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COMPARING TAX REFORMS: ANALYZING THE DRIVING FACTORS, EXPECTATIONS, AND ELEMENTS OF REFORM

MEMBANDINGKAN REFORMASI PERPAJAKAN: ANALISIS TERHADAP FAKTOR-FAKTOR PENDORONG, HARAPAN, DAN ELEMEN REFORMASI

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Abstract

A country generally performs fundamental changes in line with its economic, political, cultural, and social circumstances. As a part of changes, tax reform is an important step in the development of a country. Certainly, the Implications for each country vary according to characteristics of that country. Therefore, it would be very interesting if we compare tax reforms among countries before formulating a better approach to tax reform in the future. This paper aims to provide a flow of analysis to compare tax reforms based on the perspective of driving factors, expectations, and elements. This flow will help us to find - in a systematic way - similarities of tax reform implementation among countries. We simulate descriptively the flow to identify them in transition, developed, and developing countries based on the literature and on previous studies. As a result, we highlight clearly the similarities of tax reform between those countries from the perspectives of driving factors, expectations, and elements.

Keywords: tax reform, analysis flow, driving factor, expectation, element.

Abstrak

Sebuah negara umumnya melakukan perubahan penting sejalan dengan, situasi politik, budaya, dan sosial ekonomi. Sebagai bagian dari perubahan, reformasi pajak merupakan langkah penting dalam pembangunan suatu negara. Tentunya, implikasi untuk masing-masing negara berbeda sesuai dengan karakteristik negara tersebut. Oleh karena itu, akan sangat menarik jika kita membandingkan reformasi pajak di antara beberapa negara sebelum merumuskan pendekatan reformasi pajak yang lebih baik di masa yang akan datang. Makalah ini bertujuan untuk memberikan alur analisis dalam membandingkan reformasi pajak berdasarkan perspektif faktor pendorong, harapan, dan elemen. Alur ini akan membantu kita menemukan - dengan cara yang sistematis - kesamaan pelaksanaan reformasi pajak antar negara. Kami mensimulasikan alur ini untuk mengidentifikasi kesamaan tersebut di antara negara-negara transisi, maju, dan berkembang berdasarkan literatur dan penelitian sebelumnya. Sebagai hasilnya, kami menyoroti dengan jelas kesamaan reformasi pajak antara negara-negara tersebut dalam perspektif faktor pendorong, harapan, dan elemen.

Kata kunci: reformasi pajak, alur analisis, faktor pendorong, harapan, elemen.

INTRODUCTION

Reports from the World Bank and PwC have recently stated that countries continue to reform their tax systems, even though the outlook for the global economy remains uncertain. On the other hand, the report found that the number of countries engaged in reform had reduced from 35 last year to 31 countries. However, these countries continue their focus on reducing the burden of tax administration such as by introducing improved online systems in order to increase the level of tax compliance (PwC, 2013).

Development of a tax regime in a country commonly reflects the socio-economic characteristics of that country, so the tax reform requires fundamentally changes in every aspect of taxation in which at least include improving the quality of human resources, tax regulation, and tax information service system to achieve comprehensively optimal tax system, where simplicity, efficiency, voluntary compliance, and tax revenue Increased significantly (Alm, James, 1996).

In a country that undergoes crisis, tax reform is an important part to maintain macroeconomic stability. A good example of this is namely tax reforms undertaken in Mexico, Indonesia, and Russia. Mexico, as a country that has repeatedly experienced crises, has made fundamentally tax reform since 1998. Tax reform performed is expected to increase government revenue by roughly 1 percent of GDP in 1998 and allowed the government to sustain the budget deficit in 1999 and 2000 at around 1.25% and 1.00% of GDP respectively. In Indonesia, tax reform was performed when the debt crisis threatened constructively in 1980s because of declining oil prices in the early and mid-1980s. Reform policies have helped the government to improve a new domestic revenue source to counterbalance the decline of revenues from the oil and gas sector. After tax reform in 1980s, Indonesia tax ratio increased from around 7 percent in the period 1981-1985, to nearly 10 percent in the early 1990s, and reached approximately at 12 percent in the mid-1990s. In contrast to Mexico and Indonesia, Russian accomplished tax reform in 1990 in order to facilitate its economic transition from the socialist economy system to economy based on market mechanism. Economic transition process that conducted Russian caused decreasing the government revenue from state enterprises as traditional sector in the socialist era. Consequently, Russia then noticeably dropped in crisis. Therefore, tax reform was regarded as an important part in order to maintain Russia's macroeconomic stabilization (Rizali, 2001).

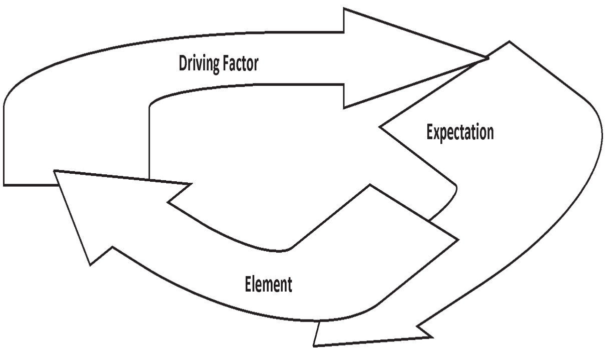
From an overall experience, we can assume that there is the similar driving factor of tax reform implementation in Mexico, Indonesia, and Russia namely to maintain the macro economy stabilization. Therefore, the central question to this paper is whether other countries have the same factor in tax reform. In order to answer this question, we first design a flow of comparison study. Secondly, we stimulate this flow toward transition, developed and developing countries by describing pre-reform condition to get information about general circumstances, occurred problems, and weaknesses of administration as driving factors. Thirdly, we explore expectations and elements of reform regarding to driving factors. Finally, we provide discussion and some concluding remarks.

METHOD

Implementation of tax reform among countries in the world during the same period emerges an assumption about the existence of equal induces of tax reform. A good example of this statement is the globalization condition currently that brings a country to unity of market economy, so it is not possible a country can live alone without any interaction. While it may be true that the globalization gives a positive impact espesially in trading aspect, on the other hand, when the economic crisis occured extraordinarily and alarmingly, its effect on state finance felt in almost all countries in the world. This condition makes the state to conduct the financial reform including taxation.

Learning from this case, It is important for countries to do a comparison study to get more information about tax reform from other countries before formulating appropriately the next tax reform. Although the implementation of tax reform differs according to the characteristics of each country, but it is possible if there are generally similar factors among them. When done, the information obtained will be useful, at least be a tool of learning to get better decision.Based on this assumption, a framework built systematically to facilitate the comparison analysis of tax reform is as shown below:

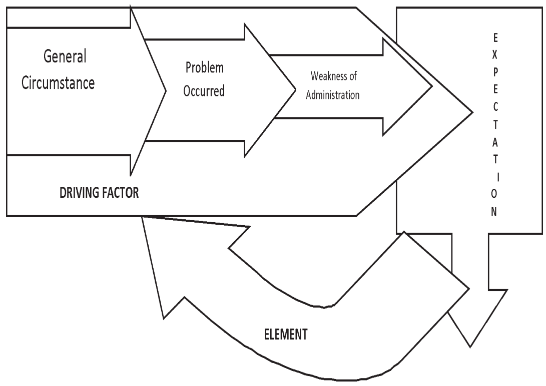
Figure 1. framework of flow by driving Factor, expectation, dan element



Source: analysis of author

According to the framework, in general, tax reform process covers three stages namely driving factor, expectation, and element. Following the figure, driving factors arise some expectations that then are implemented specifically by elements of tax reform. The flow developed is schematically as follows:

Figure 2. Flow of Analysis of Comprehensive of Tax Reform



Source: analysis of author

Looking at the figures, we can see that firstly, the flow clarifies driving factor in form of general circumstance, problem occured, and weakness of administration. Theoretically, in the tax system, tax administration is an important factor, so that the weakness of this aspect will affect the tax performance. Secondly, all driving factors will evoke expectations both from the government and taxpayer. Finally, in the last stage of the flow, expectations are implemented by elements formulated based on driving factors and expectations. From an overall perspective, we can summarize all information to find similarities between some countries compared systematically.

To simulate this flow, the author conducted a literature study toward tax reform implementation in transition, developed and developing countries by following all stages. The reason of dividing three groups because the large scale of tax reform occurred before 2004. According to the IMF classification, before April 2004, countries in the world were divided by the developing country that is a country with levels of well-being or quality of life in the development stage, then developed country that is a country with well-being or quality of life is high, and transition country that is a socialist country (non-democratic) in the middle ages, after the development of European and collapse of the Soviet Union which performed transitions of following the market economy (Martinez, et al, 1997). Afterward, in the progress, all countries in the world are divided by income per capita, namely (1) low income state by income per capita of $975 or less, (2) lower middle income state by income per capita between $976 and $3.855, (3) upper middle income state by income per capita between $3.856 and $11.905, and (4) high-income state by per capita income more than $11.906. The World Bank classifies entirely all low and middle income countries as developing countries (Word Bank, 2010). From an overall perspective, it is expected to produce a result that describes the implementation of tax reform in transition, developed and developing countries.

RESULT

Driving Factors

The driving factors of tax reforms in Transition, Developed and Developing Countries could be elaborated as follows:

Transition Countries

According to the implementation of tax reforms in transition countries, its driving factors (Jorge Martinez -Vazquez, and Robert McNab, 1997; John Toye, 2000) can be differentiated into:

General Circumstances

Implementation of taxation in transition countries follow the model of centralized economy in which the government role is large in controlling the economy. Tax considerably becomes a tool of government for economic development where profit tax, turnover tax, and payroll tax were noted as the largest tax types. Concentration of government is to collect taxes on state enterprises and a little on the individual income tax in which no large corporate dominance and no taxes on the private sector and property. Consequently, It was not suprising that nearly 50% of revenues are used to subsidize state enterprises and households and then the corporate tax has over four times larger than western countries.

Problem Occurred

Before tax reform, transition countries have problems with the low rate of voluntary compliance owing to the lack of public trust to the government that tends to corrupt and lack of public awareness to pay taxes that still becomes a burden. The low rate of compliance leads high rate of tax frauds and tax arrears. This condition is exacerbated by the lack of tax audit activity that does not exert modern audit techniques and lack of law enforcement. Uncertain and unstable tax system occur simultaneously on account of the excessive influence of government by task dualism as the owner and executor, changeable tax tariff, and absence of coding and database systems. This leads to low performance of tax revenue and the financial crisis.

Weakness of Tax Administration

In terms of tax administration, transition countries have problems about computerized tax registration information systems and tax collection management including the weak tax audit technique standard for corporate and accounting standard that do not refer to the modern accounting standard. The low capacity of tax administrator due to lack of training and low salaries generate apparatus behavior that tends to dishonest including the lack of service quality to taxpayers.

Developed Countries

The driving factors of tax reforms in developed countries (Jensen, Jonas and Florian Wohlbier, 2012; Alm, James and Benno Torgler, 2006; Esteller, 2005; Burgess, Robin and Nicholas Stern, 1993) is listed as follows:

General Circumstances

Implementation of taxation in developed countries have fundamentally a strong democracy tradition in which the taxpayer is considered wholly as a society who has equal rights and obligations as well as community involvement in political decision-making to solve problems including issues of taxation. The community also knows how tax money is utilized in accordance with expectations. Tax system occurs by strict law enforcement, no justified tax evasion, and focusing on customer, efficiency and controllable regulation. By these conditions, it is generally agreed that voluntary compliance is high and individual income tax became the biggest tax income at around 36% or about two-thirds of the tax revenue which reached roughly at 31.2% of GDP. Utilization of state revenue to public interest is markedly also quite high, in which the government allocation for social security and health reaches above 31%.

Problem Occurred

The high level of corruption in developed countries led to the decreasing public trust toward government. This condition is worsened by the global economic crisis that led the country's financial. These circumstances caused the decline of tax morale and a high rate of tax avoidance, tax evasion, and underreporting tax. Furthermore,the high tax tariff and tax compliance cost by forced law enforcement become other factors that cause the taxpayer non-compliance.

Weakness of Tax Administration

The high dependence of tax administration toward computer technology leds to a lack of relationship between taxpayers with tax officers. Lack of the tax administrator integrity is supported by the still high influence of political power to the implementation of tax administration

Developing Countries

Based on the implementation of tax reforms in developing countries, its driving factors (Mansfiel, 1987; Burgess, Robin and Nicholas Stern, 1993; Laurence, Henry 1999; Toye, John 2000; Yoo, Ilho 2000; Islam, Azizul 2001; Bird, Richard M. 2004) are provided as follows:

General Circumstances

The tax role towards state revenue is extremely large due to the high demand of country after independence from colonialism, financing war and reconstruction, public necessity for development, and government operations for the public service. Surprisingly, one of the first things to note is that almost 80% of state revenues depend on tax revenue. This dependence is also supported by lack of involvement of non-tax revenue sector. In term of tax type, it is noted that two thirds of tax revenue come from indirect taxes such as foreign trade taxes and customs. The existence of country's dependence on foreign loans leds to the quite large role and influence of international organizations and some developed countries in decisions relating to fiscal and economic.

Problem Occurred

It is interesting to see that problems in developing countries occur because of the complex tax system, narrow tax base, high tax compliance cost, injustice such as loopholes and exceptions, and high government intervention. The existence of state finance deficit due to the high debt, inflation, banking crisis and global economic crisis leads an impartial tax policy such as high tax rates and complex administrative procedures. Furthermore, the economic inequality, lack of tax education and knowledge, large tax burden, and inequity service led to the high rate of non-compliance such as tax evasion and tax avoidance. In addition, the lack of integrity due to poor salary structure and law enforcement brings to moral hazard behaviors that tend to corrup.

Weakness of Tax Administration

The weak tax administration infrastructure induces the no maximum tax administration service. Implementation of tax administration tends to be unstable and inefficient owing to the high tax administration cost. The low individual income tax role occurs due to the unsupported tax administration system in which the government focus is still on enforcing tariff and improving tax regulation.

EXPECTATION AND ELEMENT TAX REFORM

The results from the expectation and element perspective for each kind of countries are namely:

Transition Countries

The expectations and elements of tax reforms in Transition Countries (Martinez-Vazquez, Jorge and Robert McNab, 1997) could be elaborated as follows:

Expectations

From the government side, a striking point is that transition countries expect the improvement and modernization of the tax administration and begin to introduce gradually the western accountancy system in the tax implementation. Furthermore, there are the monitoring tax collection and mounting VAT compliance by the integration of VAT administration and corporate income tax. Increasing tax revenue is expected through four main tax such as comsumption tax, payroll tax, profit tax, and custom, then strengthening withholding tax mechanisms, using tax norms as a base to impose not measurable and monitored taxes, creating non-taxable income limits, and reducing the income instability by not relying on a single source of income. From the taxpayer side, tax reform is expected to strengthen the implementation of self-assessment, capacity and independence of the administrator so that services to taxpayers to be maximum and the existence of close relationship between tax administrators and taxpayers in frame of customer satisfaction.

Elements

To realize these expectations, tax reform elements undertaken in transition countries are primarily namely designing the tax system that adopts the modern administration system conducted in western countries and Europe, reducing the export and import tax to rise revenues in the trade side, determining the tax exemption for pensions, scholarships, compensation for insurance for social welfare, expanding the tax base, introducing the new tax, final tax, and changing tax rates to increase tax revenues.

Developed Countries

The expectations and elements of tax reforms in Developed Countries (Jensen, Jonas and Florian Wohlbier, 2012; Alm, James and Benno Torgler, 2006; Burgess, Robin and Nicholas Stern, 1993) can be outlined as follows:

Expectations

From the government side, It is generally agreed that expectations of developed countries are namely mounting tax revenue to overcome the economic crisis, rising tax compliance and moral taxpayer to turn down tax non-compliance behavior such as tax evasion and tax avoidance. In addition, the government also hopes the existance of improving the integrity of administrator to prevent corruption. From the taxpayer side, one thing that clearly stands out is specifically an expectation toward thepresence of fair regulation and law enforcement, especially for the private sector. Service to taxpayers is also expected to increase through a modern tax administration without leaving interpersonal relationships.

Elements

To achieve these expectations, developed countries undertake some elements of tax reform in which the tax determination based on the market economy and tax services due to customer satisfaction through the one gate service and building the organization owing to function. Furthermore, the government issues some regulations to increasethe role of VAT on goods and services including the simplification of income tax structure by unifying tariff and expanding tax base. Moreover, it also conducted an augmenting the tax system role by simplifying tax regulation, provisioning the taxpayer with tax information and education, reducing tax amnesty, and conducting taxpayer verification program based on the risk pyramid approach to tax segmentation. The integrity management program is also carried out to improve the integrity and tax morale.

Developing Countries

The expectations and elements of tax reforms in Developing Countries (Burgess, Robin and Nicholas Stern, 1993; Laurence, Henry 1999; Toye, John 2000; Yoo, Ilho 2000; Islam, Azizul 2001; Bird, Richard M. 2004) are carried out through:

Expectations

From the government side, It is generally true to say that developing countries have expectations to simplify the tax system by expanding the tax base and simplifying the tax laws according to economic conditions. Futhermore, they hope gradually the existence of liberalization of economic and financial system in accordance with directing international organizations in the context of country integration within the globalization and market economy framework. Moreover, tax revenues are also expected to increase through introducing the new tax products, maximizing the income tax, enhancing the VAT role and changing the tariff in order to turn down the role of seignorance, and foreign loan. In addition, tax compliance is also expected to go up by rising the role of self-assessment and strict law enforcement for tax fraud and corruption. From the taxpayer side, the presence of simple tax administration and improved services are expected by modernizing the tax administration, improving the tax administrator integrity, and the realizing the tax money for public goods.

Elements

It is interesting to see that elements of tax reform in developing contries related mainly to improve tax administration and tax revenue. In detail, the elements are separately namely modernizing the tax administration, simplifying tax laws, establishing an organizational structure based on the function, rationalizing tax rates by considering inflation and global economic crisis, determining the progressive tariff for income tax, accomplishing the program efficiency and assessment based on performance for tax administration, raising the indirect tax role such as the VAT by determining more precise and single tariff. Moreover, program of intensifying tax revenue is carried out by introducing the self assessment system and some new taxes, improving control functions, reducing loopholes, exemptions, various allowances, and changing tax tariffs. In addition, law enforcement program is directed to turn down fraud and corruption. The government also conducted actively integrity improvement programme to grow public trust so that voluntary compliance increased positively.

DISCUSSION

Tax reform is basically a price that must be paid by countries in the world, which impose taxes on the public in order to make improvements in every sector to achieve comprehensively the optimal tax implementation. Globalization framework likely allows some states do tax reform at the same time by the same factor. According to the literature analysis by using the analysis flow of tax reform in transition, developed and developing countries is obtained similarities of tax reform implementation in perspective of driving factors, expectations, and elements.

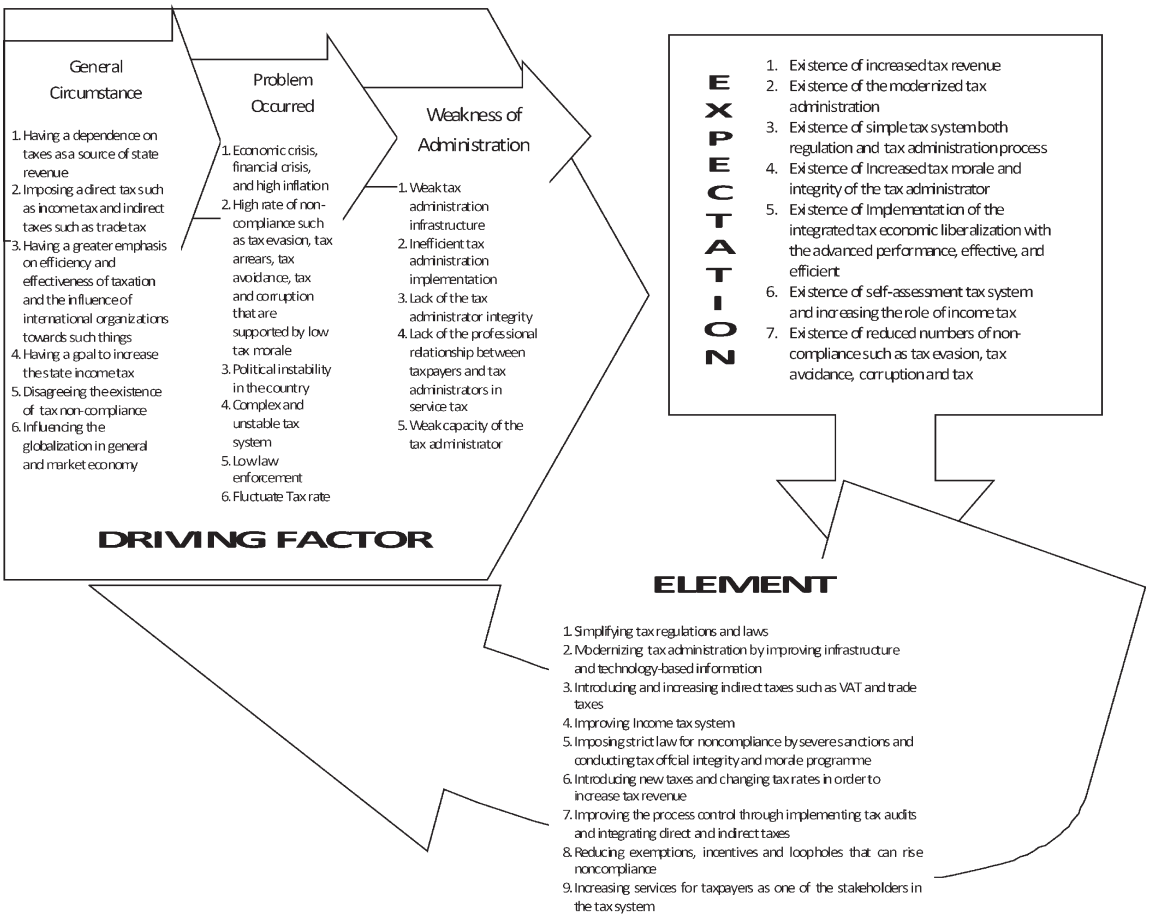
In the perspective of driving factors, in the context of general circumstance, it is generally true to say that they have a dependency on taxation as a source of state revenue; imposing direct taxes such as income tax and indirect taxes such as trade tax and VAT; having a greater emphasis on efficiency and effectiveness by existence of the influence of international organizations; having a tax objective to increase the tax revenue; disagreeing on tax non-compliance, and influencing generally the globalization and market economy. In the context of problem, several things that clearly stands out are the economic crisis, financial crisis, and high inflation are empirically the main problems. Other problems are namely high rates of non-compliance such as tax evasion, tax arrears, tax avoidance, and tax corruption that are supported by the low tax morale; political instability in the country; complex and unstable tax system; still poor law enforcement, and fluctuate tax rates. In the context of weakness of administration, one of the first things to note is that the weakness of tax administration infrastructure is the main problem. Other problems are inefficient tax administration, lack of the integrity and capacity of tax administrator, and lack of a professional relationship between the taxpayer and tax administrator in tax services.

In the perspective of expectations, one of the first things to note is that an augmenting tax revenue is markedly the main expectation. Other expectations are noticeably the existence of modern tax administration, simple tax system both regulation or tax administration process; increased tax morale and integrity of the tax administrator; integrated tax implementation with economic liberalization by prioritizing performance, effective, and efficient; self assessment tax system and elevating the income tax role; and reducing the number of non-compliance such as tax evasion, tax avoidance, and tax corruption.

In the perspective of elements, it is interesting to see that modernizing the tax administration by improving the infrastructure based on the information technology, introducing new taxes such as VAT and sales tax, and changing tax rates become the main elements of tax reform. Other elements are separately the simplifying tax laws and regulations, improving income tax system, enforcing strict law for non-compliance by severe sanctions, conducting integrity and morale improvement programme, working up control over the tax collectionby audit process, integrating direct and indirect taxes, reducing exemptions, incentives and loopholes that can rise non-compliance, and improving services to taxpayers as one of stakeholders in the tax system.

Illustration of similarities of tax reform in transition, developed, and developing countries according to the flow from an overall perspective both driving factor, expectation, and element is shown in the following figure:

Figure 3. Similarities ofTax Reform Implementation Based on Flow of Analysis



Source: analysis of author

CONCLUSION

This paper has offered systematically a simple analysis flow in order to conduct a comparison for finding similarities of the tax reform between some countries in perspective driving factors, expectations, and elements. From an overall perspective, by using this flow, it is resulted that there are similarities of driving factors of tax reform such as economy crises, administration problems, and others within transition, developed and developing countries.

Therefore, In the future, tax reform should be instituted seriously and performed continuously by the specific unit that has a job to identify necessities and inputs (Goode, 1993). Furthermore, a comprehensive evaluation toward the modernized tax administration is required because of its important role in the tax system and spending more the public money. By this evaluation, it is expected to be found the weak factors and some improvements can be conducted to achieve more efficient modern tax administration as a manifestation of government accountability in using the public money. This process indeed takes time. Like the wise words “Rome was not built in a day”, which implies literary that the modern tax administration system can not be established within one or two years. It takes many years, a gradual and sustainable process including cultural and economic adjustment. The big challenge will be faced explicitly and implicitly by all countries in the world when the development process of modern tax system administrative was performed (Bird, Richard M., 2004).

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