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# Technical Assistance in Taxation
# – What influence does the IMF have? –

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## § 1. – Introduction

In this article an overview is given on the technical assistance the International Monetary Fund (IMF) is provided to its member countries in taxation. This technical assistance is provided in various manners and mainly covers areas as tax policy, tax administration and legal drafting. In focusing on the provided assistance in legal drafting (as the ultimate implementation of tax policy recommendations) it will address to what extend this assistance is influencing the tax laws of these countries.

## § 2. – The Role of the International Monetary Fund

The International Monetary Fund (IMF) was established at the Bretton Woods Conference of 1944. Its original goals were to supervise international exchange rates in an attempt to ensure fair terms of economic trade. The IMF was endowed with the supply of gold and currencies from its member countries that could be lent on a short term basis to any of its member countries which needed temporary financing in case of balance-of-payments difficulties[1]. This function has ceased to exist with the collapse of the fixed exchange-rate system. However, its role as the lender of last resort has since expanded and evolved. The IMF – as part of its surveillance duties – also has the power to require information from its member countries concerning macroeconomic indicators.

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*The views expressed in this publication are those of the author and do not necessarily coincide with those of the organizations he works with.

[1]Articles of Agreements of the International Monetary Fund, Article 1, http://www.imf.org/external/pubs/ft/aa/aa01.htm.

Although developing countries and countries in transition have increasingly been able to borrow through the international commercial banking system and/or from other donor institutions[2], the importance of the IMF has grown through its conditionality. For a country to be eligible for such lending, it must abide by IMF conditionality, as most commercial banks place a heavy reliance on IMF approval of a country's macroeconomic program as indicating its creditworthiness.

The IMF has numerous lending facilities[3] of which the Stand-by Arrangement (SBA) is the main facility. Since 1999 it has introduced the Poverty Reduction and Growth Facility (PRGF) that intends to support programs to strengthen substantially and in a sustainable manner balance-of-payments position and to foster durable growth, leading to a higher living standard and a reduction in poverty[4]. All of the loan facilities are associated with conditionality under which a country commits to a program of economic reform as a condition of receiving (further) financial assistance. The main instrument of conditionality is the Letter of Intent (LOI) in which the country receiving the loan provides its intentions of strengthening its financial position. It is since the mid-80s that tax conditionality has gained importance as part of the IMF policy. Conditionality can take a variety of forms including Prior Actions[5], Quantitative and Structural Performance Criteria[6], and Structural Benchmarks[7].

## § 3. – Technical Assistance in Taxation

### A. General

Tax policy and administration are core areas on which the IMF provides technical assistance.

The Fiscal Affairs Department (FAD) is providing most technical assistance, whereas the Legal Department (LEG) contributes to that and provides further assistance in drafting tax legislation.

Technical assistance on tax administration is typically focused on the internal (re-) organization of revenue administrations, the

[2] World Bank, Regional Development Banks, bilateral donor organizations, e.g. SIDA, DANIDA and DIFD.

[3] See: http://www.imf.org/external/np/exr/facts/howlend.htm.

[4] See: http://www.imf.org/external/np/exr/facts/prgf.htm.

[5] Prior Action requires that the member country adopts or commences measures before approval of an arrangement, completion of a review or release of trenches of funds is concluded.

[6] Performance Criteria (either quantitative or structural) are formal conditions of obtaining IMF finance, can be objectively monitored by IMF staff on regular basis, and are considered critical to achievement of program goals.

[7] Structural Benchmarks are points of reference against which progress may be monitored.

logistical implementation of tax legislation, and procedural aspects of collecting taxes. Technical assistance on tax policy involves the assessment of tax systems, provides member countries with alternative tax policy solutions and their quantitative impacts on the macroeconomic environment, and formulates best tax practices. Technical assistance on legal drafting focuses mainly on the transformation of formulated tax policy and tax administration policies into legal documents. This somewhat artificial division is – in practice – blurred as experts in tax administration become involved in drafting, whereas experts in legal drafting are involved in advising on policy choices.

The IMF uses both long-term (> 6 months per assignment) and short-term experts (typically hired to conduct a mission of 2-3 weeks) to provide technical assistance. Most experts are former tax administrators, policy advisors and academics from around the world.

## B. TAX POLICY "PACKAGE"

Although tax policy recommendations are tailor-made, a best practice approach – often found in technical assistance on tax policy given to developing countries – can be formulated. This "package" includes a single-rate broad-based value-added tax replacing existing sales and turnover taxes, a broad-based income tax which is as neutral as possible so as to minimize interference in the economic allocation process (minimizing tax incentives), the streamlining of excise duties (limiting the number of excisable goods) and the reduction – eventually the elimination – of import tariffs.

While most developing countries have introduced a value-added tax, there are still various issues that need attention. Many important sectors (e.g. services) are still left out of the VAT net, the credit mechanism is often excessively restrictive (e.g. no cash refunds), and multiple rates are applied.

Technical assistance on the income taxes emphasizes mainly the taxation of corporate profits, as the personal income tax raises relatively little revenue in most developing countries. Particularly relevant for these countries are the issues of multiple rates based on sectoral differentiation and the incoherent design of the depreciation system (too many asset categories, excessively low depreciation rates, and not in accordance with the relative obsolescence rates of the business asset). With respect to tax incentives for investments, the policy recommendations tend to move towards incentives which allow for a quick recovery of capital expenditure (accelerated depreciation) rather than tax holidays which are most popular amongst developing countries. In this respect the phenomenon of tax competition has been raised in some regional efforts to harmonize those incentives.

Limitation of excisable goods to those goods that are usually inelastic in demand will make the excise duties more effective, as it narrows the tax base and generates revenue at relatively low administrative costs. Finally, the globalization and liberalization of trade has forced developing countries to reduce import tariffs[8].

## C. Tax Administration Policy

The primary goals of technical assistance on tax administration are to support the revenue mobilization component of IMF-supported programs, to assist countries in improving the effectiveness of their tax administration, and to increase taxpayer compliance. Traditionally assistance is provided in restructuring tax and customs administration, the improvement of management, and establishing a so-called "Large Taxpayer Unit". More recently, FAD has also provided so-called 'strategic' technical assistance in developing reform strategies and monitoring the implementation of such developments with the support of the World Bank and other providers of technical assistance.

## D. Legal Drafting

In the last decade LEG has assisted more than 40 countries in drafting over 100 tax laws and regulations. Most of these are entirely new or substantially reformed laws, including entire tax codes, income tax laws, value-add tax laws, and laws on tax procedures. Recently LEG has also been involved in drafting budget laws and customs codes. As the staff resources are very limited, LEG typically uses external experts (most of them leading tax law academics) from around the world. These experts are trained in various legal systems. There are various examples of hypothetical tax laws on the internet[9] which are used by these experts as starting point for tailor-made assistance to member countries.

Most of the technical assistance provided is related to IMF-funded programs, although some requests are made by individual member countries outside such programs to assess their tax legislation or to assist in implementing new tax concepts (e.g. by the accession states in Central and Eastern Europe to implement the European Parent/Subsidiary Directive and the Merger Directive).

[8]COMESA has recently established a tariff-free zone amongst their member states.

[9]The IMF has posted two income tax codes (Taxastan and Commonwealth of Symmetrica) and three value-added tax laws (Fantasia, Commonwealth of Vatopia and Commonwealth of Republica) on its website: http://www.imf.org/external/np/leg/index.htm.

The philosophy is to strive for a simple and clear drafting style, while recognizing that tax is a technical area and will not be fully understandable to the average person in the street. In addition, the assistance provided strives to be consistent with the drafting style of the jurisdiction in question.

The most challenging aspect of providing technical assistance in legal drafting is to overcome the hesitation by countries to accept an outsider to prepare their legislation as this area is considered as a (or sometimes even – the last) sovereign prerogative of the ministry. However, this prerogative of sovereignty must be reconciled with the reality that many countries do not dispose of personnel with sufficient tax law drafting experience.

## § 4. – Influence or Effectiveness of Technical Assistance

Most of the performance criteria adopted in LOIs are quantifiable as they are easier to monitor by economists. However, tax policy and tax administration policy recommendations do occur as performance criteria or structural benchmarks in LOIs. As those criteria are typically formulated based on policy recommendations which are considered best practices (e.g. broadening the corporate income tax base or the introduction of a large taxpayer department), the influence of the IMF is binding as to the result to be achieved, but leaving at the discretion of the individual states the form and method of its implementation.

If the IMF is involved in drafting tax legislation within the frame of an IMF-funded program, it rarely constitutes a performance criterion or structural benchmark. A good reason for that is the technical character of tax laws; it would require a very precise formulation of concepts to be assessed against the content of draft legislation. Another reason why the actual influence of the IMF in draft legislation might not be over-estimated is inherent to the way technical assistance is provided. As a matter of 'ownership', initial drafts made by IMF staff or external experts are discussed in a face-to-face discussion with country officials. The final draft would, therefore, reflect the policy decisions made by these officials (or their political bosses). Even in the worst case scenario[10] that the expert's initial draft is pushed through without any changes, we have to bear in mind that the officials (and therefore ultimately the expert) will lose control over the draft. This will usually happen either at the moment the draft is discussed in the Council of Ministers or in Parliament.

[10]It is my firm believe that good assistance would require an open-minded expert who is willing to listen to the intentions of the authorities and accommodate the process of weighing alternative language to the complex concepts of taxation, rather than forcing him or herself through and leave the country with a highly sophisticated draft that is not 'owned' by the authorities.

On the other hand, one cannot deny any influence of the IMF as it comes to the implementation of best practices. All our experts draw on a broad knowledge in comparative tax systems, which means that concepts commonly used around the world (or in specific regions) are well known to and used by them. It is therefore that tax laws of member countries can give away the identity of the expert who was assisting the authorities. It can easily been seen that all the tax legislation (i.e. the income tax codes) of former Soviet Republics in Central Asia[11] are drafted along the lines as provided in the IMF example for the fictious republic of Taxastan [12]. A similar observation can be made regarding the implementation of the EU Merger Directive[13] in most of the new EU member states[14]. However, this influence is less visual in some African countries where legislation is found which dates directly back to its colonial past [15]. Respect for the individual drafting style of the various countries remains the main reason for differences in individual laws.

Rather than calling it the influence of the IMF in drafting tax legislation, I would prefer to speak about the effectiveness of such drafting assistance. A quick self-assessment of previous assistance provided over the past decade learns that in a vast majority of cases our assistance has contributed to the successful passage of legislation. The good record of passage can be attributed to the fact that technical assistance is normally provided upon direct request from the authorities, rather than forcefully imposed (i.e. by performance criteria).

## § 5. – Conclusion

The IMF does have influence in shaping tax systems of countries mainly through their tax policy recommendations. However, this influence is limited to the introduction of best practices rather than providing them with a blue print. In assisting developing countries in implementing these practices in draft laws, IMF experts usually bring in their comparative expertise to provide alternative solutions to achieve those best practices. Nevertheless, their influence can be substantial depending on their individual skills to convince authorities of their views.

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[11] E.g. Azerbaijan, Georgia, Kazakhstan, and Tajikistan.

[12] See Fn 9.

[13] Council Directive of 23 July 1990 on the common system of taxation applicable to mergers, divisions, transfers of assets and exchanges of shares concerning companies of different Member States (90/434/EEC).

[14] The Czech Republic, Hungary, Latvia, Lithuania and Slovenia received in various forms assistance in implementing the European directives.

[15] A striking example was found in the previous Ethiopian income tax legislation where parts of the Italian income tax from 1936 were still applicable.