

**Tax Reform Diagnostic:
Suggested Terms of Reference Content Guidelines**

Final Report

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ABSTRACT

The objective of this report is to provide content guidelines for terms of reference to be drafted by a technical committee and issued by the Ministry of Finance, pursuant to USAID FY04 Cash Transfer Condition Precedent, Number [18], for a diagnostic study to serve as the basis for a comprehensive tax reform program.

ABBREVIATIONS AND ACRONYMS

AMIR	Achievement of Market-friendly Initiatives and Results Program
IMF	International Monetary Fund
MOF	Ministry of Finance
USAID	United States Agency for International Development

TABLE OF CONTENTS

Data Page	ii
Abstract	iii
Abbreviations and Acronyms.....	iv
Table of Contents.....	v
Executive Summary.....	1
1. Introduction.....	2
2. Terms of Reference Elements.....	3
2.1 Background	3
2.2 Objective	3
2.3 Indicative Tasks	5
A. Review of Existing Tax System.....	7
B. Analysis and Recommendations.....	7
C. Deliverables.....	8
3. Suggested Further Reading	9

EXECUTIVE SUMMARY

The objective of this report is to provide content guidelines for terms of reference to be drafted by a technical committee and issued by the Ministry of Finance (MOF), pursuant to USAID FY04 Cash Transfer Condition Precedent, Number [18], for a diagnostic study to serve as the basis for a comprehensive tax reform program. This note assumes that the Government of Jordan will approach comprehensive tax reform through a two-step process. The first step will be to commission a consultant or team of consultants to conduct a diagnostic study of the Jordanian tax system and develop a detailed strategy for its reform. It is expected that such a study might require two to four months of effort and modest resources. The second step will be the staged implementation of that strategy through a dedicated program. It is expected that such implementation might require two to five years of effort and substantial resources. This note assumes that the terms of reference in question is for the first of these two steps.

This report provides guidelines for the preparation of terms of reference, viz., background, introduction, objective, and indicative tasks. It also suggests further readings on tax systems. It is important to note that the suggested diagnostic study will examine the entire tax system, including tax policy, administration, and enforcement. It will encompass *all* sources of central government revenue, including all direct and indirect taxes, all fees and penalties, all income earned from any financial asset held by the government, and privatization proceeds. It will emphasize tax revenue, including personal and corporate income tax, consumption taxes and excises (including all revenue raised from the sale of fuel), and capital and property taxes. It will examine the net benefits to the government for charging fees for the goods and services it provides.

1. Introduction

The objective of this note is to provide content guidelines for terms of reference to be drafted by a technical committee and issued by the Ministry of Finance (MOF), pursuant to USAID FY04 Cash Transfer Condition Precedent, Number [18], for a diagnostic study to serve as the basis for a comprehensive tax reform program. This note has been prepared by the PSPI Component of the AMIR Program, as per the request of USAID/Jordan.

This note assumes that the Government of Jordan will approach comprehensive tax reform through a two-step process. The first step will be to commission a consultant or team of consultants to conduct a diagnostic study of the Jordanian tax system and develop a detailed strategy for its reform. It is expected that such a study might require two to four months of effort and modest resources. The second step will be the staged implementation of that strategy through a dedicated program. It is expected that such implementation might require two to five years of effort and substantial resources. This note assumes that the terms of reference in question is for the first of these two steps.

This note also assumes the following about the diagnostic study. It will examine the entire tax system, including tax policy, administration, and enforcement. It will encompass *all* sources of central government revenue, including all direct and indirect taxes, all fees and penalties, all income earned from any financial asset held by the government, and privatization proceeds. It will emphasize tax revenue, including personal and corporate income tax, consumption taxes and excises (including all revenue raised from the sale of fuel), and capital and property taxes. It will examine the net benefits to the government for charging fees for the goods and services it provides.

2. Terms of Reference Elements

The terms of reference in question should include sections describing the task's background and objective, at least. It may also include a section identifying specific tasks to be undertaken. Following is a brief discussion of these sections.

2.1 Background

The **background** section should describe the context and challenges to be addressed by the project. It should describe the current situation of the tax system, encompassing both its structure and administration. It should also describe its evolution and progress over recent years, including any internally- or externally-driven reform initiatives. It is especially important to describe internally-driven reform initiatives, as they demonstrate ambitions, mindset, and capacity of the relevant institutions.

The International Monetary Fund (IMF) has reportedly done a substantial amount of previous work related to tax administration in Jordan. The technical committee might base this section on the problems in tax structure and administration that have already been identified in the reports on this IMF work.

The technical committee might also base this section on equivalent sections in model studies of a similar sort that have been undertaken in other countries. For example, the Canadian Ministry of Finance framed the terms of reference for the comprehensive study undertaken by the Technical Committee on Business Taxation in 1996-1997 with the following, simple background.

“Canadians want their tax system to generate revenue in a fair and simple manner. They also want it to encourage economic growth and job creation. Given the complexity of combining these objectives, the Government of Canada has decided to undertake a review of those aspects of tax law that most affect the creation of jobs.”¹

2.2 Objective

The **objective** section should describe what the project specifically seeks to achieve. The technical committee might invent original objectives for its study. It is worth noting that comprehensive tax reform projects are traditionally built upon three pillars: (1) efficiency, (2) equity, and (3) simplicity. Equity is based on the principle that parties with the same ability to pay should be taxed equally; it should apply both horizontally and vertically, to both investors and citizens. Simplicity refers to ease of both administration and compliance.

The technical committee might also base the objectives for its study on national objectives that have been articulated through previous efforts by the Jordanian public or private sectors, as well as the international donor community. Examples of such efforts

¹ “Report of the Technical Committee on Business Taxation” (1997), B.19

include Jordan Vision 2020, The Investor Roadmap, and The Investment Task Force.² For example, Jordan Vision 2020 offers the following national objectives with regard to taxation in its strategy document.

“Design...a comprehensive tax reform programme. Efficiency, fairness, transparency, and even-handed application should be hallmarks of Jordan’s tax system. The current situation in which Jordanian businesses must spend three to six months of the year negotiating with the tax authority to determine a final tax assessment if unacceptable and must be changed. In addition, tax structures need to be framed so that they strengthen and support Jordan’s business development and competitiveness in the region and in those sectors likely to form the basis of any future ‘knowledge industry’ in Jordan.”³

The technical committee might also base the objectives for its study on the objectives of model studies of a similar sort that have been undertaken in other countries. For example, the Canadian Ministry of Finance built the terms of reference for the comprehensive study undertaken by the Technical Committee on Business Taxation in 1996-1997 on the following three principle objectives.

- “Improving the tax system to promote job creation and economic growth in an open economy”
- “Simplifying the taxation of business income to facilitate compliance by taxpayers and administration by Revenue Canada”
- “Enhancing fairness in the tax system by ensuring that all businesses share the cost of providing government services”

The technical committee may choose not to include a **tasks** section, as is the case for the terms of reference for the aforementioned Technical Committee on Business Taxation in Canada. In such a case, it would be incumbent on the party commissioned to undertake

² Jordan Vision 2020 is a public-private initiative launched in 1999 by leading business associations and led by the private sector to “set a course based on known future trends to maximize economic prosperity for all Jordanians.” For further information about Jordan Vision 2020, see its strategy document – “Jordan Vision 2020” (2000). Discussion of tax reform can be found on pages 31-32 and 49.

The Investor Roadmap is an initiative undertaken by the USAID-funded AMIR Program, initially in collaboration with the World Bank Foreign Investment Advisory Service. This initiative seeks to outline the critical procedural path that investors are required to take to start-up and operate a business in Jordan; highlight the major administrative, procedural, and regulatory constraints to business start-up and growth; and suggest the ways and means to make necessary improvements. For further information about the Investor Roadmap, see the two principle reports that have been published – “The Investor Roadmap” (1998) and “The 2002 Investor Roadmap of Jordan” (2002). Discussion of tax reform can be found primarily on pages 58-60 of the former and 132-196 of the latter.

The Investment Task Force is a public-private initiative launched in 2001 by His Majesty King Abdullah II upon the recommendation of the Economic Consultative Council and led by the private sector to “improve the investment environment in Jordan” and “lead to the responsiveness of the Jordanian economy to the requirements of the investors in an ever-changing world economy.” For further information about The Investment Task Force, see the two principle reports that it has published – “Executive Summary: Methodology, Initiatives and Recommendations” (March 2002) and “Executive Summary” (January 2002). Discussion of tax reform can be found primarily on pages 18 and 22 of the former and 30, 62, 67, 69, 71, 74, 77-79, 81, 86, and 88 of the latter.

³ “Jordan Vision 2020” (2000), p. 31

the task to identify the tasks required to achieve the stated objectives. The advantages of this approach are as follows.

- It prevents the committee setting the review agenda and reduces the risk of directing resources to inappropriate tasks
- It reduces the work of the committee
- In general, only the most interested consulting firms will submit a proposal
- The committee will be able to determine from the detailed methodology set out in each proposal the bidder's level of understanding of the tax reform process system and the Jordanian tax system in general
- The committee need not set the budget, as the bidder will likely submit a range of costed review options

If the technical committee does choose to include a tasks section, it should describe what specific steps the project should take to achieve its stated objectives. The technical committee might base the tasks listed in this section on tasks related to tax reform that have been articulated through previous efforts by the Jordanian public or private sectors, as well as the international donor community. Examples of such efforts include Jordan Vision 2020, The Investor Roadmap, and The Investment Task Force. For example, The Investment Task Force recommends the following tasks with regard to tax reform in one of its documents.

- "Simplify tax to attract investors and improve FDI and DDI"
- "Unify tax treatment and levies by applying fairness in the tax application"⁴

The technical committee might also invent original tasks for this study. Such tasks should cover a broad range of tax issues. Following is a list of indicative, generic tasks, based on the most common tax reform experiences. It is important to note that this list is *not* meant to be definitive. Instead, it is meant only to serve a point of departure for the technical committee's consideration of this subject and to provide a sample of the *sort* of material that the tasks section *might* contain. The actual tasks included in the terms of reference should only be determined after the technical committee has completed the appropriate due diligence process.

2.3 Indicative Tasks

A. Review of Existing Tax System

(1) Tax Policy

- a. From tax administration records, compile database of taxpayer information and tax revenue in sufficient detail to conduct necessary quantitative analysis
- b. Examine revenue performance per revenue source and describe changes in tax policy over time
- c. Estimate the tax gap and assess causes for the gap
- d. Review legislative developments in substantive tax laws and recent reform history
- e. Assess the complexity and certainty of tax legislation
- f. Examine the policy-making process and the role of the private sector

⁴ "Executive Summary: Methodology, Initiatives and Recommendations" (March 2002), p. 17.

- g. Review the existing tax structure including the tax mix, exclusions and tax rates
- h. Examine the symmetry of assessable gains and deductible losses and the inclusiveness of all forms of income
- i. Examine the tax treatment of different categories of taxpayers (e.g., small businesses, workers, and foreign investors)
- j. Examine personal income tax thresholds, exemptions and deductions. Estimate the degree of progressivity.

(2) Tax Administration and Enforcement

Review the following elements of current tax administration.

Human Resources and Organization

- a. Political support for tax reform and accountability of senior tax officials
- b. Staffing levels, skill levels, job functions, and turnover
- c. Infrastructure for human resource development, personnel policies, performance evaluation, and incentive structures
- d. Training capacity and provision in the tax administration
- e. Level of corruption
- f. Corporate mission and strategy, and code of ethics
- g. Civil service restrictions on recruitment, procurement, and budget-setting
- h. Lines of responsibility between national and regional tax offices

Operations

- i. Systems to register and track taxpayer actions
- j. Systems to process returns and payments
- k. Systems to detect stop-filers and delinquent taxpayers
- l. Methods to collect payments, include withholding taxes
- m. Capacity and effectiveness of existing information technology systems to meet the information needs, especially audit requirements, of the tax administration at an appropriate cost
- n. System used to select and conduct taxpayer audits. Is a risk-based selection system in place? What resources are committed to auditing functions?
- o. Internal and external systems to monitor and evaluate tax administration operations

Enforcement

- p. Systems to monitor and enforce tax payment by size of taxpayer, particularly large taxpayers and small businesses
- q. Systems to follow-up tax payer audits, stop-filers, and delinquent taxpayers
- r. Effectiveness and fairness of the existing range of penalties
- s. Incentives for prompt payment of taxes and penalties
- t. Time and cost to follow formal objection and appeal procedures
- u. Perceived fairness and efficiency of objection and appeal procedures

Client Relations

- v. Rights and obligations of taxpayers
- w. Sharing of information among tax departments and with other government agencies (e.g., Customs)
- x. Provision of advice and other taxpayer services by size of taxpayer
- y. Relations with the accounting and legal professions
- z. Level of voluntary compliance and self-assessment

- aa. Extent of publicity campaigns and taxpayer education

(3) Performance Indicators

Select and measure a set of tax system performance indicators that can be used to identify weaknesses in the current system and monitor improvements. These indicators could include the following.

- a. Total tax revenue as a share of GDP
- b. Actual tax revenue/ tax revenue estimated in the budget
- c. Tax revenue gap by tax, by selected taxpayer types, by economic sector, and activity-wise (e.g. non-filers versus under reporting).
- d. Amount of tax revenue paid voluntarily/ total tax revenue collected
- e. Additional tax revenue collected/ the number of declarations audited
- f. Amount of tax revenue arrears collected/ total tax revenue arrears
- g. Cost of collection
- h. Client perceptions

B. Analysis and Recommendations

(1) Tax Policy

- a. Analyze the efficiency costs of the existing tax structure and likely disincentive effects on different classes of taxpayers
- b. Develop a quantitative model to estimate revenue and disincentive effects of different tax structure scenarios for Jordan
- c. Determine the appropriate mix of policy and administrative reform to address the tax gap
- d. Estimate the expected reduction in customs revenue over time and forecast potential revenue from alternative sources, including petroleum taxes
- e. Define tax residence
- f. Recommend an appropriate tax base mix of all revenue sources and recommend a set of tax rates for residents and non-residents. Propose appropriate exclusions, thresholds and deductions
- g. Recommend a private/public sector institutional structure to formulate tax policy

(2) Tax Administration and Enforcement

- a. Recommend an appropriate organization structure and appropriate staffing levels and functions to administer the recommended tax policy
- b. Consider combining tax administrations into a revenue authority
- c. Recommend appropriate job descriptions, performance appraisal and incentive structure and a training program for staff
- d. Recommend appropriate business processes to collect tax revenue under the proposed tax system, including new or improved forms of withholding and self-assessment
- e. Design appropriate risk-based audit systems
- f. Recommend improvements to the existing tax computer systems to improve administration efficiency and to accommodate proposed changes
- g. Recommend appropriate levels and collection mechanisms for penalties and other sanctions to encourage compliance

- h. Consider alternate dispute resolution mechanisms for tax offences in order to save litigation time and expense
- i. Recommend improved taxpayer services and a tax education program, including possible binding rulings

C. Deliverables

1. Develop diagnosis report discussing analysis and findings of the above tasks
2. Develop strategy for reform and action plan, including timing, cost, and priority of recommended reforms
3. Note appropriate sequencing of projects and any pilot projects in the strategy
4. Account for required political will and appropriate change management controls in the strategy for reform
5. Identify and address foreseeable risks to the reform process

3. Suggested Further Reading

Following is a list of documents on the subject of tax reform. These documents, together with reports specific to Jordan, may be of assistance to the technical committee.

Barbone, Luca, Arindam Das-Gupta, Luc De Wulf, and Anna Hansson. "Reforming Tax Systems: The World Bank Record in the 1990s." World Bank.

Brooks, Neil. "Key Issues in Income Tax: Challenges of Tax Administration and Compliance." Asian Development Bank, 2001.

Gill, Jit B. S. "A Diagnostic Framework for Revenue Administration." World Bank, June 2000.

Gill, Jit B. S. "The Nuts and Bolts of Revenue Administration Reform." World Bank, January 2003.

Silvani, Carlos and Katherine Baer. "Designing a Tax Administration Reform Strategy: Experience and Guidelines." International Monetary Fund, March 1997. (WP/97/30)

Stepanyan, Vahram. "Reforming Tax Systems: Experience of the Baltics, Russia, and Other Countries of the Former Soviet Union." International Monetary Fund, September 2003. (WP/03/173)

Stotsky, Janet G. and Asegedech WoldeMariam. "Central American Tax Reform: Trends and Possibilities." International Monetary Fund, December 2002. (WP/02/227)

Tanzi, Vito and Howell H. Zee. "Tax Policy for Emerging Markets: Developing Countries." International Monetary Fund, March 2000. (WP/00/35)