

Business taxation: the interplay of administration and tax policy

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The importance of business taxation

Efficient and equitable taxation of businesses is a vital pillar of any strong fiscal system

Well-designed policies have multiple objectives

- Cost-efficient tax revenue collection for the government
- Low compliance costs for firms
- Minimal distortions to firms' investments and growth
- Fair distribution of taxes across firms

These objectives are constrained by country-specific features

- Economic structure, broad institutional settings, tax administration

Individuals & businesses behaviour affected by tax policy and administration

Tax policy parameters

- Tax base
- Tax rates

Tax administration parameters

- Reporting requirements/compliance costs
- Enforcement mechanisms
- Tax administration businesses interact with

All of these can vary in practice by type of business

- Size (e.g. turnover), sector, location, organisational form/ownership
- Not necessarily in line with multiple policy objectives

Broad questions

- Effect of tax system (policy & administration) on businesses' performance
- Opportunities to improve the tax system to boost revenues and economic growth

TaxDev researchers' work in Ethiopia

1. How do tax factors affect businesses' incentives to incorporate?
2. Understanding tax compliance behaviour

Both are work in progress - early stages

Project 1: Incentives to incorporate in Ethiopia



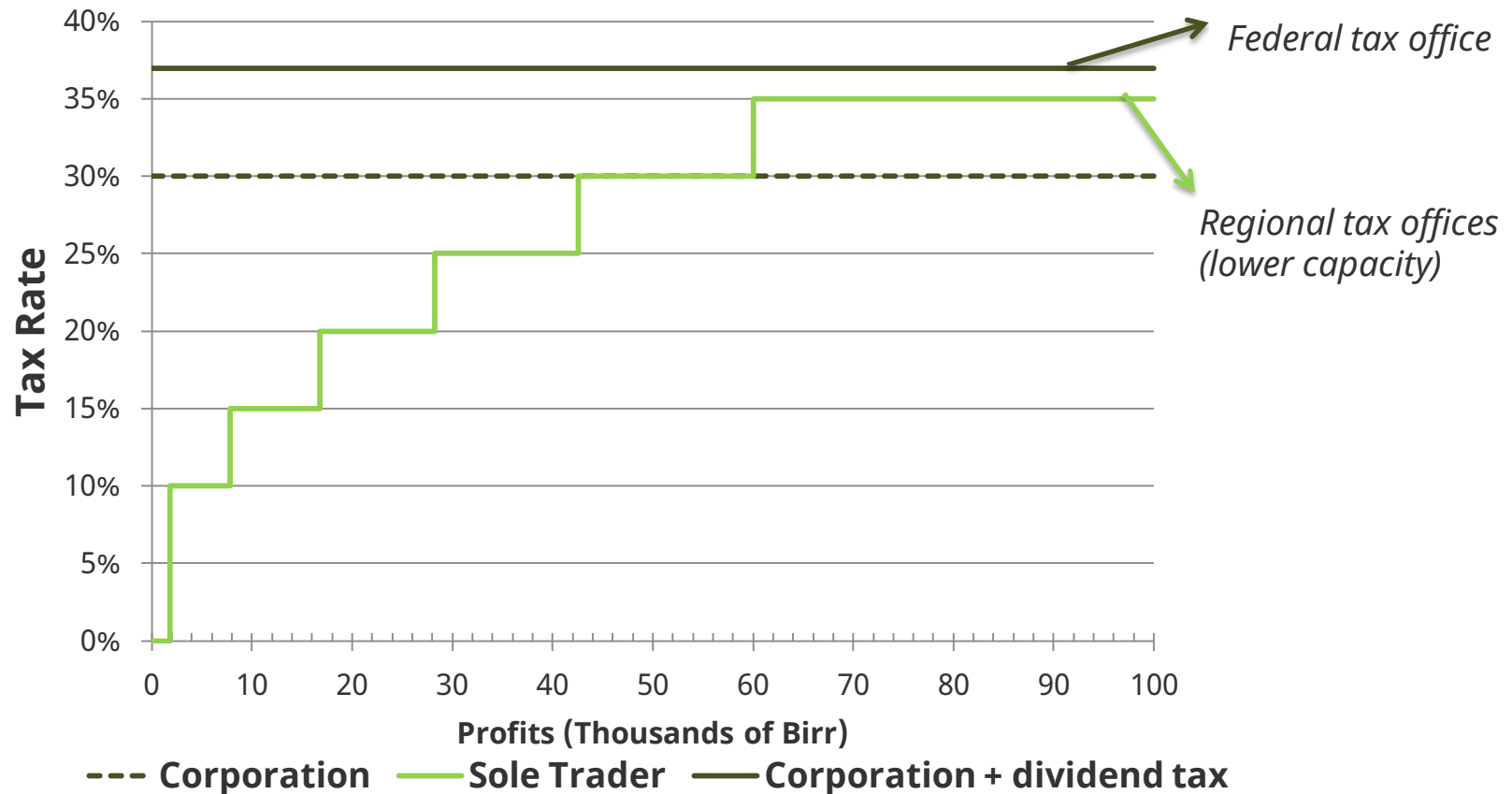
Research questions

- How important are tax factors in the decision to incorporate?
- If possible, how do ETR affect firms' performance?

Exploit variation in benefits and costs to become incorporated to answer these questions

- Tax rate schedule for profit tax
 - Inflation means it changes over time
- Tax administration taxpayers deal with
 - Federal office if incorporated/regional offices if non-incorporated
 - Merger of regional and federal in Addis Ababa gives variation over time

Profit tax by business type in Ethiopia



Birr 27/£1

Project 2: Understanding tax compliance

Firms may have incentives to locate below/above relevant thresholds to minimise tax related costs

- Thresholds are pervasive generating changes in
 - tax bases & rates
 - compliance costs/enforcement intensity
- E.g. manipulate reported turnover so that it is just below the registration threshold of VAT to avoid paying VAT → observe excess bunching of turnover below the threshold

Understand trade-offs between compliance, administration & efficiency costs and tax revenue when moving specific thresholds

- E.g. Increasing a registration threshold may decrease compliance & administration costs and tax burden, but decrease tax revenues

Thresholds and bunching analysis in Ethiopia

Ethiopia

- Enforcement: LTO threshold (corporations and individuals) – Birr 35 million annual (£1.3million) turnover since 2015
- Compliance costs: Reporting requirements are looser below Birr 500k
- VAT registering threshold: Birr500k (£18.5k); below which firms pay 2% turnover tax to regional offices

Research questions

- How do firms respond to these thresholds?
- How do these responses affect tax revenues?

Contribute to a growing empirical literature on the interplay between tax policy and tax administration for business taxation

- nascent in low and middle income countries

Administration and collectability becomes very relevant in developing countries

- Tax bases and administrations are less modern
- Policy prescriptions may be different to those in high-income countries