However, disposal in the sixth year and thereafter will be taxed at 5%. With effect from 1 April 2007, exemption has been given to all transactions.

3. What are the functions of your taxation system in relation to economic development?

- 3.1 Tax system can affect the pace of economic development and the way the rewards of that development are distributed. Developing countries receive a lot of advice on how to create a tax system that will advance the well-being of their residents. It is important to stress policies that we believe will promote economic growth. Fiscal policy is therefore being shaped to ensure a fair distribution of wealth that propagates economic activities and as a result, spur up the economic development of Malaysia.
- 3.2 The main function of our taxation system is to boost tax collection in order to ensure a sustainable economic development. Revenue will have to be collected for government expenditure and therefore facilitate economic development through various sectors.
- 3.3 Malaysia has moved from agriculture-based to manufacturing-based economy. Naturally, certain parts of the country or major towns such as Klang Valley, Penang and Johor Bharu are being focus for this purpose and pioneer status were given for certain industry to ensure sustainable economic growth.

4. What are the main tax factors that affect economic development

- 4.1 Incentives and tax measures are some of the main tax factors that affect economic development. By giving more tax incentives, it will not only spur up the Small and Medium Enterprises (SMEs), but will also enhance the business community at large.
- 4.2 When tax rate is being reduced, SMEs and other corporations use this tax savings to increase their investments. Profits from investment abroad that is remitted back to the country are exempted from tax.
- 4.3 Malaysia offers an extensive array of tax incentives covering a variety of industries and activities, ranging from manufacturing and related services to new areas such as information and communications technology, biotechnology, regional services and islamic financial products & services. Typically, tax incentives are structured as a tax holiday called Pioneer Status or tax allowances based on qualifying capital expenditure, known as Investment Tax Allowances. There are double deductions allowed for certain expenditure, such as those incurred qualifying research and development and the promotion of exports.

5. How to increase the usefulness of your tax system as an instrument for economic development

- 5.1 Introducing new incentives are some of the ways to increase the usefulness of our tax system as an instrument for economic development. Incentives such as reinvestment allowance, abolishing Development Tax and carry-back losses, to name a few, will be of great help to the business community. These measures have been charted out as a result from the dialogue feedback given by industry players.
- 5.2 Feedback from international organization such as OECD, IMF and World Bank is indeed very beneficial to the country. System's benchmarking with other tax authority is equally important to ensure we are at par with others and not lagging behind. By increasing the usefulness of our tax system, it will attract foreign investment and

therefore will create a spin-off effect such as creating employment, transfer of technology, growth of supporting industry and etcetera.

6. Outline the main features of recent tax policy reform that helped economic development

- 6.1 Self-Assessment System - Introduced in 2001 for companies meanwhile individuals & other taxpayers self-assessed since 2004 and tax payers are required to calculate, report and pay the right amount of tax. It managed to boost tax collection from RM29.156 billion (YA 2000) to RM42.098 billion (YA 2001) since companies started the Self-Assessment System.
- 6.2 A 'Mini Budget' was tabled by the Minister of Finance on the 10th of March 2009 to cushion the impact of global financial crisis. One of the measures was to introduced a new Section 44B to the Income Tax Act 1967 (ITA1967) to allow businesses to carry-back losses which cannot be absorbed in the current year of assessment (YA) for setting off against the defined aggregate income of the immediately preceding year of assessment . The amount of loss allowed to be carry-back is limited to RM100,000 a year and is limited to YA 2009 and 2010 only. For example, if the business had paid tax in YA2008 and in YA 2009 suffered loss, then the YA 2009 loss can be carry-back to YA2008 for setting-off against the defined aggregate income. If the taxpayer had paid the YA2008 tax, he would be due for a refund from the IRB. Though this provision is only for a 2 year period namely YA 2009 and YA 2010, it nevertheless allows loss making companies to gain access to some tax refund from tax paid in the previous year. Without the loss carry back provision the loss can only be set-off against future income.
- 6.3 From 1.1.2008, the single-tier system for taxation of companies becomes effective. Under this system, taxes paid by companies are not passed through to the shareholders. There is no imputation credit attached to dividends. Therefore dividends are not taxed in the hands of shareholders and companies can now pay dividend out of capital gain as there is no worry about requisition. Five years transitional period has

been given for companies to use up available credits and companies with paid up capital below RM 2.5 million were taxed at 20% for the first RM 500,000 chargeable income.

7. Do you consider tax incentive to be an effective fiscal tool for the promotion of local or foreign investment?

Yes, we certainly do. Some says that “incentives are but the ‘icing on the cake’ of the host country business environment. No amount of icing can compensate for a poorly baked cake”.

7.1 Since its introduction in 1948, income tax has been one of the tools used by the government to stimulate economic growth in the country. Income tax is also used to direct the economy such as countering inflation, directing investment in certain preferred sectors, discouraging certain market activities and stimulating savings, investments or consumption.

7.2 Certain taxes were also abolished to generate economy, such as Excess Profit Tax (abolished in 1991 and abolished as part of the effort to strengthen the investment climate and to attract foreign investment), Development Tax (abolished in 1993 to increase the competitiveness of Malaysian business), Estate Duty (repealed in 1991) and Real Property Gains Tax (exemption for all transactions after 1/4/2007).

7.3 Exemption for remitted Income is to encourage Malaysian companies to invest overseas and to repatriate their incomes into Malaysia. Since YA 2001, various incentives have been given to venture capital companies to promote funding for new technology start ups. By 2007 there are 52 registered venture capital companies and 45 venture capital management companies managing a total of RM3,308 million (*USD 931.83 m*) in funds. SMEs in the manufacturing industry are given 5 years tax exemption.

7.4 Malaysia’s transformation from commodity based economy to manufacturing based economy was driven by several factors, namely generous tax breaks & incentives to attract FDI, a stable government &

political climate, cheap and skilled labour and good infrastructure. However, the advantages are fast diminishing as other developing countries are catching up and competing with Malaysia for FDI. New strategies to overcome this will be shifting from labour intensive industries to capital intensive industries, move up the value chain and from production based to knowledge based. Several tax incentives are introduced to encourage companies to diversify in these new areas.

- 7.5 The main objective of branding is to move up the value chain, to manufacture higher value completed product for marketing under own brand and therefore incentive given include double deduction for the promotion of brand names locally or overseas.
- 7.6 A local company that acquires a foreign owned company to penetrate market for products manufactured in Malaysia, overseas or to acquire high technology or proprietary rights for production in Malaysia, incentive given are an annual allowance of 20% of the acquisition cost for five years.
- 7.7 The global demand for halal food provides vast potential for Malaysia to be one of the leading producers and exporters in the world (Halal Hub). Double deduction is given on cost for obtaining halal certification. Companies which have obtained halal certification and incurred capital expenditure within a specific period on machinery and equipment to produce halal food are given tax allowance of 100% of the expenditure.
- 7.8 Establishment of Multimedia Super Corridor (MSC) will enable Malaysia to leapfrog into the information age. It creates environment which encourages innovation, helps local and international companies to reach new technology frontiers. It also promotes partnership with global IT players and provides opportunities for mutual enrichment and success. MSC status is given to companies which are provider or heavy user of multimedia products and services, employs substantial number of knowledge workers and provides technology transfer and knowledge to Malaysia. Incentives given are 5 years tax exemption extendable to 10 years or 100% Investment Tax Allowance for 5 years.

Examples given here are clear evidence that tax incentives can be an effective fiscal tool for the promotion of local or foreign investment in ensuring a progressive economic development.

8. Identify the biggest challenges that face your tax system in its endeavour to encourage economic development

8.1 There had been 2 major financial crisis since 1997, that is the Asian financial crisis in 1997 and the current financial crisis which began in 2008. During economic crisis, government need to intervene in the economy in order to stabilize the economy, assist businesses, stimulate economic growth and boost confidence. Tax exerts a burden on business, reduces the returns from investments, increase the cost of doing business and affects competitiveness. During crisis, businesses turn to government to reduce tax burden. This is where tax system must be tailored to the current economic scenario of the country.

8.2 Malaysia is the leader in Islamic Banking and the government plans to make Malaysia as an International Islamic Banking Centre. In line with this, Malaysia need to enhance the competitiveness of Islamic banking products and to stimulate the growth of Islamic banking. In 2007, Malaysia was the largest issuer of Sukuk in the world with a total value of US\$25bil. This is about 53% of the total value of Sukuk issued in the world of US\$47.099 in 2007. The challenges are to ensure Sukuk products remain attractive to local and international players.

8.3 Taxation has contributed to the rapid economic growth by raising required revenue to fund development projects, attracting domestic and foreign entity through incentives and encouraging investment in technology and human capital. However, the rapid economic growth was not solely tax incentives driven. There are other factors that contributed to economic growth. Voluntary tax compliance is also a key challenge to be dealt with the changes from Official Assessment to Self Assessment System. In order to attract multi-national enterprises, then there will also be issues of transfer pricing, thin capitalization, cross border transactions and e-commerce to address.

9. What tax strategies have been adopted to overcome these problems?

- 9.1 Cost of doing business need to be reduced accordingly. Steps taken to materialize this are abolishing supplementary taxes, RPGT exemption w.e.f. 1 April 2007, lowering tax rates (corporate tax rates and personal income tax rates), audit fee allowed as expenses, reduction in withholding tax rate (for company from 15% to 10% and for employees from 5% to 3%) and review of penalty for non-deduction of withholding tax.
- 9.2 Tax neutrality for Islamic banking and Takaful are being adopted to enhance the competitiveness of Islamic banking products and to stimulate the growth of Islamic banking. Tax treatment under ITA 1967 has been streamlined to ensure tax neutrality with conventional banking products since 2004 (Budget 2005) and tax incentives are also offered (with limited time frames).
- 9.3 To enhance voluntary tax compliance, we have had strengthen enforcement activity such as field audit, business survey conducted on regular basis, upgrade training to officers and extensive usage of TACS (tax audit compliance system).
- 9.4 Cooperation with other organizations or tax authorities are essential in order to seek for best practices in other parts of the world. For instance, experience, knowledge and exchange of information can be shared with other organization such as JICA, CATA, ATAIC, SGATAR and etcetera.

10. What are the lessons that can be learnt from the experience of your country

- 10.1 Tax policy must be tailored to the current need of the country. There are certain economy incentive packages being introduced by the government such as the 2009 Mini Budget to fulfill this need. There is always room for improvement and it will be an on-going process.

- 10.2 Enhancing the usage of IT to facilitate tax collection are always crucial to ensure a correct step in the right direction. Data warehousing and other computer system such as CMS for tax audit & investigations, ReMS for tax collection monitoring and VIS & ETP for data gathering & distribution are some of the applications that prove to be very useful to IRB. With the optimum usage of IT, we believe this will enhance our service delivery system to the taxpayers.
- 10.3 IRB endeavours to make paying tax easier to taxpayers. As IT usage is increasing among businesses and in line with the government's drive on e-KL, IRB's thrust in making it easier to pay tax will be predominantly IT based. The e-Hasil initiatives strive to provide various services through electronic means for the convenience of taxpayers.

11. Conclusion

- 11.1 Malaysia was ranked No. 2 in tax reforms out of 188 countries surveyed in 2007 (2009 World Business Survey). Malaysia's ranking under the Paying Taxes Category rose from 25th in 2008 to 21st in 2009. This helped Malaysia's ranking on the Ease of Doing Business to rise from 25th in 2008 to 20th in 2009.
- 11.2 We will not sit on our laurel but will continue to strive to improve the tax system and service delivery so that Malaysian businesses will continue to remain competitive and prosper and as a result contribute more to the nation's development through taxes.



Taxation and Economic Development in Malaysia

Presented by
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Taxation and Economic Development in Malaysia

Presentation outline

1. Brief background of Malaysia's economy
2. General characteristics of Malaysia's tax structure
3. Functions of Malaysian taxation system in relation to economic development



Presentation outline

4. Main tax factors that affect economic development
5. Increasing the usefulness of Malaysian tax system as an instrument for economic development
6. Main features of recent tax policy reform that helped economic development

3



Presentation outline

7. Tax incentive as an effective fiscal tool for the promotion of local or foreign investment
8. Biggest challenges that face Malaysia's tax system in its endeavour to encourage economic development
9. Tax strategies adopted to overcome these challenges

4



Presentation outline

10. Lessons that can be learnt from the experience of Malaysia
11. Conclusion

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1. Introduction

1. 29th largest economy in the world by purchasing power parity
2. GDP for 2007 was estimated to be USD357.9 billion with a growth rate of 5% to 7% since 2007
3. Malaysia GDP per capita has been estimated to be USD15,700 in fiscal year 2008

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Taxation and Economic Development in Malaysia

Revenue Collected by IRB and Government's Forecast, 1990-2007

Year	Budget Estimate (RM Million)	Direct Taxes collected by IRB (RM Million)	% over Government's Estimates
1990	9,793	10,402	106.20
1991	11,439	13,199	115.40
1992	14,097	15,403	109.30
1993	17,781	17,070	96.00
1994	19,250	20,160	104.70
1995	20,186	22,699	112.40
1996	23,778	25,851	108.70
1997	26,908	30,433	113.10
1998	31,456	30,016	95.40
1999	20,099	27,247	135.50
2000	29,096	29,156	100.20
2001	33,802	42,098	124.50
2002	36,801	44,351	120.50
2003	50,587	43,016	85.00
2004	49,261	48,703	98.90
2005	45,100	56,860	126.10
2006	52,008	61,572	118.39
2007	70,116	69,396	99.00

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Taxation and Economic Development in Malaysia

2. General characteristics of Malaysia's tax structure

- All income of companies and individuals accrued in, derived from or remitted to Malaysia are liable to tax
- Direct taxes and indirect taxes

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Component of Government's Revenue

<u>Year</u>	<u>Direct Taxes (%)</u>	<u>Indirect Taxes (%)</u>	<u>Non-tax Revenue (%)</u>
1970	28.54	48.13	23.33
1975	38.89	44.28	16.83
1980	39.46	47.14	13.40
1985	43.85	35.24	20.91
1990	35.24	36.73	28.04
1995	44.55	37.23	18.22
2000	47.13	29.12	23.75
2005	50.37	25.45	24.18
2007	49.45	18.39	32.16



2. General characteristics of Malaysia's tax structure – cont'd

- Sources of income which are liable to income tax
- Company tax
- Personal income tax
- Real Property Gains Tax



Taxation and Economic Development in Malaysia

Reduction In Tax Rates

Corporate Tax Rate YA 1995-2009

Year of Assessment	Corporate Tax Rate (%)
1995	30
1998	28
2007	27
2008	26
2009	25

SMEs now taxed at preferential rate of 20% for first 500,000 of chargeable income.

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Taxation and Economic Development in Malaysia

Personal Income Tax Rates YA 1985-2009

Chargeable Income (RM)	Year of Assessment				
	1995	1996	2000 CY	2002	2009
1 st 2,500	0	0	0	0	0
Next 2,500	3	2	1	1	1
Next 5,000	6	4	3	3	3
Next 10,000	7	6	5	3	3
Next 15,000	12	10	9	7	7
Next 15,000	18	16	15	13	12
Next 20,000	23	21	20	19	19
Next 30,000	28	26	25	24	24
Next 50,000	31	29	28	27	27
Next 100,000	32	30	28	27	27
Above 250,000	32	30	29	28	27
Threshold (RM)	10,501	11,001	15,834	23,834	25,500

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3. Functions of Malaysian taxation system in relation to economic development

- Boost tax collection to facilitate economic development
- Policies to promote economic growth
 - incentives to attract FDIs
 - more sectors to benefit

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4. Main tax factors that affect economic development

- Tax measures
- Reducing tax rates
- Extensive array of tax incentives

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5. Increasing the usefulness of Malaysian tax system as an instrument for economic development

- Introduce new incentive
- Feedback from international organization

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6. Main features of recent tax policy reform that helped economic development

- Self – assessment System
- ‘Mini Budget’ – to ease financial burden
- Single-tier system for company tax

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7. Tax incentive as an effective fiscal tool for the promotion of local or foreign investment

- Stimulate economic growth
- Abolish certain taxes to generate economy
- Exemption for remitted income – encourage overseas investment

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7. Tax incentive as an effective fiscal tool for the promotion of local or foreign investment – cont'd

- Encourage companies to diversify
- Moving up the value chain
- Leading players in Halal hub
- Enhancing ICT

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8. Biggest challenges that face Malaysia's tax system in its endeavour to encourage economic development

- Financial crisis setback
- Enhance the competitiveness of Islamic banking products
- Voluntary tax compliance
- Transfer pricing, thin capitalization, cross border transactions and e-commerce

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9. Tax strategies adopted to overcome these challenges

- Reduced cost of doing business
- Tax neutrality for Islamic banking and Takaful
- Strengthen enforcement activity
- Cooperation for best practices

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10. Lessons that can be learnt from the experience of Malaysia

- Tax policy must fulfill the current need
- Enhancing the usage of ICT
- Make it easier to pay tax

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11. Conclusion

- Responsive to input from stakeholder and taxpayer
- Strive to improve tax and service delivery system

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Thank you for your attention

TERIMA KASIH
SHUKRON

Morocco

TAXATION AND ECONOMIC AND SOCIAL DEVELOPMENT

Introduction

The Kingdom of Morocco has implemented since 1998, several structural, sectorial, institutional and financial reforms, aiming at improving the investment environment, instilling principles of good governance in public administrations, integrating Morocco in its international environment, diversifying sources of growth and strengthening the competitiveness of the national production capabilities. The objective is to consolidate the foundations for a strong and sustained economic growth, generating wealth and employment.

In this context, the relationship between taxation and economic and social development can be approached from the angle of tax reforms, perceived as the concrete translation of government choices in directing State and local authorities' mobilized resources towards common strategic goals, which would allow, through the elaboration and the implementation of public policies, the achievement of a social well being.

Tax reform is a universal and recurring theme. All over the world, states are trying to find sustained resources to meet the increased needs for financing public policies. Internal taxation is increasingly becoming the main source of funding which would allow to offset against the loss of revenue from international trade agreements.

Morocco has launched a great tax reform in the 1980s. The outline law of 1984 triggered a process of tax reforms which resulted in the gradual introduction of VAT in 1986, the corporate tax in 1987 and the income revenue in 1990.

In the 1980s, the financial, economic and social crisis in Morocco, constrained the Kingdom to adopt a policy of structural adjustment in order to meet the costs of the external debt. The outline law of 1984 on tax reform was adopted under this policy. In this context, improving the tax yield was one of the main objectives. The revision of the investment codes in 1988, in the sense of reducing tax benefits, enabled the Tax to retrieve its classical function which consists of providing sustained resources to finance public expenditures.

However, this principle of Tax neutrality could not resist the many pressures. In 1996, the investment charter embodied tax incentives intended to certain leading sectors.

The successive introductions of derogatory regimes will garble the meaning of the reform announced in 1984.

In the late 1990s a new wave of tax reforms will be gradually introduced, but this time with no external constraints. The national tax conference organized in 1999 has enabled the Tax Administration to listen to the main economic and social partners, to know their expectations, to carry out a diagnosis and to elaborate a coherent and appropriate strategy.

The Speech of His Majesty the King in Jorf Lasfar in September 2000 underpinned the government orientations adopted thereafter. The importance of taxation in the economic and social development resulted in the adoption of a new approach in the tax policy management leading towards a culture of accountability and performance based on efficiency and effectiveness of the public expenditures.

Furthermore, this new approach of the tax reform has originated from a reflection on the optimization of financial resources. Three main objectives have been set in this context:

- Simplification, rationalization and modernization of the tax law;
- Mobilization of the tax potential to better fund public expenditures;
- Boosting growth, maintaining the competitiveness of Morocco in the international economy and reducing tax burden on businesses and households;

The current context of international financial and economic crisis, rather than being a threat to the reform process, initiated over the last ten years, could accelerate it and constitute a new challenge.

1 - GENERAL FEATURES OF THE TAX STRUCTURE IN MOROCCO

The Moroccan Tax System is composed of the Corporate Tax, the Income Tax, the Value Added Tax and the Registration and Stamp Duties. Besides these State taxes, The General Tax Administration also manages the local taxes: the Business Tax, the Property Tax and the Municipality Tax.

The standard rate of the corporate tax is 30%. This rate is 37% for credit institutions and similar establishments, "Bank Al Maghrib", "Caisse de Dépôt et de Gestion", as well as insurance and reinsurance companies. These new rates apply from the 1st January 2008, replacing respectively the rates of 35% and 39.6%.

Concerning the Income Revenue, and as from January 1st, 2009, the marginal rate of tax was reduced from 42 to 40%. The exempted threshold was increased from 24000.00 to 28 000.00 MDH, with a revision of the overall income tax scale which impacted all intermediary revenue brackets and their correspondent rates.

Regarding the VAT, there are four rates: 7%, 10%, 14% and 20%. However, it should be noted that the rate of 20% and 10% generated 86% of total collected inland VAT revenue in 2008. The current reform trends under consideration aim at the gradual removal of exemptions and the reduction VAT rates.

The registration duties have been revised and simplified as to adapt to the social and economic evolution. The number of rates applicable has been reduced from eleven to four: 6%, 3%, 1.50% and 1% with a single fixed fee of 200 dirhams and integration of the notary tax in the registration duties.

Stamp duties and the Special Annual Tax on Vehicles also witnessed a deep overhaul and were included in the General Tax Code by the budget bill for the year 2009.

From 1998 to 2008, the tax revenue structure has undergone major changes. The total revenue has registered a sharp increase, from 74 billion dirhams to 185 billion dirhams. The share of the Corporate Tax recorded in 1998 was 11.8% and was lower than the Income Tax, whose share reached 17.4%. In 2006, the shares of revenue from these two taxes will be almost equal, for The Corporate Tax 19.3% and for Income tax 19.5%. From 2007, the revenue of the Corporate Tax will exceed the Income Tax revenue.

In 2008, the share of the Corporate Tax largely exceeded that of the Income Revenue, respectively 25.1% and 17.7%, and this, despite the reduction of Corporate Tax rates from 35% to 30% as regards the standard rate and from 39.6% to 37% for the specific rate applicable to the financial sector.

Furthermore, the structure of tax revenue was characterized by the importance of indirect taxes, which account for 50.5% of total tax revenue. The share of revenue from VAT accounts for 33% of total tax revenue.

Nevertheless, it should be highlighted the significant increase in the share of direct taxes in relation to the total tax revenue. While they represented only 30.7% in 1998, this share reached 43% in 2008.

In comparison with the share of indirect taxes, this latter will decline over the same period, from 64% to 50.5% but with a steady increase of the VAT from 26.3 to 33%.

The share of Registration and Stamp duties has been maintained throughout this period, around an average of 5.5%.

The increase in internal Tax revenue, especially revenue from the Corporate Tax, the Income Tax and VAT, has helped to offset against declining revenue from customs duties resulting from the entry into force of the free trade agreements concluded by the Kingdom of Morocco. Thus, the share of customs duties decreased from 17.4% of total tax revenue in 1998 to 7.4% in 2008, the one relating to the Internal Consumption Tax has gone down for the same period from 20.2% to 10.1%.

The gradual opening of the Moroccan economy has been conducted in a favourable tax context, without threatening the balance of the main financial aggregates of the State.

The good performance of the Moroccan economy and the efforts to modernize the Tax Administration have permitted to pursue this trend of revenue mobilization and control of expenditure.

After reaching 5.6% of GDP in 2005, the overall deficit was brought down to 2.2% of GDP in 2006 and to 3.3% in 2007. This has resulted in budget surplus of 0.7% in 2007 and of 0.4% in 2008.

Finally, the improvement of public finances situation results from the willingness of the authorities to raise the tax policy as a strategic priority to achieve their economic and social development objectives. Emphasis has been put on transparency, modernization of the tax system and control of expenditure. The simplification of the tax system, the strengthening of the Tax Administration and the broadening of the tax base led to an increase in tax revenue.

This performance stems from the increasing yield of the VAT, the Income Tax and Registration and Stamp duties.

Non-tax revenue have, however, decreased by 10.2% in 2007. They suffered the decline in privatization revenues (- 15.6%) and other non-tax revenues (-6.4%). The two annexes attached indicate in detail the evolution of income tax structure and tax revenue from 1998 to 2008.

2- FUNCTIONS OF THE TAX SYSTEM IN RELATION TO ECONOMIC DEVELOPMENT

Besides the budgetary function, the Tax system plays an important role in the economic and social development. Indeed, the tax tool is also used for purposes other than merely balancing the budget, although this remains on the agenda, especially in the current international economic and financial crisis.

Thus, in addition to this traditional function, the tax system aims to the achievement of others priorities such as the fulfilment of social and economic objectives. These objectives are set around the following main axes which are: boosting the economic growth, achieving a regional development, promoting small and medium enterprise and improving living standards and purchasing power of the population. A significant number of tax incentives are intended to the property sector to encourage the eradication of insalubrious housing and the access to social housing by low income households. Incentive tax measures have been especially dedicated to enterprises located in some regions where the economic development remains low or to encourage employment.

Nevertheless, studies have shown that taxation is not always a leading factor in the economic development. Other more important non Tax measures, profitable to the development, resulted in targeted investment in the construction of infrastructure, the mobilization of public land, the simplification of procedures, the fight against corruption and the accomplishment of institutional reforms, especially the justice...

3 – MAIN KEY TAX FACTORS IMPACTING THE ECONOMIC DEVELOPMENT

The reduction of the Corporate tax rate brought by the Budget law 2008 and that of the Income Tax rate brought by the Budget law 2009 have positively impacted the internal

and external investment power of enterprises while, contributing substantially to the improvement of the purchasing power and therefore, to consumption and to savings.

These measures were accompanied by the broadening of the tax base which has helped to offset against the loss of tax revenues, to master the risks of budgetary losses and to promote tax equity. These measures are in keeping with the international pattern of widespread tendency of lowering tax rates. They have also enabled the Kingdom of Morocco to strengthen its competitive position on the international economic scene.

4 - HOW TO STRENGTHEN THE ROLE OF THE TAX SYSTEM, AS AN INSTRUMENT OF ECONOMIC DEVELOPMENT?

From the taxation viewpoint, the policy adopted in Morocco during the recent years, responded to the triple objectives of: financing government expenditures, stimulating growth and promoting fairer allocation of wealth.

The reform agenda has focused on the simplification of tax legislation, the monitoring of tax expenditures, the progressive removal of derogatory regimes with better targeting of priority sectors on the economic and social level which are to continue to enjoy certain tax incentives, the rehabilitation of the VAT and the further modernization of the Tax Administration.

This program is based on the awareness that equity, transparency and citizenship are inseparable and ultimately play a fundamental role in the economic and social development.

5 - MAIN FEATURES OF THE RECENT REFORM OF TAX POLICY

The Kingdom of Morocco has learned from international tax experiences, in noting that countries that have benefited most from the economic benefits of their tax policy are those which have implemented structural adjustments rather than sectorial incentives.

It is in this perspective that the choice of tax transparency has been set as a strategic option fitting more generally in the context of budgetary transparency.

The program adopted by the Moroccan government, since the Budget law 2008, is in line with this orientation.

Thus, the reduction of the corporate tax rates was accompanied by the removal of the exceptional reserve and the rebates applied to capital gains (...). This way, the government wanted to bring closer the effective rate applied to corporate tax with the standard rate.

The various reductions of 50% of the tax set with regards to corporate tax have also been replaced by a proportional fixed rate of 17.5% which applies to the taxable income of:

- Exporting firms;
- Enterprises selling their finished products, meant to export, to companies located in export platforms;
- Hotel establishments;
- Mining companies;

- Enterprises located in the province of Tangier and in some provinces and prefectures named by decree;
- Handicraft Enterprises;
- Private educational institutions and vocational training establishments;
- Property developers who carry out construction operations of students' housing, residences and university campuses of 150 rooms instead of 250 previously.

In the same Context, with respect to income revenue, taxpayers under the category of Business income who benefit from a reduction of 50%, are now subject to a reduced rate of 20% non fully discharged of the income tax.

These new tax provisions point up the openness of Morocco on the international level and promote trade and free movement of persons and capitals.

6 – TAX INCENTIVES, EFFECTIVE TOOL TO PROMOTE LOCAL AND/OR FOREIGN INVESTMENT?

In Morocco, the authorities have realized that the real problem of tax reform is not restricted to tax incentives or more or less attractive tax rates. But, it is rather a matter of tax burden compared to GDP.

Businesses and households show a better adherence to tax and are more willing to contribute directly and indirectly to the promotion of investment when they face a fair and transparent tax system.

To this purpose, the government has focused, over the last decade, on simplifying and rationalizing the tax system with a better targeting of sectors or activities that should still benefit from tax incentives.

7 - WHAT ARE THE MAJOR CHALLENGES FACING YOUR TAX

SYSTEM AND THE EFFORTS MADE TO ENCOURAGE

ECONOMIC DEVELOPMENT?

In the current context of international financial and economic crisis, the first challenge relates to the classical financial objective of any tax system: collect the necessary financial resources for the State to meet the public expenditures which are becoming more and more irreducible.

Moreover, the globalization of economies requires more vigilance. The fight against international tax fraud and evasion has been set as a priority and has been integrated in the Moroccan tax policy, through the introduction of new provisions which would help counteract against the transfer of profits and other type of abuses affecting the competitiveness of domestic firms.

The fulfilment of these objectives would certainly impact positively the economic and social development.

8 - TAX STRATEGIES ADOPTED TO ADDRESS THESE PROBLEMS

Major reforms initiated have to be pursued. The Modernization of the tax system, irreversible choice, is in keeping with the strategic objectives of transparency, fairness and promotion of citizenship, particularly, through the improvement of the quality of service (simplification and dematerialization of management procedures and provision of services, E-filing and E-payment, development of front desk services, improvement of communication ...).

To face these new challenges, the tax system must be continuously evolving and dynamic. The public authorities shall take into account the new constraints and opportunities.

The dogmatic attitude must give place to innovation and adaptation to change.

In this context, the tax strategy currently adopted in Morocco is an attempt to respond to the international environment and to the economic and social partners' expectations.

The reduction in taxation rates of the corporate tax and the income tax, preceded by intensive and progressive work of simplification, harmonization and rationalization, is further pursued through the broadening of the tax base especially, through the reduction of exemptions and thus tax expenditures.

This reduction of exemptions will be pursued along with the modernization of Tax Administration.

Thus, the use of the new information technologies is mainly intended to improve the quality of services rendered to taxpayers.

The information system has undergone an overall revamp which resulted in the setting up of two key projects: the SIT (Integrated system of taxation) and the SIMPL (online tax services). The SIT is primarily a national user oriented database which will gradually replace the regional databases, allowing the identification of taxpayers and the adoption of a global tax management approach to get an overall profile of the taxpayer. This system is basically designed around the single taxpayer file with an unique tax identifier as a key feature.

Through the provision of online tax services, the Tax Administration offers more diversified services to taxpayers, such as E-filing and E-payment.

Consequently, the tax relief on enterprises and households would be compensated by a qualitative management and a fairer allocation of taxes among the community.

The Improvement of the quality of service and the promotion of citizenship are set as core strategic axes of the new tax reforms.

9 - LESSONS TO BE LEARNED FROM THE MOROCCAN EXPERIENCE.

The tracks for tax reforms are numerous and Morocco has to find the right possible balance between the different taxes which constitute the foundation of its tax system, while at the same time, improving domestic resources mobilization required to finance public expenditures, broadening the tax base, ensuring Tax equity and promoting the attractiveness of the country in an increasingly competitive environment.

The reforms implemented in Morocco have allowed to modernize the tax system in its different components, while ensuring a significant increase in tax revenues (see annex on the evolution of tax revenue from 1998 to 2008).

The release of the General Tax Code, currently single reference book on state taxation, the gradual removal of exemptions as a fundamental aspect of the rationalization and widening of the tax base, the integrated management of tax, the progressive dematerialization of the management and the provisions of services (...), all these actions have led to the implementation of structural changes and to the achievement of qualitative results, creating a favourable environment either for investment or for the fulfilment of tax obligations by enterprises and households.

This evolution can only be beneficial to the economic and social development which would have to be global and sustainable, where wealth is fairly allocated while protecting future generations against the repercussions and risks of an irrational exploitation of natural resources.



TAXATION AND ECONOMIC AND SOCIAL DEVELOPMENT



KINGDOM OF MOROCCO



Introduction

➤ implementation since 1998 several structural, sectorial, institutional and financial reforms aiming at:

- improving the investment environment;
- instilling principles of good governance in public administrations;
- integrating Morocco in its international environment; diversifying sources of growth;
- strengthening the competitiveness of the national production capabilities.

➤ The objective is to consolidate the foundations for a strong and sustained economic growth, generating wealth and employment

Tax Reforms:

➔ concrete translation of government choices in directing State and local authorities' mobilized resources towards common strategic goals for the achievement of social well being

➔ seeking the optimization of internal taxation to :

- offset against the loss of revenue from international trade agreements
- guarantee sustained resources to finance public policies