

**Increased tax revenues –  
to what extent has improved tax compliance contributed?  
- Summary of results -**

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## Structure

1. Background
2. Quantitative analysis
  - Development of revenues as share of GDP
  - Analysis of effective tax rates
  - Summary of quantitative analysis
- 3 Results from interviews with tax advisors and company representatives
4. Conclusions
5. Further need for improvement

# 1. Background

- Large nominal increase in tax revenues observed in 2017
- At the same time administrative reforms in tax administration and customs

Research question:

- Have recent reforms of the state tax service and customs service led to improved compliance and contributed to the increase?

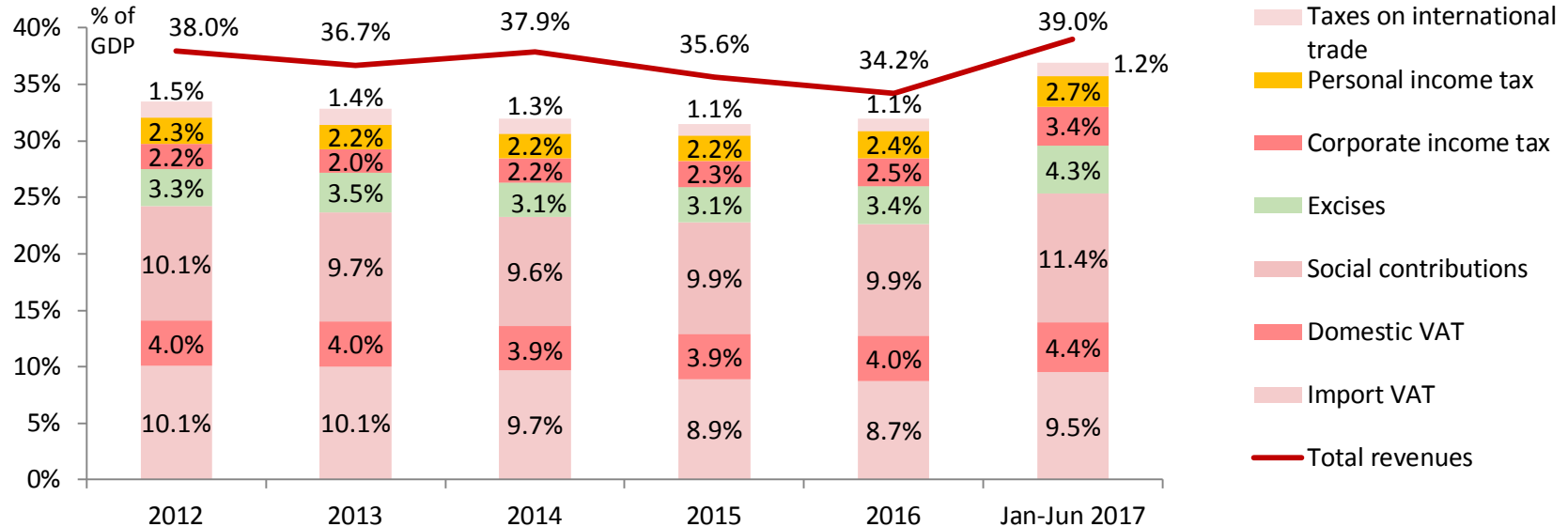
Task:

- Identify revenue increase due to more effective tax collection and better compliance

Method:

- Quantitative analysis of revenue data
- Qualitative analysis: interviews with companies and tax professionals

## 2. Quantitative Analysis: Development of revenues as % of GDP



- 1<sup>st</sup> step: analysis of revenue to GDP ratio
  - H1 2017 revenue to GDP was 39.0% - up from 34.2% in 2016 → revenues grow much faster than economic activity
  - Increase of revenue shares of most main revenue sources e.g. CIT rose from 2.5% to 3.4% of GDP – domestic VAT from 4.0% to 4.4% of GDP
- **Revenues growth faster than economic activity**

## Effective tax rates: Personal income tax (PIT)

### Personal income tax – effective tax rate

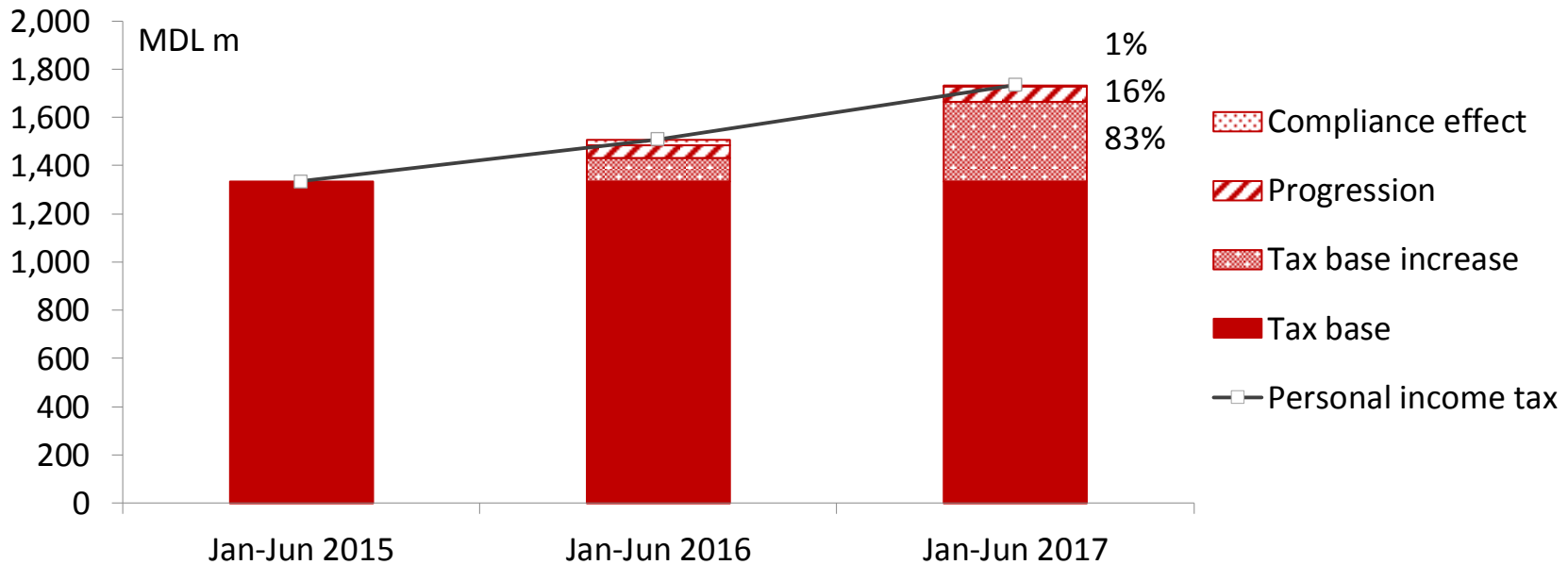
	2012	2013	2014	2015	2016	Jan-Jun 2015	Jan-Jun 2016	Jan-Jun 2017
Personal income tax, MDL m	2,027	2,206	2,447	2,745	3,182	1,334	1,510	1,735
Share of nominal GDP	2.3%	2.2%	2.2%	2.2%	2.4%	2.5%	2.6%	2.7%
Wage sum, MDL m	33,631	36,591	40,015	43,449	47,359	20,859	22,414	26,084
Effective tax rate	<b>6.0%</b>	<b>6.0%</b>	<b>6.1%</b>	<b>6.3%</b>	<b>6.7%</b>	<b>6.4%</b>	<b>6.7%</b>	<b>6.7%</b>

Source: Own calculations based on Ministry of Finance NBS data

- Significant increase of effective tax rate between 2012 and 2017 – up from 6.0% in 2012 to 6.7% in first half of 2017
- No change in effective tax rate since 2016
- But progressive tax – how much of increase due to progression?

# PIT increase due to progression effect and wage growth

PIT revenues – tax base, progression and efficiency effect



Source: Own calculations based on Ministry of Finance NBS data

- Analysis of factors behind PIT revenue increase
- Increase of taxable income (tax base effect): 83% of increase
- Progression effect: 16% of increase
- Thus: only minimal increase due to improved tax compliance

Source: Own calculations based on Ministry of Finance NBS data

## Effective tax rates: Social insurance contributions

### Social insurance contributions – effective tax rate

	2012	2013	2014	2015	2016	Jan-Jun 2015	Jan-Jun 2016	Jan-Jun 2017
Social contributions, MDL m	8,948	9,723	10,777	12,128	13,277	5,782	6,261	7,273
Share of nominal GDP	10.1%	9.7%	9.6%	9.9%	9.9%	10.9%	10.7%	11.4%
Wage sum, MDL m	33,631	36,591	40,015	43,449	47,359	20,859	22,414	26,084
Effective tax rate	<b>26.6%</b>	<b>26.6%</b>	<b>26.9%</b>	<b>27.9%</b>	<b>28.0%</b>	<b>27.7%</b>	<b>27.9%</b>	<b>27.9%</b>

Source: Own calculations based on Ministry of Finance NBS data

- Social insurance contributions closely connected to the PIT as they have the same tax base
  - A moderate increase of effective rate since 2012, but stable over last 2 years
- Most recent increase largely due increase in wages and employment, not due to improved tax collection and compliance**

## Effective tax rates: Corporate income tax (CIT)

### Corporate income tax– effective tax rate

	2012	2013	2014	2015	2016	Jan-Jun 2015	Jan-Jun 2016	Jan-Jun 2017
Corporate Income tax, MDL m	2,027	2,206	2,447	2,745	3,182	1,334	1,510	1,735
Share of nominal GDP	2.2%	2.0%	2.2%	2.3%	2.5%	2.8%	3.1%	3.4%
Estimated company profits, MDL m	40,055	47,128	54,489	60,424	67,612	23,573	27,180	26,938
Effective tax rate	<b>4.9%</b>	<b>4.4%</b>	<b>4.5%</b>	<b>4.6%</b>	<b>5.0%</b>	<b>6.2%</b>	<b>6.6%</b>	<b>8.1%</b>

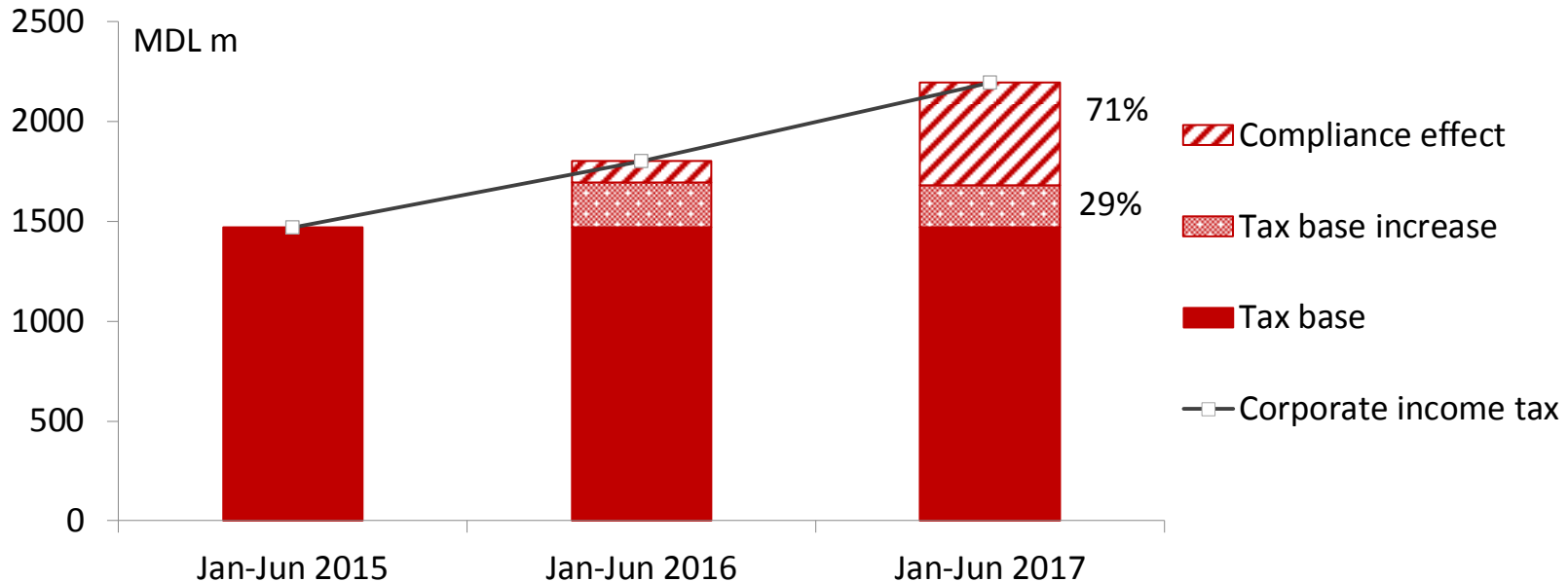
Source: Own calculations based on Ministry of Finance NBS data

- Substantial increase of effective rate over past years
- H1 2015 vs H1 2017 increase of effective tax rate by 1.9 pp
- But how much of increase due to better compliance and revenue collection?



# CIT – revenue increase mainly due to improved tax compliance

CIT revenues – tax base and efficiency effect



Source: Own calculations based on Ministry of Finance NBS data

- 71% of revenue increase due to better compliance and revenue collection
- 29% increase is due to an increase of the tax base (profit growth)

**→ Most recent CIT revenue increase largely reflects improved compliance and revenue collection**

## Effective tax rates: Domestic value added tax

### Domestic value added tax – effective tax rate

	2012	2013	2014	2015	2016	Jan-Jun 2015	Jan-Jun 2016	Jan-Jun 2017
Domestic VAT, MDL m	3,506	3,990	4,370	4,830	5,374	2,208	2,462	2,821
Share of nominal GDP	4.0%	4.0%	3.9%	3.9%	4.0%	4.2%	4.2%	4.4%
Dom. Consumption MDL m	52,825	58,936	65,303	76,071	84,777	32,345	36,247	37,329
Effective tax rate	6.6%	6.8%	6.7%	6.3%	6.3%	6.8%	6.8%	7.6%

Source: Own calculations based on Ministry of Finance NBS data

- Effective rate up from 6.8% in H1 2015 to 7.6% in H1 2017
  - 55% of increase can be attributed to a higher tax base
  - Remaining 45% due to better compliance and collection
- Domestic VAT revenue increase also due to improved compliance and more effective collection in 2017. Similar picture as for CIT.

## Effective tax rates: Import value added tax

### Import VAT – effective tax rate

	2012	2013	2014	2015	2016	Jan-Jun 2015	Jan-Jun 2016	Jan-Jun 2017
Import VAT, MDL m	8,911	10,106	10,892	10,952	11,761	5,069	5,284	6,088
Share of nominal GDP	10.1%	10.1%	9.7%	8.9%	8.7%	9.6%	9.0%	9.5%
Imports, MDL m	63,140	69,153	74,644	75,016	80,101	35,865	37,244	42,212
Effective tax rate	<b>14.1%</b>	<b>14.6%</b>	<b>14.6%</b>	<b>14.6%</b>	<b>14.7%</b>	<b>14.1%</b>	<b>14.2%</b>	<b>14.4%</b>

Source: Own calculations based on Ministry of Finance NBS data

- Collected through customs not tax administration
  - Over the past 5 years the effective rate is more or less constant
- **Effective tax rate for import VAT more or less unchanged, increase in revenue is mostly the result of an increase in the tax base**

## Summary of quantitative analysis

### Reasons for recent tax increase

Effective tax rate increase H1 2015 vs. H1 2017		Mainly due to		
		Progression	Tax base	Improved compliance
Personal income tax (PIT)	+0.3 pp	✓	✓	
Social security contributions	+0.2 pp		✓	
Corporate income tax (CIT)	+1.9 pp		✓	✓
Domestic VAT	+0.8 pp		✓	✓
Import VAT	+0.3 pp		✓	

Source: Own research

- Corporate taxes (CIT, domestic VAT) show improved compliance
- For PIT, social insurance contributions and import VAT the revenue increase is largely due to an increase of the tax base

### 3. Results from interviews

#### Objective

- Explore reasons for improved tax compliance

#### Questions covered during interviews

When comparing to the situation 2/5 years ago ...

- i. Did you notice any changes in **interaction with tax authorities**?
- ii. Have you noticed a change regarding **fiscal inspections**?
- iii. How do you assess the **professionalism of tax administration** (level of knowledge, speed and quality of responses)?
- iv. How do you assess the ease and speed of obtaining **tax refunds**?
- v. How do you assess the **overall administrative burden** of paying and reporting taxes?
- vi. How do you in general assess **incentives and sanctions** to pay taxes?
- vii. How do you assess the **interaction with customs authorities**?

## I. Did you notice any changes in interaction with tax authorities?

### Last two years:

- Most companies have not noticed significant changes
- Some (especially smaller) companies took note of reorganisation of tax services
- Also report of change in the mentality of tax authorities
  - More service oriented
  - Improved understanding of business needs and openness

### 5 years ago:

- All respondents report an improvement in interaction with tax authorities
- Tax payers improvements over the last 5 years in interaction with tax authorities

## II. Have you noticed a change regarding fiscal inspections?

- General assessment: “Number of fiscal inspections low”
  - Inspections not considered a great burden – especially for large tax payers with good tax compliance record
  - Again not a recent development: decline in the number of inspections took place over the past five years
  - At the same time increase of telephone calls from tax officials
- Improvement of inspections regime over past years may have fostered tax compliance

### III. How do you assess the professionalism of tax administration?

- The professionalism of the tax officials assessed as mixed
  - Knowledge level of the tax administration staff varies
  - The speed of responses within 30 day limit, but often not satisfactory answers
- 
- While some tax professionals excel, efforts are needed to ensure a consistently high level of professionalism for all tax officials
  - Professionalism of tax official can be considered to have a great effect on tax compliance



## IV. How do you assess the ease and speed of obtaining tax refunds?

- Majority of respondents notice improvements in obtaining refunds
  - Described as recent development
  - But VAT inspection in case a company makes a refund request → effort to obtain refund is considerable, only considered in cases of large refund
- 
- Improved refund situation provides an incentive for companies to officially report their own sales and also their purchases
  - Knock-on effects in the form of de-shadowing and reduced tax avoidance possible

## V. How do you assess the overall administrative burden of paying and reporting taxes?

- Administrative burden of reporting and paying taxes has reduced considerably over the last five years
- Main improvement measure: **Electronic tax declaration**
- But: Administrative burden in the sphere of taxes remains high
  - Especially reporting payroll taxes
  - Recent merger of five tax reports into one positive, but actual amount of information remains the same
  - Complaints that tax forms change too often
- Reduction in the administrative burden for reporting and paying taxes may have contributed to increased tax compliance
- Data collected in electronic format also gave the state authorities better means to detect tax avoidance

## VI. Sanctions and incentives to pay taxes

### Sanctions

- Level of fines in the sphere of taxes is considered high
- But in general only levied in case of verifiable infringements
- Not a problem for large companies with experienced accountants
- But maybe problem for smaller companies, especially new entrants

### Incentives to pay taxes

- Number of calls from tax authorities gone up
  - Pressure on tax payers to pay higher advances on the tax payments
  - Anecdotal evidence of improved voluntary compliance
    - Transport companies and real estate companies are more likely to accept official (electronic) payments
    - Tax advisors seem to have noticed an increased voluntary compliance and improved tax discipline from their clients
- Reduced cost of compliance, gentle pressure from the tax officials and increased risk detection may change attitude among tax payers

## VII. Interaction with Customs

- Respondents state that customs services have improved considerably
- Improvement described as a rather recent development
- Positive impact of the introduction of electronic declarations
- Noticeable change in the conduct of customs administration
- Import and export procedures require much less time and carry considerable less risk for companies

### **Conclusion:**

- Reduced administrative burden (cost of tax compliance) for import and export
- Recent reforms may have increased the capacity of customs to detect avoidance and smuggling
- Quite recent, increase in revenue collection may take some time to take effect

## 4. Conclusions

- **Quantitative analysis** confirms increased tax compliance, especially for corporate income taxation and domestic value added taxation
- Other taxes no increase in tax compliance as measured by effective rate
  - But part of the increase of the tax base is possibly also due to improved tax compliance
- **Interview results** support increased findings of higher compliance due to a number of reasons
  - Reduction in the administrative burden when reporting and paying especially corporate taxes (electronic tax declaration)
  - Electronic tax data base may have enabled fiscal authorities to be more effective in detecting tax avoidance
  - Too early to tell the effect of the most recent set of reforms
  - Based on experience with past reforms: recent measures likely to further improve tax compliance and thus revenue collection

## 5. Further need for improvements

- Analysis encourages continuation of reform processes aiming at reduction of administrative burden for reporting and paying taxes
- Especially payroll taxes still burdensome
- Government should consider how to extend and improve the refund regime
- Consider a training programme aiming at aligning the level of knowledge among tax officials
- Further reforms in order to achieve more clarity in the tax code

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