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Tax Systems and Tax Administration in Developing Countries

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Abstract

Many developing countries have reformed their tax systems in order to modernize them and to cope with changes in the socio-economy. They have made major reforms in their tax administration as well. Although the challenges concerning tax policy faced by such countries vary, there seems to be a common approach in handling the reforms of the tax system and administration.

This article clarifies the common characteristics of tax regimes in developing countries and considers which direction their reforms should head in order to achieve proper taxation and to improve tax compliance. The consideration includes lessons that Japan has learned in its effort to boost tax compliance since introducing the self-assessment system in 1947, and some important points in the Shoup Recommendation which guided the post-war tax system and tax administration in Japan.

This article also covers taxation on small businesses under the self-assessment system, revenue targeting, tax incentives to attract foreign direct investment, tax administration and several issues concerning each tax. Income taxation, in particular, will increase in importance as a potential revenue source and a measure to achieve social equality along with economic development. It is, however, expected to become increasingly complicated considering the diversification of taxpayers who are obliged to file tax returns properly.

Enforceability and economic development are crucial factors in reforming the tax system. A proper tax system and administration will contribute not only to fair taxation but also to economic growth in developing countries.

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I. Introduction

Many developing countries have implemented reforms to their tax systems in order to modernize them and to cope with changes in the socio-economy. They have made major reforms in their tax administration as well. Although the challenges concerning tax policy faced by such countries vary, there seems to be a common approach in handling the reforms of the tax system and administration.

This article sets out to clarify the common characteristics of tax regimes in developing countries and to consider which direction their reforms should head to achieve proper taxation and to improve tax compliance. The consideration includes lessons that Japan has learned in its effort to boost tax compliance since introducing the self-assessment system in 1947, and some important points in the Shoup Recommendation which guided the post-war tax system and tax administration in Japan. This article also covers taxation on small businesses under the self-assessment system, revenue targeting, tax incentives to attract foreign direct investment, tax administration and several issues concerning each tax.

Chapter II focuses on the importance of the tax system and tax administration in developing countries which face relatively high disparities between the rich and the poor while relying on customs duty for revenue, income taxation is expected to play a larger role in line with economic development and trade liberalization. Chapter III examines the self-assessment system, focusing on the difficulties of implementation by small businesses, approaches to solutions, and the promotion of book-accounting in business enterprises. Chapter IV examines revenue targeting, and considers compatibility with the self-assessment system. Chapter V focuses on tax incentives to attract foreign investment, and considers their advantages and disadvantages. Chapter VI considers proper tax administration in the context of promoting voluntary tax compliance and countermeasures against non-compliance. Chapter VII considers some aspects of improving income taxation, consumption taxation, property taxation and international taxation. Finally, Chapter VIII draws some conclusions.

II. Share of tax revenue

The degree of national income inequity between the rich and the poor is relatively large in many developing countries when measured by the national Gini coefficient index(2). When there is a large inequity in the distribution of income, income taxation plays an important role as it serves to redistribute income.

With regard to the revenue share in law income countries, however, the ratio of income tax remains lower than that in high income countries. Trade taxes including customs duty account for a substantial proportion of the total tax revenue in low income countries compared to high income countries (Chart 1), while corporate and individual income tax plays a relatively minor role.

Regarding the trend of trade liberalization, the revenue share of customs duty is expected to decline(3). As this share declines, a main portion of the tax revenue will be replaced by revenue from individual income tax, corporataion tax and VAT. Especially, individual and corporate income taxes are highly likely to become main potential sources of revenue in accordance with economic development. However, income taxation is more difficult to administer, and poses various challenges for revenue agencies. They need to create an environment in which taxpayers can easily comply with regulations and file tax returns properly.

Inequity of income distribution is expected to widen at the initial stage of economic development(4). One of the important functions of income taxation is

(2) The Gini coefficient is an index of the degree of inequity in the distribution of income in a country. This trend has continued. As for recent figures of each country, see "GINI index" published on the World Bank's website (http://data.worldbank.org/indicator/SI.POV.GINI). As for the world social situation of inequity, see United Nations, "Inequity matters-Report of the World Social Situation 2013," Chapter 1.

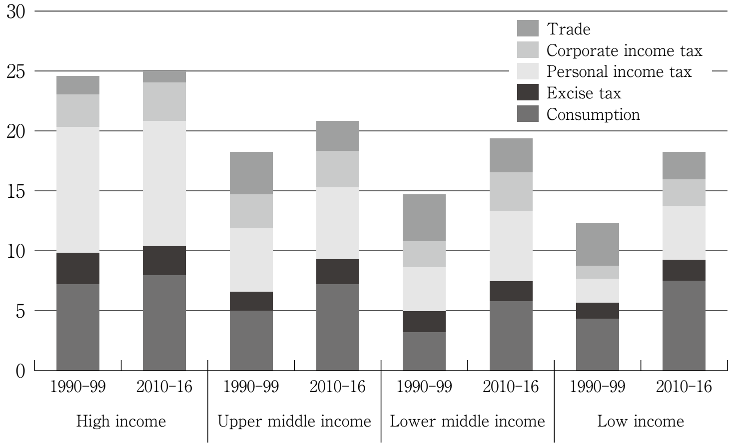
(3) See Figure 7 in IMF (2011), p. 16.

Chart 1

Tax levels and composition

The composition of taxes in richer countries differs from that of poorer countries, with greater emphasis on broad-based consumption and excise taxes.

(revenue, percent of GDP)



Source: International Monetary Fund WoRLD Data set.

Cited in Coardy (2018), Chart 2, p. 25.

to redress this inequity by utilizing its redistribution function through progressive tax rates. However, many developing countries do not effectively utilize this advantageous function of income taxation, and the revenue share of income tax in total tax revenue has remained low. In addition, the number of taxpayers of income tax is limited to only a small portion of the nation. A large share of the tax revenue comes from a limited number of large enterprises in many countries.

Regarding the large inequity between the rich and the poor, we need to examine whether the tax system as well as tax administration fairly collect taxes from high-wealth taxpayers. The tax system tends to have a narrow

(4) According to Simon Kuznets' hypothesis, economic inequality increases over time while a country is developing, and then after a certain income is attained, it begins to decrease.

tax base of high-income taxpayers and it works against horizontal equity. In addition, average-income taxpayers should also bear a certain amount of the tax burden considering the need to secure national revenue and social equity. Many developing countries do not provide adequate social welfare services to lower income people. In order to secure the necessary fiscal revenue for redistribution through social welfare services, the tax net should be widened and society should be sustained by many people. Proper and fair tax collection from a large number of taxpayers by widening the tax base and taxpayer coverage is necessary, but it is also a challenge in many countries.

Many revenue agencies have large-taxpayer offices (LTOs) which focus on proper taxation of large enterprises including multinational corporations and foreign corporations. However, proper taxation of small businesses is equally important, and yet organizations focusing on the taxation of small and medium-sized enterprises tend to have insufficient capacity to administer properly the payment of taxes by diversified taxpayers. The taxation of small businesses is not an easy task. Revenue agencies should consider possible strategies in their revenue management including compliance activities as well as sufficient resource allocation.

III. Self-assessment system and the taxation of small businesses

A. Introduction of the self-assessment system

Many countries have already introduced the self-assessment system while others have been considering its introduction[5]. Under the self-assessment system, taxpayers calculate their income by themselves, file tax returns with revenue agencies and pay their taxes. This regime, in which taxpayers sustain society by calculating their tax amount and paying the taxes, would appear to be compatible with democratic management of a nation.

Some countries have changed their tax payment system from the official assessment system to the self-assessment system. The main reason for the change is that, under the official assessment system, they found it difficult to assess the taxes of all taxpayers based on information submitted by them, and difficult to send assessment notices to taxpayers as the number of taxpayers increased and the tax base widened.

In Japan, the official assessment system was replaced by the self-assessment system in 1947. This change caused considerable confusion because many taxpayers were not used to calculating their taxes by themselves with book-accounting, and so it was difficult for them to file correct tax returns. In addition, tax officials were also not used to the new regime. The number of

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(5) For example, Asia Development Bank Institute (ADBI) "Tax Administration 2006 Summary Report" 21–23 March 2006, ADBI website (http://www.adbi.org/files/2006.03.20.cpp.taxadministration.2006.summary.pdf) states as follows:

> Malaysia expanded the application of the self-assessment system, which was introduced for corporations in 2001, to cover individuals in 2004. The system has the advantage of making tax administration more efficient, but applying it to SME's is a big challenge for the tax agency. The Inland Revenue Board is making efforts to make the system take root by providing public rulings to allow for clearer understanding of tax laws and procedures, improving efficiency of work procedures and processes, developing a new computer system, providing tax education, and upgrading taxpayer service.
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> Vietnam started to implement the self-assessment system on a trial basis from 2004 and has gradually expanded its coverage [note by author: full implementation in 2007]. A comprehensive reform is undergoing covering four main functions of tax administration; (a) taxpayer services, (b) tax return processing and payment, (c) debt collection, and (d) audits. The tax administration is restructuring the organizations based on functions and developing an integrated tax administration information system.
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> In Cambodia, the self-assessment system (Real Regime) was introduced in 1994 in Phnom Penh capital, but for small enterprises, it is the official assessment system (Estimated Regime) that is being applied. Efforts are being made in (a) facilitating voluntary filing through taxpayer service, (b) promoting book-accounting practice, (c) improving the environment for SME's, (d) improving audits, (e) enhancing enforcement activities, and (f) human resources development.
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> In Lao PDR, the self-assessment system is applied to large and medium sized taxpayers, while the contract method (gross profit margin estimation based on turnover) is taken for small taxpayers. The challenges under the self-assessment system include raising the level of expertise in tax administration, dealing with tax evasion, human resources development, and the use of IT.
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> Myanmar is taking the official assessment system today, but it is studying possible introduction of the self-assessment system. It is also contemplating replacing the existing commercial tax with VAT. Challenges include public relations efforts to taxpayers, computer system, simplification of the tax system, and the use of information.

cases of non-filing and under-reporting of income surged. Although administration of the self-assessment system in Japan started amid such confusion, the system eventually became settled through repeated trial and error over a long period.

Proper tax management under the self-assessment system is a challenge for a revenue agency: changing the tax payment system requires organizational reform, upgrading of computer systems, and sufficient staff training programs. In addition, efforts are required to promote taxpayer service and public relation activities for taxpayers who voluntarily file proper tax returns. Tax audit activities must also be strengthened to cope with non-filers and under-reporting of income. Various strategies including strengthening compliance activities, developing a database system for tax audits, and re-organization to cope with various types of taxpayers should be considered.(6)

B. Taxation of small businesses and promoting book-accounting

It is not easy for revenue agencies to implement the self-assessment system properly. Many small businesses are not accustomed to book-accounting practices, and they tend to lack sufficient funds to ask tax practitioners to handle their book-accounting or prepare their tax returns. When coverage of the self-assessment system reaches many taxpayers including small businesses, ensuring proper tax filing by small businesses becomes a difficult task in tax administration.

Many countries have estimate regimes, under which tax amounts are calculated in certain ways such as scale of business, turnover or comparison with equivalent-scale enterprises in the same industry. Also, some countries

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(6) Silvani and Baer (1997: p. 12) state that "Extensive reliance on a self-assessment system combined with targeted enforcement would allow the tax administration to effectively administer the tax system. Among the key elements which must be in place for a self-assessment system to operate effectively are: (1) good taxpayer services programs to facilitate taxpayers' understanding of their obligations and entitlements; (2) simple procedures; (3) a strong but fair penalty system; and, (4) effective verification and enforcement programs. These two broad principles, voluntary compliance and self-assessment, are the foundation of modern tax administrations."

impose a unified tax which is a single business tax, covering individual income tax, corporate income tax and VAT, on small businesses. There are various regimes of such deemed or unified tax, and they are often called 'estimate regime', 'single tax', 'special tax regime', 'presumptive tax', 'lump-sum tax' or 'composite tax system'. Weighing the fairness of taxation and the cost of compliance and tax administrative capability, these deemed taxation regimes on small businesses are a realistic approach. Nevertheless, these regimes should not discourage small businesses from adopting book-accounting under the self-assessment system. In order to encourage them to actually calculate their income, the deemed profit rate should not be too low, otherwise book-accounting is unlikely to spread.

However, deemed taxation regimes in many countries seem to give tax concessions to small businesses. According to Shome (2004):

> In both Asia and Latin America, small to medium taxpayers do possess significant revenue contribution potential, possibly a quarter of the total.... Nevertheless, small taxpayers are often made subject to scaled-back taxation under the concept of a "single tax" (*monotributo*), which typically collects less tax from them than their potential. The idea of a single tax is a poor one since it tends to increase inequity and encourage the unwillingness of small taxpayers to graduate from single tax.[7]

Preferential tax treatment by deemed taxation discourages the proper calculation of income based on book-accounting. Creating incentives for proper book-accounting is an effective way to shift small businesses from taxation based on estimation of income to taxation based on actual income calculation. The cost of complying with book-accounting is a reason for creating preferential treatment for taxation based on actual income calculation.

In Japan, the "blue return system" rewards taxpayers with preferential tax treatment for accurate book-accounting and proper book-accounting and compliance. There was no habit of book-accounting in small businesses when

(7) Shome (2004), pp. 27–28.

the self-assessment system was introduced in Japan in 1947. The Shoup Mission (1949), which recommended revising the tax policy in the post-war period, stated that:

> It is axiomatic that proper taxpayer compliance under a self-assessment system is possible only if the taxpayer keeps accurate books and records whereby he may ascertain his income. Present day record-keeping in Japan is in a deplorable state. Books and records do not exist at all for many business concerns. They exist in super abundance for other concerns, and only the taxpayer knows which is the reality and which the mask. The result is a vicious circle. Tax officials claim they must resort to office assessments based on standards and other averages because of the absence of accurate and reliable books. Taxpayers state that there is no point to keeping accurate books, even assuming that they were competent to do so, because the tax officials refuse to credit the books. This circle must be broken.(8)

The mission recommended creating preferential treatment for proper book-accounting. Based on this recommendation, the "blue return system" was introduced in 1950. The blue return system gives preferential treatment to taxpayers who file tax returns with proper book-accounting, such as carryover of loss. This regime encouraged book-accounting and contributed to stabilizing the self-assessment system. In 1950, the number of blue return filers was 110,000, which counted for only 4% of individual tax returns. In accordance with several tax revisions relating to the blue return system to enlarge preferential treatment, combined with various activities by the NTA, the number of blue return filers has increased significantly since then (Chart 2).

One of the main reasons for the increase in blue return filers was the adoption of a simplified book-accounting system for small businesses, which can gain preferential tax treatment. This system for small businesses is an option in developing countries to encourage book-accounting.

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(8) Shoup Mission (1949), p. D56.

Chart 2 Number and ratio of blue return individuals[9]

Year	Number of Blue Return Filers (10 thousand)	Ratio (%)
1950	11	4
1955	52	32
1960	58	33
1965	79	48
1970	161	53
1975	242	52

The growth of small businesses is an engine of economic development. Proper book-accounting is beneficial not only for proper tax filing and payment but also for business development, by enabling them to use the accounting books to analyze their business. One of the important contributors to high growth in Japan after the Second World War was that many businesses kept accounting books, which they used to analyze their business. Shome (2004) stated:

> Large developing countries such as Brazil, India, and, to some extent, China, experience impressive growth in their service sectors as in the developed countries of the European Union and the United States. And the growth is represented significantly by small entrepreneurs, contributing to the dynamism in the recently experienced economic growth. ....Thus, for example, if the small services sector is viewed as an engine of economic growth, then this sector has to be successfully targeted for revenue intake and has to be assimilated as quickly as possible within the overall tax administration framework, rather than being subject to minimalist tax structures especially devised for them.[10]

In order to support the growth of small businesses including the small ser-

(9) Source: National Tax Agency (2004), p. 33.
(10) Shome (2004), pp. 6–7.

vices sector, the tax system should not hinder their development. If the tax system is too preferential for small businesses under the estimate regime, they will tend to remain small and be reluctant to enter the real regime which is applied to large businesses.

In order to promote book-accounting, the revenue agency should co-operate with tax practitioners and associations in the private sector, in addition to its own efforts. The co-operation of tax practitioners and the private sector to improve tax compliance should be developed by providing sound business management with proper book-accounting.

In Japan, various types of private cooperative organizations for tax filing and payment have been organized, and they have expanded their activities nationwide and promote proper filing with proper book-accounting. When taxpayers cannot prepare accounts for proper tax filing, they can ask tax accountants to handle the tax filing work. The Certified Public Tax Accountant (CPTA) Law was enacted in 1951, which prescribes that a public examination be taken in order to become a CPTA and to register as a CPTA. Under the CPTA law, the mission of CPTAs is to adopt an independent and fair standpoint, and to ensure taxpayer compliance with the tax code. CPTAs sustain the self-assessment system by encouraging taxpayers to perform book-accounting. They also encourage the modernization of management in each business.

Many developing countries have Certified Public Accountant systems, but only a limited number of countries stipulate the role and responsibilities of tax practitioners. It is meaningful to clarify the roles of tax practitioners and to promote proper book-accounting with their cooperation.

IV. Revenue targeting

Many developing countries have set revenue targets or tax collection goals. The targets are set in various ways by each country, such as a certain ratio of forecasted GDP or calculation based on tax revenue in the previous year.

Japan, too, used to set revenue targets. When the self-assessment system was introduced in 1947, the General Headquarters of the Supreme Commander for the Allied Powers (GHQ/SCAP), which administered Japan during the post-war period from 1945 to 1952, called for revenue targets and set a target for each tax office to strengthen tax collection. Based on these allocated revenue targets, each tax office estimated the income of each taxpayer by desk research in accordance with the target average income level and number of taxpayers in each industry set by financial bureaus. District directors of tax offices were severely punished when their offices failed to achieve the target, and receive incentive bonuses when they achieved it. As a result, the amount of tax collected increased drastically from 34% of the target revenue at the end of 1947 to 110% at the end of March 1948. Although the revenue in the budget was achieved by the revenue target approach, many taxpayers objected and started to file tax appeals, and there were also many opposition campaigns against tax offices. This revenue target approach in Japan was strongly criticized by the Shoup Recommendation and was abolished. Taxpayers would have lost trust in the revenue agency if tax offices had stuck to revenue targets and imposed taxes not in line with the tax laws. The Shoup Recommendation stated as follows:

> Voluntary self-assessment is directed toward ascertainment of the accurate income of a taxpayer. Its basic principles are in direct contrast to practices of the "goal system". Under this system a tax collection goal is assigned to, or computed by, each Tax Office. The total of these goals is the budget figure of expected income tax collections. .....Such a goal system was perhaps initially necessary to prevent total collapse of income tax collection. But sound tax administration will not appear until it is abandoned. .....the goal system should be abandoned as a step toward objective tax assessment.(11)

The revenue target system works in many countries as a benchmark for tax

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(11) Shoup Mission (1949), pp. D5–D6.

collection. It is formed and used in the process of forming government budgets. Under the self-assessment system, taxpayers voluntarily file tax returns properly in accordance with tax laws. The effects of the revenue target regime should be closely examined by comparing the concept of tax revenue estimation in the process of forming government budgets.

V. Tax incentives

Many developing countries have set various types of tax incentives including tax concessions for foreign investment in order to attract it. Foreign direct investment is beneficial in terms of: (a) promoting economic development, (b) supplementing insufficient domestic saving, and (c) acquiring cutting-edge technologies. However, whether these tax incentives are truly effective has not been definitively proved by experimental studies. Bird and Oldman (1990) pointed out that “Most studies suggest that the level of investment is not particularly sensitive to tax incentives.”[12] It has also been observed that “While granting tax incentives to promote investment is common in countries around the world, available evidence suggests that their effectiveness in attracting incremental investments (above and beyond the level that would have taken place if no incentives were given) is often questionable and that their revenue cost could well be high (e.g., tax incentives can be abused by existing enterprises disguised as new ones through nominal reorganization).”[13]

Although tax incentives may have positive effects of promoting investment in certain industries or attracting foreign investment, there are some problems:

(a) Inequity of competitiveness between foreign capital and domestic capital
(b) Possibility of disguise as foreign investment
(c) Increase in complexity of tax laws and difficulty of tax administration

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(12) Bird and Oldman (1990), p. 130.
(13) Tanzi and Zee (2000), p. 24.

due to detailed application requirements for using incentives

(d) Difficulty of abolishing incentives once introduced

(e) Inefficiency of resource distribution in the nation

The tax system is merely one factor in attracting foreign direct investment. In order to promote foreign direct investment, it is necessary to consider various other factors besides preferential tax treatment such as: (a) political and social stability, (b) skilled and cheap labor force, (c) social infrastructure, (d) scale and accessibility of domestic markets, (e) stable economy and currency, and (f) stable and transparent legal system.

It would appear to be more important, rather than tax incentives, to ensure that the tax system is easy to understand, to ensure fairness for all taxpayers, to secure taxpayers' rights through transparent tax administration, and to provide fair opportunities and fair judgments in tax appeals. In order to gain the trust of taxpayers, taxation in accordance with tax laws with accompanying accountability to taxpayers without discretionary taxation by revenue agencies is indispensable.

Preferential tax treatments for specific industries in order to develop certain industries may also have adverse effects such as: (a) reducing the tax base, (b) reducing fiscal revenue, (c) causing inefficient distribution of investment, (d) inducing tax avoidance, or (e) disturbing horizontal fairness. Redressing these issues will simplify the tax system, foster economic neutrality in business activities, and promote fairness in the tax system. A report of the OECD (2001) states that "Generally the considerations raised in the report can be seen on balance as cautiously over the introduction of special tax incentives, with simplification and base protection advantages identified with reducing the statutory corporate income tax rate as a means to lower the host country tax burden. However, the report stops short of policy recommendations, recognizing that decisions over the use of incentives will depend on the specific country situation, and moreover rest in the sovereign domain of national government."(14) The IMF (2011) also states that "Incentives pose concerns of effectiveness, leakage, governance and spillovers."(15) Even though a country may create tax incentives, it is necessary to examine the effects, fairness between domestic corporations and foreign corporations, advantages and disadvantages of preferential treatments, and exit policies including the duration of the incentives.

VI. Fair tax administration

Developing countries face various challenges. Among them, revenue agencies should pay close attention to creating an environment for taxpayers that encourages: easy compliance with tax laws, compliance activities including tax audits, utilization of information and communication technologies (ICT), and staff training.

A. Promoting voluntary compliance by taxpayers

Under the self-assessment system, it is crucial that taxpayers fulfill their tax obligations by proper tax filings and payment, with an understanding of the significance and role of taxes. Revenue agencies should diffuse tax knowledge, conduct public relations to promote voluntary tax compliance, and provide tax counseling on calculating taxes and ways of filing. It is also necessary to create an environment where taxpayers pay taxes with sufficient understanding and convinced of the reasons for paying taxes. When a revenue agency finds under-reporting in tax filings and imposes additional taxes, it needs to explain clearly to taxpayers the reasons for reassessment and opportunities for appeals should be provided if taxpayers are unsatisfied; the decisions in appeals should be fair and the reasons for the decisions should be clear.

While revenue agencies are encouraged to create an environment for proper tax payment, the cooperation of tax practitioners and various private associations is indispensable to promote voluntary tax compliance. Tax prac-

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(14) OECD (2001), p. 7.
(15) IMF (2011), p. 35.

titioners are expected to play a positive role in fair tax payment when taxpayers ask them to prepare tax returns.

B. Strategies to cope with non-compliance

Under the self-assessment system, tax audits play a vital role in achieving fair taxation. Understatement of income in tax filings or non-filers must be surely corrected by strict audits. Revenue agencies must combat cases of intentional tax avoidance by intensive and thorough tax audits in order to secure fairness among taxpayers. They need to overcome the risk of tax evasion and avoidance activities by developing tax audit strategies. During tax audits, they should also urge taxpayers to file proper tax returns.

Revenue agencies are encouraged to create a database of taxpayers and system for supporting tax audits including information analysis systems in order to prevent tax evasion or malicious tax delinquency. The ratio of tax officials who work in compliance related activities such as field audits or tax collection among all tax officials in a revenue agency is not high in many developing countries. Increasing the number of officials in this field and allocating human resources appropriately in each revenue agency without reducing the level of service to taxpayers should be closely considered.

C. Utilization of ICT

In order to secure taxpayers' compliance with the limited resources of each revenue agency, ICT should be fully utilized to streamline and upgrade operations in a cost-efficient way. Recently, re-engineering or innovation in tax administration often requires ICT development. However, ICT systems are costly, incurring costs for development, operation and revision. The revenue agencies must consider the strategy for prioritizing ICT system development.

When prioritizing ICT system development, high priority should be put on constructing an effective database of taxpayers at the first stage. The database should include basic information on taxpayers such as name, address, their filing and payment information, and record of tax audits. Tax compliance activities such as tax audits and taxpayer services are conducted by using these databases.

An important point relating to system development is that the database should not contain huge amounts of unnecessary data, otherwise system development may suffer significant delays, inefficient use of data, difficulties of system revision, and significant cost. The volume of data is greatly influenced by whether the scope of information is limited only to taxpayers who operate a business, or includes all taxpayers who file tax returns. Given the limited resources of the system such as cost, development workload, and speed of data processing, the scope of taxpayer information in the database should be closely examined and only information that is useful for compliance activities should be selected. During system development, close communication between those developing the system and those who will use it is indispensable. The amount of data to be stored must also be carefully considered. For example, data entry followed by cross-checking of the data should be examined with the feasibility of implementation and cost-benefit analysis.

Even if the scope of the database is not sufficiently broad, the database should be designed to use the information effectively at first, allowing for the possibility of later expansion. Although an online network system covering district tax offices nationwide is desirable, it is possible to start with an offline system using batch processing, provided the database is relevant.

Recent IT developments enable revenue agencies to offer various taxpayer services such as providing various information on websites, e-filing and e-payment. It is recommended to provide an environment that enables taxpayers to comply easily with tax laws and that revenue agencies can easily use with ICT.

D. Staff training

While ICT system development supports the operations of a revenue agency, it needs to be operated by skilled officials. In each revenue agency, human resource development is imperative. In order to operate tax administration under the self-assessment system, tax officials need to obtain expertise in tax laws and tax accounting with high integrity. They need to conduct proper taxation in accordance with tax laws and coherent taxation treatment including reliable interpretation of tax laws. Tax auditors should explain the reasons for reassessment in audit procedures so that taxpayers understand the reasons for additional tax payment. Taxation in accordance with laws promotes the transparency of tax administration as well as trust in the revenue agency. Therefore, a well-developed program for training tax officials to raise their skills and quality is a high priority for a revenue agency. Many developing countries do not yet have systematic staff training programs and well-developed training systems with experienced officials as trainers.

In Japan, the Taxation Training Institute of the Ministry of Finance was established in 1941 as the first independent training institute providing training to officials of the Ministry of Finance. With the creation of the National Tax Agency (NTA) in 1949, this institution became the Training Institute of the NTA. In 1964, the Institute was reorganized and became the current National Tax College. It has contributed to human resource development in the NTA since then.

Some developing countries have problems such as difficulty in recruiting skilled staff because of low remuneration, or high turnover of officials to private accounting firms after they have obtained knowledge at revenue agencies. This is an issue not only for revenue agencies but also for many government agencies. Given these difficulties, the organization management strategy should include how to motivate officials to work, how to improve the workplace environment, and how to promote the integrity of officials in various ways including work incentives and internal audit mechanisms[(16)].

VII. Tax system

The tax policy should achieve a good overall balance among taxation on income, consumption and property. The balance of this tax mix policy changes with the economic stage of development of each country.

Many countries change their tax regimes as their economy changes. For example, the first stage of business taxation is taxation on business licenses, with which a government permits certain kinds of business activity. The second stage is taxation on turnover, and the third stage is taxation on profits or income. These taxation regimes may co-exist with each other according to the scale of business activities. However, as license tax shifts to turnover tax, and turnover tax shifts to income tax, the complexity for taxpayers of calculating their tax base increases, and the difficulty of implementation by revenue agencies also increases. In many countries, consumption tax such as VAT for small businesses is often calculated based on their turnover. On the other hand, large-scale enterprises calculate the value-added which is created by their business. Although the calculation of value-added is complex, this taxation approach is fairer.

The rationale of property taxation is to secure fairness relating to the possession or transfer of property. Taxation upon inheritance serves to redistribute wealth and prevent the concentration of wealth, and it also serves to supplement income taxation. The considerations of each tax system are outlined below.

A. Taxation on Income

1. Role of income taxation

The ratio of income taxes in total tax revenue is low in many developing countries, and the number of income taxpayers is small. The reasons why

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(16) Tanzi (1998) (pp. 585–586) explains the effects of corruption as follows:

(a) It reduces investment and, as a consequence, reduces the rate of growth.
(b) It reduces expenditure on education and health, which does not lend itself easily to corrupt practices on the part of those who make budgetary decisions.
(c) It increases public investment.
(d) It reduces expenditure for operation and maintenance.
(e) It reduces the productivity of public investment and of a country's infrastructure.
(f) It reduces tax revenue.
(g) It reduces foreign direct investment.

income tax is not a major source of tax revenue are: (a) difficulty of defining income, (b) difficulty of calculating income accurately, (c) low tax compliance, (d) limited number of income taxpayers due to a high threshold, (e) difficulty of collecting tax from various types of taxpayers, and (f) inadequate administrative resources. One of the issues to be considered in the income taxation regime is the scope of income. One example is how much non-business income should be included in taxable income. Taxation of occasional income other than business income is often difficult to implement. Revenue agencies should therefore also consider enforceability when examining the scope of taxation.

In accordance with economic development in each country, income tax has the potential to become a leading source of revenue. In order to secure stable tax revenue along with redistribution in the income taxation regime, many taxpayers should pay a commensurate tax burden, rather than tax being limited to only a certain portion of taxpayers.

On the other hand, various measures in the tax system and administration are needed in order to gather tax from many taxpayers. Although comprehensive income taxation, in which all kinds of income are aggregated and taxed together, is theoretically clear and attractive, it is difficult to implement properly in practice. In view of tax compliance and the limited resources of the revenue agency in each country, it is difficult to achieve comprehensive income taxation of all income. Thirsk (1997) points out that "Although scheduler elements are an unattractive aspect of an ideal income tax, in the real world scheduler taxation of capital incomes may be necessary on administrative grounds to cope with the problem of effectively taxing capital incomes."[17] Retaining the scheduler system in the income tax regime with withholding tax is a realistic approach in view of taxpayer convenience and effective tax administration.

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(17) Thirsk (1997), p. 26.

2. Use of the withholding tax system

There are two approaches to income taxation: taxation of business profit, or taxation of wages, interest and dividend from financial assets or capital gains. Although the taxation method may differ, it is effective to use the scheduler regime with the withholding tax system to secure proper tax payment and effective tax collection. Compared to a large number of tax filings followed by processing them in revenue agencies, the withholding tax system has advantages in terms of (a) assuring tax payment from a limited number of withholding agencies, (b) reducing the cost of tax compliance, and (c) effective tax administration. However, it involves great difficulty in regimes in which many taxpayers other than business enterprises file tax returns and revenue agencies process these returns properly. While the cooperation of withholding agencies is necessary, the withholding system is an efficient method of tax administration. In some countries, the government pays fees to withholding agencies. Even if revenue agencies pay certain fees to withholding agencies, they should efficiently utilize the withholding tax system. Tax payment is completed by employers who withhold taxes from wages paid to employees, or by payers of interest or dividends. As for business income, payers of certain kinds of payments or fees in business activities withhold taxes. Receivers aggregate all kinds of income earned in their business and calculate their tax amount after deducting tax withheld. Given the limited resources of revenue agencies, this mechanism works as a backstop against taxation leakage.

In many developing countries which receive large amounts of foreign investment, cross-border transactions and fund transfers are expected to increase. Since globalization poses difficulties for tax administration, the withholding tax mechanism in line with a global standard should be efficiently utilized.

3. Income from agriculture

Some countries have a different approach for taxation of agricultural income. Instead of an income taxation regime, for example, the tax base of agriculture is calculated based on the area of farmland with a lenient tax burden. As stated in Chapter II, deemed taxation based on the turnover of businesses is one realistic approach. The same approach as deemed taxation on small businesses can be applied to taxation of agricultural income. Preferential treatment of agricultural income should not hinder the development of agriculture. Regarding agricultural income, the Shoup Recommendation stated as follows:

> The income tax procedure applicable to farm income is at present based almost entirely on the use of standards. ... While the standards may be fairly accurate as averages, they are no better than averages and hence represent either considerable unfairness of considerable leniency in individual cases. In keeping with the goal of an objective individual measurement of net income, this system of standards should, therefore, be replaced by methods that take account as far as possible of differences in income productivity per tan among individual farmers.(18)

One approach for income from agriculture is to shift from deemed taxation to the real regime, while creating certain incentives for the real regime.

4. Corporate income calculation with modern corporate accounting

Some countries exclude certain kinds of expenditure as deductible expenses in calculating corporate tax. For example, certain proportions of advertising expenses, sales promotion expenses, and royalty payments on intangible assets cannot be deducted from corporate income. Modern corporate accounting is the basis of modern tax systems in calculating corporate tax and VAT. Proper calculation in accordance with the modern accounting system will contribute to the modernization and development of corporate businesses. In the context of tax administration, modern accounting leads to the proper calculation of various taxes besides corporate tax, such as VAT,

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(18) Shoup Mission (1949), pp. D14–D15.

withholding tax, and real estate tax, which are calculated in the process of calculating corporate tax.

B. Taxation on Consumption

Regarding taxation on consumption, most countries have adopted excise taxes on consumption goods and VAT. In some countries, turnover tax has been replaced by VAT, although calculating value added is more difficult than calculating turnover. Some countries adopt a hybrid calculation method in their VAT regimes: the turnover based calculation is typically used as a substitute for calculating value added for small businesses.

1. Tax base

Many countries adopt the invoice credit method in the VAT system although VAT regimes vary from country to country. Some countries have a regime in which the input tax credit on purchasing fixed assets is not fully admitted or only partially admitted in accordance with depreciation of the fixed assets. Some countries oblige taxpayers to use an official form to receive input tax credits. Some notable features in the base of the VAT regime in developing countries are as follows:

(a) Many kinds of goods and services are exempted from VAT taxation.
(b) Some countries limit the taxpayers of VAT to corporations only.
(c) As stated in Chapter III, some countries have introduced a unified tax or lump-sum tax applied to small businesses instead of individual/corporate income tax and VAT. Under this regime, the amount of tax is calculated as a certain proportion of turnover or scale of business.

Although these features arise from social policy or constraints in tax administration, the tax base of VAT should be sufficiently wide in order to utilize the advantages of VAT, namely fairness of taxation and economic neutrality through a wide tax base.

As for the simplified tax regime in the VAT for small businesses, one practical way is to set the deemed input ratio at a low level in order to encourage them to shift to calculating the input tax credit by the real regime. Otherwise, they may be reluctant to expand their business, which means that the tax system hinders business development.

2. Multiple tax rates

Many countries have multiple tax rates in their VAT regimes in order to redress the regressivity of VAT. The reasons for creating multiple tax rates include social policy to decrease tax rates on necessities, and influences remaining in the process of transition from excise duty to VAT. The IMF (2011) recommends a broad base, single rates and a fairly high threshold in a VAT regime.[19] In order to utilize the advantages of the VAT such as neutrality of taxation among various kinds of goods and services, and reducing compliance costs as well as administrative costs, it is recommended to minimize the scope of goods and services to which reduced rates are applied. The implementation of multiple tax rates creates many difficulties for revenue agencies. Without a thorough consideration of administration, multiple rates and many exemptions will not work well. Thirsk (1997) states that "Often the VAT has been seen as a panacea for a wide variety of fiscal ills, including the need for higher revenue. Experience in a few countries, however, tempers this unqualified enthusiasm for the VAT by pointing to the possibility of a poorly designed VAT. If preparation for the VAT is inadequate and enforcement in weak, as was the situation in Bolivia in an initial attempt to adopt the tax in 1975, or if the VAT has numerous rates and is interlaced with extensive exemptions, as in Morocco, it may operate with the same defects as, and indeed may be even worse than, the indirect taxes it replaced."[20] When designing the VAT regime, it is important to consider enforcement.

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(19) IMF (2011), p. 24.
(20) Thirsk (1997), p. 20.

3. Unification of tax administration between direct taxes and the VAT

In countries adopting the VAT, it is worth considering the unified tax administration of direct taxes and the VAT. Taxpayers prepare accounting books based on invoices, and they calculate the amount of both individual/corporate income tax and the VAT based on the accounting books. When revenue agencies conduct tax audits and find under-reporting of turnover, the reassessment of tax is not limited to the individual/corporate income tax, but also the influence on the VAT. Some countries have separate organizations or departments to administer income tax and the VAT. The unified organization and administration of income tax and the VAT should be considered, as it reduces the compliance cost for taxpayers through a one-stop service of revenue agencies and opportunities of tax audits or tax consultation.

In some countries, there is concern about VAT fraud with falsified invoices. If VAT calculation relies too much on invoices, falsified invoices may create a challenge for VAT enforcement. Unified administrative organization is one effective way to reduce this risk. Taxpayers usually prepare an output VAT report and an input VAT report based on invoices. If the taxpayer has accurate book-accounting, it is practical to permit VAT calculation based on accounting books instead of preparing detailed output VAT and input VAT reports, and reduces the compliance cost for taxpayers. Furthermore, revenue agencies have a higher possibility of detecting VAT fraud during tax audits by examining accounting books as well as invoices. If countries permit input tax credits only using official invoice forms, it would provide an incentive for taxpayers to improve their book-accounting by permitting input tax credits without official invoice forms, provided they have accurate accounting books.

C. Taxation on Property

1. Taxation of owned property

The role of property taxation is particularly important for countries with large disparities between the rich and the poor, in order to achieve income redistribution besides securing tax revenue.

A real estate tax, which is usually a local tax, is prevalent in many countries and is a key source of fiscal revenue for local governments. Taxation of owned property has the following features that make it efficient and fair. First, compared with income taxation, it brings in stable tax revenue without large fluctuations due to economic conditions. Second, its tax base is fixed and so it cannot be avoided. Third, it reflects the principle of taxation according to benefits, assuming that owners of property have received benefits commensurate with the value of the property. Fourth, it is relatively easy to administer when the tax is based on property registration. On the other hand, one difficulty in enforcing the real estate tax is evaluation of properties. Revenue agencies need to examine fair and practical ways of evaluating properties.

2. Inheritance tax

Relatively few countries have introduced inheritance tax. Concerning the redistribution of wealth, it is worth considering its introduction in future, although it is not easy to reach political agreement on its introduction. Upon introduction, how to evaluate properties is a challenge for revenue agencies. The standard used to evaluate assets must be closely examined, considering enforceability and transparency.

D. International Taxation

The economy has become increasingly globalized with increased amount of foreign investment and cross-border business transactions. This globalization of economy has expanded business activities and operations not only in developed countries but also in developing countries. Supply chains of businesses now encompass from manufacturing to distribution across globe. Corporate activities in developing countries have also been incorporated into this global supply chain network.

This acceleration of business globalization has presented a series of challenges in taxation. For example, the number of Mutual Agreement Procedure (MAP) requests received by the NTA (National Tax Agency, Japan) has been increasing significantly in recent years, and those with non-OED economies, in particular, has increased from 40, in 2014 operating year (July 2014–June 2015) to 76, in 2017 operating year (July 2017–June 2018).

Faced with such pace of globalization, tax authorities should deepen mutual understanding regarding international taxation standard including transfer pricing and tax treaties so that international business can be facilitated.

Recently, increasing important role has been played by several international taxation forums which include developing countries. For instance, discussions over the Base Erosion and Profit Shifting (BEPS) project made in the OECD/ G20 inclusive framework which brought over 125 countries and jurisdictions to work together to implement the BEPS package.

In order to provide better environment in tax matters, the global collaboration between developed and developing countries is crucial, especially in the area of international taxation by ensuring BEPS solutions, transfer pricing rules, tax treaties, exchange of information, effective MAP procedure, etc.[21]

VIII. Conclusions

Many developing countries have relatively high income disparities between the rich and the poor. While social security should be strengthened to redress such disparities, often there are not enough funds for social security. As an economy develops, income taxation in particular becomes more important as a potential revenue source and as a means of achieving social equality through redistribution. However, it is likely to increase difficulties considering the diversification of taxpayers who are obliged to file tax returns properly. In many countries, small businesses employ the “estimation regime” or “deemed taxation” in which they calculate the tax amount based on their

(21) See OECD (2014a) and OECD (2014b).

scale of business because of their inadequate book-accounting.

In addition to the fact that the tax system generates revenue, it can also help expand business through proper book-accounting. For this reason, some form of incentives should be considered to encourage book-accounting by business entities.

Securing sufficient funds is a major challenge for each nation. Taxes are collected from economic activities. The tax system should be constantly re-examined in accordance with economic development and should not hinder business activities; rather, it should drive the growth of business. At the same time, enforceability must be considered in the process of restructuring the tax system. The words of Dr. Carl S. Shoup, "Tax administration is the key to tax policy,"[22] should be remembered. Enforceability and economic development are crucial factors in reforming the tax system. A proper tax system and administration will contribute not only to fair taxation but also to economic growth in developing countries.

This article examined common features of the tax systems and tax administrations in developing countries and proposed some directions for reforms. Needless to say, the situation varies from country to country, and the details of reforms should be drawn up country by country. I would like to continue to discuss with officials in developing countries how to improve their tax systems and tax administrations.

Tax constitutes the bedrock of a nation. Improvement of the tax system and modernization of tax administration not only generates fiscal revenue, but also leads to business growth through proper book-accounting. It also contributes to economic development, accountability of the state, and greater trust in the state. Further growth in developing countries through proper tax filing and payment is desired.

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(22) See Oldman (1992), p. 342.

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