

# Pacific Island Countries: Review of Tax Reforms and Lessons for Future Revenue Mobilization



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**PFTAC Steering Committee Meeting**

Honiara, Solomon Islands, March 15-16, 2017

# Why the Review?

- Sound tax systems are necessary if Pacific Island Countries (PICs) are to raise revenue necessary to address fiscal challenges  
... support development, reduce poverty, reduce reliance on foreign aid
- Many PICs have undertaken tax policy and/or tax administration reforms to strengthen tax systems
- Have they achieved their objectives and had an impact: revenue, equity, efficiency (both policy and administration) and simplicity?
- What are the lessons learned and how can they guide future reform ... and future technical assistance (TA) (both for PFTAC and other TA providers)?

# Review Process

- General review of tax reforms in all PICs
  - ... with focused reviews in five selected PICs
    - Fiji, Kiribati, Samoa, Solomon Islands and Tonga
- These countries were chosen because of their diversity in terms of population, location in the Pacific, and experience with tax reform
  - ... and they were also the subject of the last strategic tax policy and administration review by PFTAC in 2008
- Review period 2008 to 2016 (again from the last strategic review)
- Mission team briefly visited each of the five countries and also met with key donors in Australia and NZ
- Report currently being prepared for PFTAC

# Tax Reform Trends

- Much policy reform focused on indirect taxes (VAT/GST, import duties, excises)
  - Since 2008, 3 countries have introduced VAT and at least 3 others are considering introduction
  - Of the 6 countries that had VAT in 2008, 2 increased VAT rate (though Fiji later decreased it) and 5 countries adjusted the VAT registration threshold
  - Number of PICs have introduced or increased excises on specific goods, including sugary drinks
- Corporate income tax (CIT) rates have generally been stable despite international trend to decrease CIT rates
  - Average CIT rate for region is 25.7%, higher than the worldwide average of 23.62%

# Tax Reform Trends

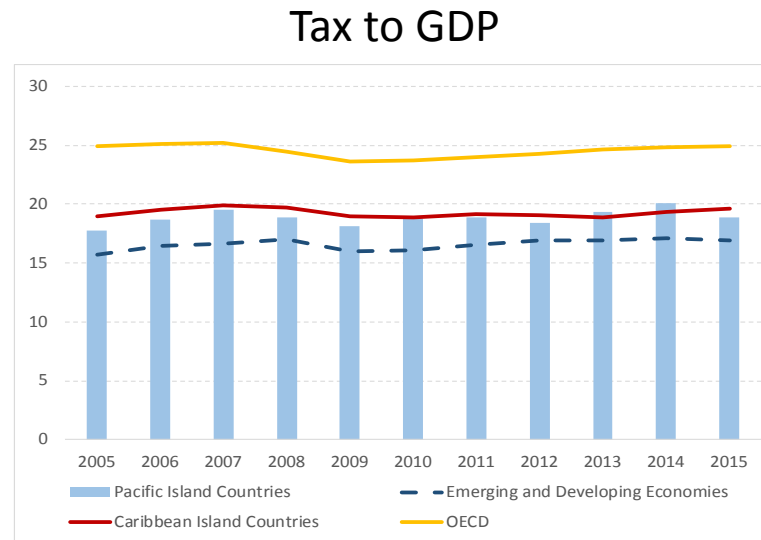
- Personal income tax (PIT) rates have also been stable
  - 4 PICs reduced PIT rates or changed the tax-free amount
  - ... lack of PIT reform in some PICs could lead to an unintended increased tax burden (i.e., ‘bracket creep’)
- Many PICs are seeking to address taxation of small businesses
  - 1 country introduced small business tax and others are considering
- International issues do not seem to be a priority for most PICs, despite worldwide interest in these issues (e.g., Base Erosion and Profit Shifting (BEPS) project)
- PICs are exploring alternative revenue sources
  - Non-tax revenues (fees, charges, fines); land and property taxes; deep sea mining taxes

# Tax Reform Trends

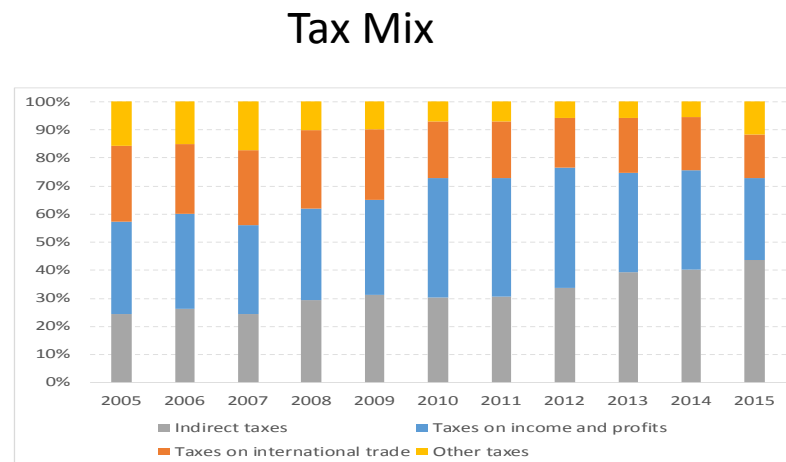
- Tax administration reforms focused on institutional strengthening and governance
  - Administration frameworks have been introduced or modernized in half of PICs
  - New governance and accountability measures have been introduced
  - Basic corporate strategic planning has been introduced
  - Many PICs have established or transitioned from a tax type operating model to a function based model or hybrid function/segment model  
... large taxpayer offices are not a feature of these reforms
  - 8 PICs have introduced or updated their information technology systems
  - PICs are also streamlining core functions (e.g., registration, filing, payment and audit)

# Reform Impact - Revenues

- Tax revenue as a share of GDP in PICs has increased though at a slow pace



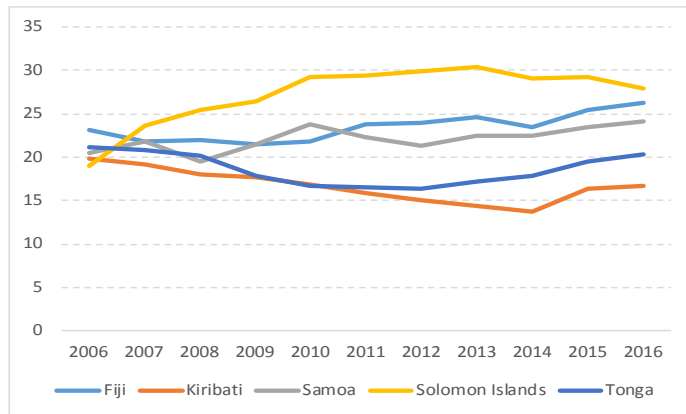
... and the mix of revenue has shifted towards indirect taxes



# Reform Impact - Revenues

- Similar results for selected 5 countries

Tax to GDP



Tax Mix



... but reforms focus was different

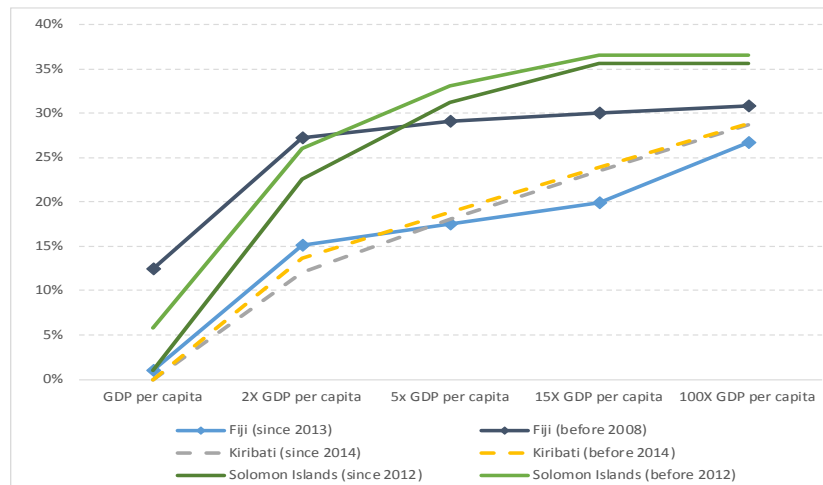
- Solomon Islands and Samoa were mainly tax administration reforms
- Other three countries had mix of tax administration and tax policy reforms, with the later being significant in some cases (e.g., introduction of VAT in Kiribati)



# Reform Impact - Equity

- Measuring effect of tax reforms on equity is difficult in general, and more so in PICs without adequate data
- One measure is changes in effective PIT rates  
... shows reduced burden, especially for low income earners, in 3 selected countries with PIT reforms

Changes in Effective PIT rates



# Reform Impact – Efficiency

- Shift away from income taxes to consumption taxes is generally more growth friendly
  - ... but high CIT rates and continued prevalence of tax exemptions in many PICs create inefficiencies and inequity
- Tax administration efficiency has been improving
  - ... but still scope for improved auditing, data collection and reporting
  - ... and concerns that most PICs tax administration do not have enough critical size to effectively carry out their mandate

# Reform Impact – Simplicity

- Simplicity has been enhanced by:
  - Rewrite of tax laws in some PICs – modernizing the laws and aligning them with international practices, and introduction of uniform tax procedures codes
  - Adoption of PAYE withholding and self-assessment in some PICs – simplifying processes for taxpayers and the tax administration

# Lessons Learned - Overall

- Successful tax reform requires political will and leadership and strong leadership and management of key government institutions (especially the tax administration)
- Establishing a skilled tax policy reform unit can assist in design and implementation of reforms
- Good data for tax policy analysis and reviewing tax administration performance is a challenge
- Extensive taxpayer consultation and community education is essential for successful tax reform implementation
- Reform efforts have benefited from well targeted TA, including long term in-house advisors  
... but need to ensure clear role of advisor (i.e., capacity building or capacity supplementing)

# Lessons Learned - Policy

- PICs continue to look for ways to increase revenues and improve the equity of the tax system
  - May be potential for revenue from other taxes such as sugar taxes and taxes on mobile phone services
- Taxation of small businesses is an ongoing concern
- Some reforms have been legislated but not yet implemented (e.g., capital gains tax, transfer pricing rules)
- Designing reforms that facilitate ease of compliance and collection are beneficial (e.g., PAYE withholding)
- Tax exemptions continue to erode the tax system
  - Some countries are now reporting the revenue forgone
- PICs do not seem to be overly concerned with the impact of free trade agreements (e.g., PACER Plus) or international tax issues

# Lessons Learned - Administration

- Most PICs have basic concepts of tax administration in place and are moving toward international practices of an effective tax administration  
... but reform is a long term journey
- Some important steps for effective tax administration in PICs include:
  - Establishing a function-based organization
  - Developing a headquarters role for planning, design and monitoring, and allocating staff to that role
  - Greater use of technology
  - More systemic use of data collection and matching from third parties
- Despite efforts, core obligations (e.g., updated registration, on-time filing, audit capability) remain stubbornly low

# Lessons Learned - Administration

- Most PICs have not reached a critical size needed to carry out their mandate
  - Staff to population ratios in PICs are low

Staff to Population Ratios	
International	1:2200
PICs	1:3795
Caribbean	1:1701

- Most PICs under-resourced for their mandate

Cost of collection	
PICs	<1 percent
Low Income Countries	2.4 percent

# Future Direction for Reforms

- Potential tax policy reforms:
  - Reducing CIT rates and tax base broadening by reducing exemptions
  - Reviewing PIT rates and ensuring no unintended increase in tax burden
  - Introducing simple small business tax in lieu of income tax and VAT
  - Introducing VAT and excises, in PICs without these taxes
  - Introducing specific taxes on sugar products and mobile phone services
  - Reviewing revenues from natural resources (fishing, mining, logging)
  - Reviewing non-tax revenues and considering alternative revenue sources
  - In the medium to long-term, addressing international tax planning in line with international practices
  - Modernizing tax legislation



# Future Direction for Reforms

- Potential tax administration reforms:
  - Increasing investment in PICs tax administration to help mobilize revenue
  - Improved data collection and analysis
  - Allocating resources to headquarters type functions (planning, design, monitoring)
  - Strengthening managerial skills of headquarters and core tax functions and improving those functions
  - Institutionalizing risk management
  - Developing initiatives to improve audit in PICs, including a regional training program and/or a regional audit team
  - Shifting to e-filing and e-payment where systems allow and mandating these processes for large taxpayers (especially e-filing)
  - Promoting the use of tools to better understand good practice, performance and compliance management (e.g., TADAT indicators)