

Strategies for Expanding Tax Bases in Iran

Morteza Asadi, PhD

**Department of Tax Study and Research
Iranian National Tax Administration (INTA)**

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In any tax system, the composition of resources and the proportional share of any kind of taxes, are among the most popular discussion topics of tax policymakers and authorities, as can be said that it reveals the main tendencies of policymakers on economic-social preferences. For example, when in a tax system, consumption tax has higher share of total taxes than that of income taxes, this reveals that such society's tax policymakers aim to support production sector, thus the main pressure of taxes is on society's consumption.

Generally before drafting a comprehensive strategy for the tax system, it is necessary to specify the basic approach to the definition of tax resources and proportional share of any of the income, consumption and wealth bases should be considered in it.

It is obvious that the tax policymaker's point of view to this issue can be under effect of factors and variables such as economic and social circumstances and operational possibilities and constraints. Also following to drafting a comprehensive strategy for the tax system, an efficient tax rate should be determined. Governments should notice that they should not raise taxes to finance their costs and expenditures. According to Peacock and Wiseman hypothesis, governments tend to spend more but people prefer to pay less and governments inevitably consider people's demands.

Therefore when governments make decisions about their costs should pay enough attention to people's attitude about taxes that they are intended to pay. Governments should not make such costs that impose over-payment to taxpayers.

Also, Clark in his theory appoints the acceptable limit of tax as 25 percent of GNP. He believes that if taxes become more than this limit, some deficiencies will appear in economic environment. But surely this ratio can differ depending upon country's development level, income per capita, existence of other resources and society's welfare level.

Tax ratio:

One of the quantitative indicators that measure the efficiency of the tax system is *T-GDP* ratio. this indicator and its degree depends on various factors like tax bases, tax rates, government size, current quasi taxes, the degree of freedom of economy, the share of various sectors of economy in *GDP*, the degree of tax evasion, tax rules, tax culture, variety of tax bases, ect.

A survey in this subject have taken in which the tax bases of 55 country of the world have been compared.

These countries are divided to four groups on the basis of income per capita and the fifth group includes Islamic countries. In these five classes, *T-GDP* ratio of these countries is identified. As noted before, *T-GDP* ratio is the most important indicator to assess tax system. As we can see in table .1 after low-income countries group with 13.3%, the lowest value of tax ratio is one for Islamic countries equal to 14.11 percent. Although some Islamic countries have high income per capita, but their *T-GDP* ratio is low, most of them are oil rich states. But the highest value for the *T-GDP* ratio is one for high-income countries group which except few; all of them are euro-zone member European countries. As said before, the ratio of non-weighted average of taxes to *GDP* ratio is 14.11% for chosen Islamic countries.

This ratio on the average is 28.3% for high-income, 22.1% for upper-middle-income, 18.4% for lower-middle-income and finally 13.3% for low-income countries.

Table -1 reveals that there is a direct relationship between income per capita and *T-GDP* ratio as the higher the income per capita , the higher the T-GDR ratio. Though there are some exceptions.

Surveys carried out about 55 countries reveals that 10 countries have a *T-GDP* ratio less than 10% which nine of them are Islamic, including Iran. Also *T-GDP* ratio for 19 countries are 10% to 20% which ten of them are Islamic. *T-GDP* for 19 countries varies between 20% and 30% including 4 Islamic countries. Finally there are 7 countries including Australia, Britain, Canada, Belgium, Norway, Denmark and Algeria that all of them are high-income (except of Algeria which is a lower-middle-income country) and *T-GDP* ratio of them is higher than 30%. The highest value of *T-GDP* ratio is for Denmark which is about 47.6%.

In general, these studies indicate that *T-GDP* ratio in Islamic countries is low. Therefore increasing this ratio should be set as one of the financial targets of Muslim governments. Low *T-GDP* ratio may be related to some factors such as large size of agriculture sector, existence of small economic unites, vast tax expenditures (including, exemptions, preferences and relieves) existence of natural resources, large size of hidden economy, low income per capita and low efficiency of the tax organization, etc. some of the this factors can be removed in short-term and some in long – term.

Composition of tax bases

The tax base is the value or criterion on which the tax is levied. Tax system distributes tax burden in three bases on the economic sectors: income, consumption and wealth bases. Designing a suitable composition of variable tax resources regarding to the bases which mentioned above can result in maximizing the amount of collectable tax with least negative effects on economic activities and cause to satisfaction and complain of people. Although classifying of taxes and other financial sources of governments is done with different methods in various countries but to make possible comparisons between countries, this survey uses the classification of the World Bank about financial sources of government which are:

1. Tax on goods and services.
2. Tax on income and capital gains.
3. social security payments
4. tax on international trade
5. other taxes
6. other incomes (*donatives* and other returns)

with Exploring the composition of incomes in group of countries (table-2) , we can observe that the share of "tax on income and capital gains and social security payments "in high-income and euro-zone member countries is higher than that of other groups including Islamic countries. On the other hand, the share of "tax on foreign trade" in high-income and euro-zone member countries is approximately zero, but this share in low-income and also in Islamic countries is noticeable. Other important issue that should be paid attention is the share of "other incomes" in total revenues of governments.

In euro-zone member and other high-income countries the proportional share of "other incomes" in total incomes of government is 7% and 16.5% in sequence. This reveals that the share of taxes in financing the governments in Islamic and under developed countries is not satisfactory. And these governments rely upon natural resource incomes and foreign aids rather than taxes. Although, suggesting a efficient composition of taxes same for all countries is impossible and this composition depends on development degree, income per capita,

quality of wealth and income distribution, natural resources ,ability of the tax collecting organization, tax rules and regulations, level of welfare, etc; but making policies to design the best composition for similar countries, is feasible.

Experiences of Islamic republic of Iran in developing tax bases, increasing T-GDP ratio and improvement of the composition of taxes:

Following the holy Islamic revolutions in Iran, increasing reliance on the tax resources and thus reducing reliance on oil incomes was targeted by government at the first¹ and second² "*five-years development programs*". Because of failing of these programs to achieve many of the targeted goals, the issue was set as one of the main priorities of government's financial policies in the third³ development program and some measures have been carried out as follows:

1. Carrying out some preliminary measures to launch VAT
2. Introducing a "*comprehensive tax scheme*" and its main characteristics
3. Establishing a stabilizing fund for excessive oil revenues.
4. Reducing relieves and preferences.
5. Carrying out some studies to design excise duties
6. Reforming tax rules and regulations.
7. Separating the tax-collecting office from the finance ministry and establishing an independent one.

1-VAT:

First attempts to introduce *VAT* in Iran started in 1989. In that year the cabinet presented "*VAT bill*" to parliament but that bill was taken back because of the economic effects of Iran-Iraq war. New resolution toward launching *VAT* appeared following the IMF reports and recommendations in 1990s. IMF as an international institute advised Iran to levy tax efficiently on consumption.

Launching of this system will result in:

1. Increasing tax revenue in Iran.
2. Expansion of tax bases and movement toward consumption tax with a wide base.
3. Help to discover the hidden sectors of economy and levy tax on them .
4. Developing the use of technology in Iranian tax office.

According to country's targets in the field of taxation, VAT bill once again presented to parliament in 2002 and its general pointes was approved by representatives and now is being approving finally at the economic commission of parliament for 5 year trial practice.

We can point some of other carried out measure as follows:

- Designing operational charts and procedures.
- Carrying out studies on economic and social effects of VAT.
- Introducing VAT to people and trying to inform them about it.
- Preparing the relative instructions and needed forms.
- Designing an educational program for VAT staff.

¹ 1989-1992

² 1995-1999

³ 2000-2005

2- Comprehensive tax scheme:

This "*IT based*" scheme will facilitate and accelerate the tax work flow so taxpayers will have more satisfaction with tax system.

About 32 numbers of projects have designed to complete this scheme. Some of them are:

- Designing and implementing "the integrated tax system (ITS) software" in national level.
- Choosing the risk based auditing(short-run)
- Defining taxpayers identity number (*TIN*)
- Standardization of processes
- Re-engineering of processes
- Choosing the risk based auditing(long-run)
- Drafting of IT strategies
- Drafting of human resources strategies and a model for their services delivery
- Revising and improvement of tax policies
- Defining and implementing of taxpayers services
- Revising and reforming of rules, regulations and instructions
- Designing and implementing of "*tax information high counsel*".
- Designing a Preventing program for tax evasion

3. Establishment of a natural resource revenue fund (or account)

Non-acquired revenues especially oil revenues are in fact obstacles in the course of development of tax bases, in developing countries especially Islamic countries. Governments of such countries have insatiable appetite to use this resources in financing their costs but government reliance on such revenues decreases government responsibility and causes to economic disorders like "Dutch disease", artificial strengthening of natural currency, unfitness of this revenue for enforcement of fiscal policies, over – expansion of government, non – renewable nature of these resources and their variable prices.

So in Islamic republic of Iran reducing reliance on oil revenue and emphasis on taxes is one of the main tactics of budget reforming, and according to "*the third development program*" article no.60, oil revenue fund has established.

4. Reducing exemptions and preferences:

Excessive increase of tax expenditures cause to limit tax bases as well as complicity of tax system, untransparency of relations, increase of collection costs and expansion of administrative corruption.

In this way, one of the basic measures to reform the tax system is to reduce tax exemptions.

"Iranian first development program" emphasized on further abolition of exemption for public corporations. Second program determine the gradual abolition of tax exemptions as one of the main purposes of tax policies. "Third development program" transparently and obviously abolished all exemptions, relieves and custom duties exemption for public or governmental institutes, ministries, corporations or non – governmental public institutes.

Ultimately article no.4 in "Forth development program" stipulated that: "*Order of any relieves, preferences or exemptions (directly or implicitly) and custom duties exemption for real and legal persons at the years of this program is forbidden.*"

So we can see that Iranian government have been developing tax bases and increasing the competitiveness of economy through implementing measures to reduce exemptions.

5. Taking studies to design "exise taxes"

Exise taxes as a complementary to consumption tax and sometimes as a tax base, are tools that can be used by government to enforce some policies. The most important kind of these taxes is environmental tax known as "green tax", which levied to reduce pollution. some similar taxes have been in Iran since 1915 , also today tax is levied on oil derivatives, cigarette, benzene, non – alcoholic drinks and polluting industries according to a law known as "*tajmi avariz*". Also Iranian government is studying to decide about designing and enforcement of complementary taxes as well as VAT. Some studies also have taken in this issue. According to these studies, such taxes can be ordered to reduce pollution and collect from people who create social costs. Today "exise taxes" have a high importance because they increase tax revenues and can encourage innovation and development of modern technologies which preserve environment. Also if the country enters "The world trade organization (*WTO*)" and if the custom duties and tariffs abolish or reduce, "*exise taxes*" can be a suitable option to repair the falling of government's financial resources.

6. Tax rules and regulations reform

According to a bill approved at 2002/2/16 by Iranian parliament, basic reforms were done in "*the Iranian direct taxes law*". the basic characteristic of this reforms are simplification, eliminating of non-efficient resources, reducing of rates and grades, increasing of the evasion risk, reform of the salary and occupation tax, reform of the structure of exemptions; etc.

Meanwhile, according to a law known as "*tajmi – avariz*" approved at 2002/1/11 ; all of the regulations related to indirect taxes collection and national charges abolished and indirect taxes get integration .

7. Forming of the independent tax organization

The structure of tax collecting organization in Iran, once upon a time, was in the form of a section in the finance ministry which was known as "tax revenue administration" but later according to the "*Third development program*", "*state tax organization*" established to increase the efficiency of tax system and to eliminate the obstacles and also to concentrate on tax collecting, under the supervision of the finance ministry. Actually many provisions to reform tax system have done following the establishment of this organization.