# CROSS-COUNTRY RESEARCH ON TAX POLICY AND INEQUALITY:

## COMPARATIVE STUDY OF INDONESIA, SOUTH AFRICA AND BRAZIL

YUSTINUS PRASTOWO
SUGENG BAHAGIJO
SITI KHOIRUN NIKMAH

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SANI SouthAfrican Network on Inequality
Empowering Civil Society Organisation in an Unequal Multi-Polar World

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# ABBREVIATIONS

| | |
|---|---|
| **AEOI** | Automatic exchange of information |
| **BEPS** | Base erosion and profit shifting |
| **BRIICS** | Brazil, Russia, India, Indonesia, China and South Africa |
| **CIT** | Corporate income tax |
| **COFINS** | Contribuição para o Financiamento da Seguridade Social |
| **CRS** | Common Reporting Standard |
| **EE** | Emerging economies |
| **EU** | European Union |
| **FAR** | Function, assets and risks |
| **FDI** | Foreign direct investment |
| **GAAR** | General anti-avoidance rule |
| **GDP** | Gross domestic product |
| **GFA** | Global formulary apportionment |
| **GST** | Goods and Sales Tax |
| **HDI** | Human Development Index |
| **HNWI** | High net worth individuals |
| **ICMS** | Imposto sobre Circulação de Mercadorias e Serviços |
| **IFF** | Illicit financial flows |
| **IHDI** | Inequality Human-adjusted Development Index |
| **IMF** | International Monetary Fund |
| **IPI** | Imposto sobre Produtos industrializados |
| **ISS** | Imposto Sobre Serviços |
| **IT** | Information Technology |
| **MNC** | Multinational company/corporation |
| **NTR** | Non-tax revenue |
| **OECD** | Organisation for Economic Co-operation and Development |
| **PAYE** | Pay-as-you-earn |
| **PIS** | Programa de Integração Social |
| **PIT** | Personal income tax |
| **SMEs** | Small-Medium Enterprises |
| **TIN** | Taxpayer Identification Number |
| **VAT** | Value-added tax |

# EXECUTIVE SUMMARY

Indonesia, South Africa and Brazil are developing countries with strong economic performances in comparison with their peers, although this is accompanied by severe inequalities. Inequality can create a number of problems, including unsustainable economic growth. Taxation is an effective policy instrument that can be used by governments to tackle the ever widening gap between rich and poor: taxes can be both a source of sustainable funds for public spending and a tool for income redistribution. At the same time, the quantity of tax revenue (the amount raised) and its quality (progressiveness, optimization of tax expenditures) can provide benchmarks for assessing a country's tax system in terms of economic inequalities.

Available data show that the revenue performance of all three countries lags far behind that of developed countries, and the way in which revenue is collected is far from equitable. In Brazil, the tax revenue system is dominated by regressive indirect taxes. In South Africa and Indonesia, tax revenues consist mostly of more progressive direct taxes but there is a significant difference between income tax revenue collected from paid employees and from self-employed individuals, reflecting low levels of voluntary tax compliance and a large dependence on pay-as-you-earn (PAYE) systems or other withholding mechanisms.

The structure of the taxation systems in all three countries leads to inequitable outcomes. Brazil has a complex system of indirect taxation based on earmarking. In terms of personal income tax, all three countries impose relatively low maximum tariffs compared with developed nations. In Indonesia and South Africa, the maximum income tax rate is applicable only to impossibly high levels of income. Furthermore, tax policies in these countries do not generally reflect principles of gender justice.

One of the reasons for low levels of tax revenue compared with what could potentially be raised is widespread tax evasion and tax avoidance, which take place in all three countries. This is made possible by international tax schemes and tax havens, of which High Net Worth Individuals and multinational corporations are able to take advantage. In studies looking at assets held in tax havens, the flow of illegal funds and losses incurred due to transfer pricing, all three countries have consistently ranked in the top ten. Many self-employed and workers in the informal sector also evade taxes, as indicated by the existence of substantial economic capacity (in terms of gross domestic product) yet insignificant tax contributions.

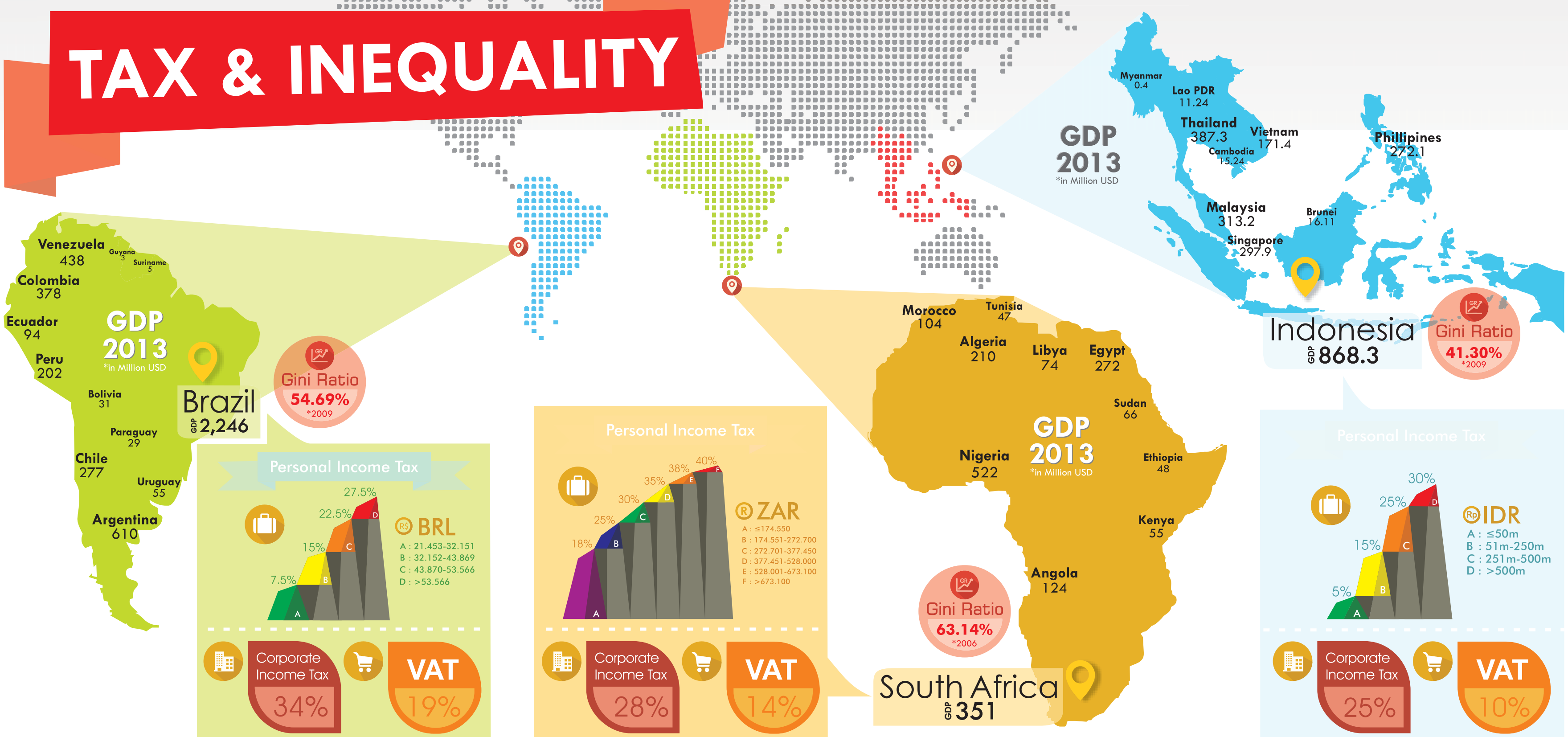
To effectively overcome disparities, a system of taxation that is sound, both quantitatively and qualitatively, must be in place. Tax potential should continually be maximized by strengthening law enforcement and increasing levels of tax compliance. Brazil needs to increase its proportion of direct taxes, while Indonesia and South Africa should work towards increasing income tax revenue from the self-employed. Tax policies (specifically regarding personal income tax) must also be able to support a progressive tax structure by setting marginal tax rates as high as possible, with the top rates applied to the lowest possible levels of income. Tax expenditures should also be optimized through tax allowances and tax exemptions targeted towards vulnerable women and children, low-income workers and other marginalized groups.

To combat international tax evasion, multilateral partnerships are necessary, engaging as many countries as possible. One way to do this is by initiating action on the digital economy, transfer pricing and the exchange of information under the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan. Beyond the BEPS Action Plan, developing countries must take initiatives themselves, including participating in discussions and the formulation of future action plans on BEPS; moving towards greater regional cooperation; reviewing unfavourable clauses and implementation of tax treaties; proposing the adoption of unitary taxation and formulary apportionment regimes by means of country-by-country reporting, as an alternative to the current 'arm's length' approach, and a comparability test for transfer pricing; and urging Northern countries to assist in information exchange in order to reduce profit shifting between tax jurisdictions.

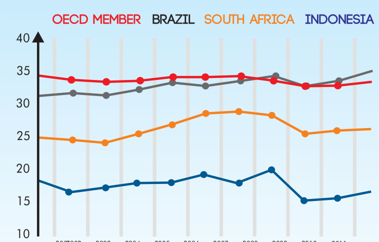
# TAX & INEQUALITY

Measured by **Gross Domestic Product (GDP)** data shows that Indonesia, Brazil, and South Africa are the largest economy for each region. But, still those countries are struggling with economic inequality.

Tax system has vital role to take over this issue, both as main source to finance social spending and as important income redistribution tool. Here we show you **economic facts** and **taxation system** of these countries.




### TAX RATIOS OF INDONESIA, SOUTH AFRICA, BRAZIL AND OECD COUNTRIES

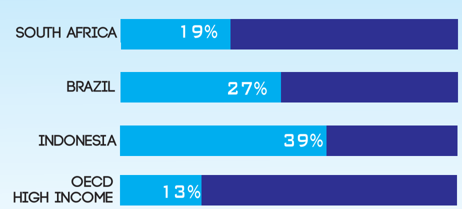



### TOTAL FINANCIAL ASSETS IN TAX HAVENS BY COUNTRY OF ORIGIN, 2010

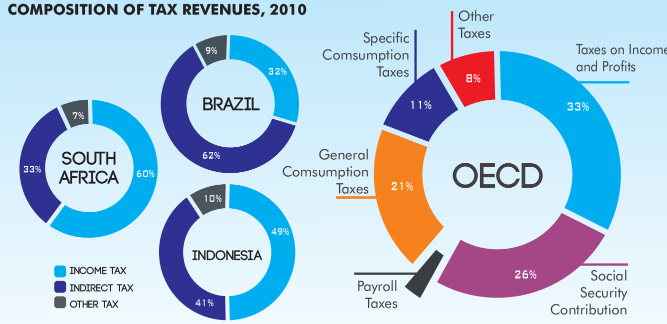
| RANK | COUNTRY | TOTAL (USD Billion) |
|---|---|---|
| 1 | CHINA | 1,189 |
| 2 | RUSSIA | 798 |
| 3 | SOUTH KOREA | 779 |
| 4 | BRAZIL | 529 |
| 5 | KUWAIT | 496 |
| 6 | MEXICO | 417 |
| 7 | VENEZUELA | 406 |
| 8 | ARGENTINA | 399 |
| 9 | INDONESIA | 331 |
| 10 | SAUDI ARABIA | 308 |

Source: Tax Justice Network (2010)

### INFORMAL SECTORS IN BRAZIL, SOUTH AFRICA, INDONESIA AND OECD HIGH INCOME COUNTRIES (%GDP)



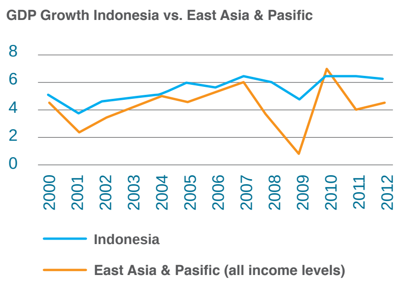

### COMPOSITION OF TAX REVENUES, 2010

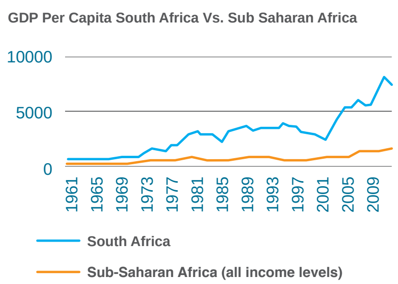


# 1 INTRODUCTION

The rapid growth of emerging economies has created a new force in the global economy. Countries such as Brazil, Russia, India, Indonesia, China and South Africa (often called the BRIICS) now play a more important role in the global economy.[1] According to the World Bank, emerging economies may join developed countries as the main drivers of global growth by 2025.[2] Among the BRIICS countries, Indonesia, South Africa and Brazil are prominent in their respective regions. For the past decade, Indonesia has had one of the strongest and most stable economies in the Asia-Pacific region. South Africa is the second largest economy in Africa after Nigeria, with a per capita gross domestic product (GDP) that far exceeds the average for sub-Saharan Africa. Meanwhile, with a GDP of USD 2.24 trillion, Brazil had the seventh largest economy in the world in 2013.

**Figure 1.1: Economic performance of Indonesia, South Africa and Brazil**




| Ranking | Economy | millions of US dollars |
|---|---|---|
| 1 | United States | 16.768.100 |
| 2 | China | 9.240.270 |
| 3 | Japan | 4.919.563 |
| 4 | Germany | 3.730.261 |
| 5 | United Kingdom | 2.806.428 |
| 6 | Brazil | 2.245.673 |
| 7 | Italy | 2.149.485 |
| 8 | Russian Federation | 2.096.777 |
| 9 | India | 1.876.797 |
| 10 | Canada | 1.826.769 |
| 11 | Australia | 1.560.372 |
| 12 | Spain | 1.393.040 |
| 13 | Korea, Rep. | 1.304.554 |
| 14 | Mexico | 1.260.915 |
| 15 | Indonesia | 868.346 |
| 33 | South Africa | 350.630 |

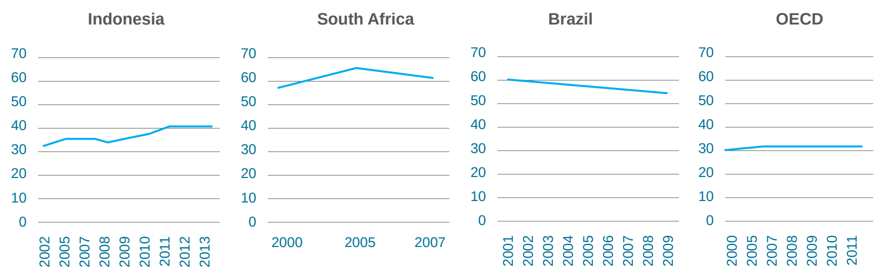
Source: data.worldbank.org

1 C. Hackenesch and H. Janus (2011) *Post 2015: How Emerging Economies Shape the Relevance of a New Agenda*.

2 World Bank (2011) *Multipolarity: The New Global Economy*. Washington DC.

Unfortunately, however, economic indicators in these three countries which at first glance appear good are in reality accompanied by severe economic inequalities. Indonesia's Gini coefficient[3] in 2013 was 41,3%, the highest since the country's independence. Brazil and South Africa have some of the highest levels of inequality in the world. Brazil's Gini coefficient was above 50% each year from 2001 to 2009, while South Africa's reached 63.1% in 2007.

**Figure 1.2: Gini coefficient ratios for Indonesia, South Africa, Brazil and OECD countries**




Source: data.worldbank.org

Economic inequality can create unequal economic growth, and a number of studies have shown that growth accompanied by high levels of inequality tends to be unsustainable.[4] Not all citizens of these countries feel the economic benefits of rapid development. One of the indicators used is the Inequality Human-adjusted Development Index (IHDI).[5] Indonesia's IHDI score is 0.553, below the regional average of 0.564, while Brazil's is 0.542, lower than the regional average of 0.559 for Latin America and the Caribbean. However, inequality is of growing concern globally.

In dealing with inequality, governments have a vital role to play. One way in which they can tackle inequality is through fiscal policy on national spending and revenue. Public spending is effective in reducing inequality; two of the most effective types of public spending are investments in quality health services[6] and public education for all.[7]

3 The Gini coefficient is used to measure the income distribution of a country's population and helps to define the gap between rich and poor. It is based on residents' net income and is expressed as a value between 0 and 1, with 0 representing perfect equality and 1 representing perfect inequality.

4 For example, research by the International Monetary Fund (IMF) has shown that growth where inequality is high lasts for a shorter duration than growth where there is little inequality. See Andrew G. Berg and Jonathan D. Ostry (2011) *Inequality and Unsustainable Growth: Two Sides of the Same Coin?*, IMF.

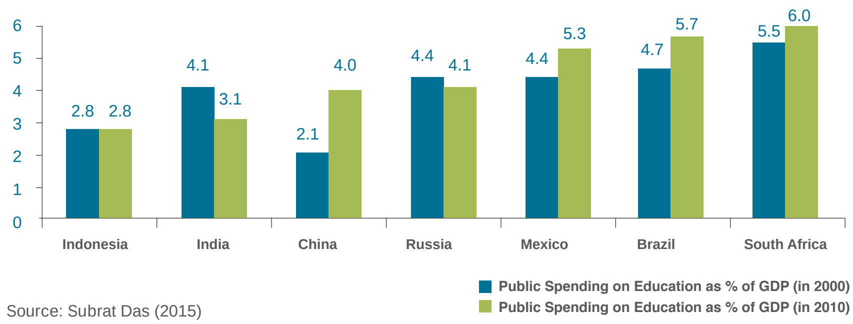
5 The Human Development Index (HDI) is a summary measure of average achievement in key dimensions of human development – health, education and income. A higher HDI value reflects greater levels of development. The Inequality-adjusted Human Development Index (IHDI) measures not only the average achievement by countries on these three basic aspects of human development, but also their distribution amongst the population by 'discounting' the average value of each according to levels of inequality. Higher levels of inequality lead to a reduction in a country's HDI score, after adjusting for the IHDI. IHDI data are unavailable for South Africa.

6 On the correlation between health and inequality, see, for example, Andrew Leigh, Christopher Jencks and Timothy M. Smeeding, 'Health and Economic Inequality' in *The Oxford Handbook of Economic Inequality* (2009); and Angus Deaton (2003) *Health, Income, and Inequality*. http://www.nber.org/reporter/spring03/health.html

7 One study which demonstrates that education reduces inequality is Abdul Jabbar Abdullah, Hristos Doucouliagos and Elizabeth Manning (2011) *Education and Income Inequality: A Meta-Regression Analysis*. However, this study also makes the point that high levels of public spending on education do not necessarily correlate with quality education.

Limited availability of state revenues leads to limited choices for governments when allocating their budgets. Research by the Centre for Budget and Governance Accountability (CBGA)[8] shows that all emerging economies have increased their health budgets, but the same is not true for education; Indonesia and India, for example, have not increased their education budgets. In Indonesia the ratio of the education budget to GDP in 2010 was 2.8%, the same as it was in 2000.

**Figure 1.3: Public expenditure on education as a percentage of GDP**




Source: Subrat Das (2015)

There is much potential for budgets to be increased if the government has the funds to afford this. Most countries around the world rely on tax revenue to fund spending because this grows in line with economic growth and well-being of the society. In addition, it does not carry the political burdens associated with aid and foreign debt. The increasingly important role of the state is supported by contributions from tax revenue, which ideally will increase from year to year. Increasing tax revenues reflect the growing independence of a country to meet its own needs, without depending on foreign aid, and also the growing contribution of its own people to development.

As well as funding spending, governments can use tax revenue to redistribute income. In general, taxes are paid by people who are better off, while common people receive benefits in the form of public goods and services provided by the state. However, this is not always the case, as taxes used as a tool to collect revenue may also be regressive i.e. they disadvantage those least able to pay.

Research by Profeta and Scabrosetti (2010) shows that spending on welfare is relatively high in democratic systems.[9] A transition to democracy requires increases in both tax revenue and public expenditure to fulfil political promises made to constituents. The same study

8 The CBGA is a policy research and advocacy organization based in New Delhi. See http://www.cbgaindia.org/

9 Paola Profeta and Simona Scabrosetti (2010) *The Political Economy of Taxation: Lessons from Developing Countries*, Edward Elgar, p.15.

shows a positive correlation between tax revenue and economic openness. Using data from the Polity IV dataset[10] and Freedom House,[11] the authors found a positive correlation between a country's GDP per worker and the quality of democracy.[12]

The present study sets out to analyse in depth how the current tax revenue performances of Indonesia, South Africa and Brazil compare with their potential. As well as analysing overall revenues, it investigates the composition of revenues by type of tax. This is important because not all taxes are progressive i.e. they do not depend on the economic ability of the taxpayer to pay. Moreover, certain types of tax are paid only by certain people: for example, payroll tax is imposed only on employees and not on self-employed workers. An analysis of the way tax revenues are composed can indicate whether a state has a progressive tax system in place and whether all segments of society are being taxed equitably.

The paper looks in depth at the prevailing tax policy in each country to measure how progressive their tax systems are, using examples of developed countries as a benchmark for comparison. It also analyses the gender dimension of tax policy to determine whether or not the country's tax system has taken gender equity into account.

Further, it examines levels of tax avoidance and tax evasion in the countries concerned and examples of the most frequently employed tax avoidance schemes. The degree of tax avoidance and tax evasion indicated by this study implies two things: (i) developing countries lose large amounts of revenue that could be used for social spending and (ii) it is comparatively easy for HNWI and multinational companies to avoid their tax obligations, given the existence of a wide range of international tax avoidance/evasion schemes of which they are able to take advantage. The paper further examines the extent of the informal sectors in the countries concerned: these escape the taxation system and so there is a large potential loss of revenue, while at the same time workers in these sectors may not be receiving the rights they are due, which worsens levels of inequality. It should be noted that informal sectors include not only small businesses but also large companies that are not properly registered.

The paper then evaluates the extent to which developing countries benefit from global initiatives to combat harmful tax practices, such as the Organisation for Economic Co-

10 The Polity IV Project measure characteristics of countries' political regime and transitions by scoring polity annually, with country reports exploring trends from 1946 to the present. See: http://www.systemicpeace.org/polity/polity4x.htm

11 Freedom House is an independent watchdog organization dedicated to expanding freedom around the world. See: https://freedomhouse.org/about-us#.VWxKV9Kqqko

12 Paola Profeta and Simona Scabrosetti (2010) *The Political Economy of Taxation: Lessons from Developing Countries*, p.45.

operation and Development (OECD)'s Action Plan on Base Erosion and Profit Shifting (BEPS). It also looks at whether such initiatives allow developing countries to expand their tax bases while also maintaining a competitive investment climate.

Finally, based on this analysis, the paper draws conclusions and attempts to formulate recommendations on taxation for these three emerging economies, in the context of both domestic policy and global participation, that would help them to reduce inequality while achieving sustainable growth and prosperity.

# 2 ANALYSIS OF TAXATION IN INDONESIA, SOUTH AFRICA AND BRAZIL AND IMPLICATIONS FOR INEQUALITY

In many countries, tax is the largest source of state revenue and also the most sustainable because it grows in line with economic growth and the population's well-being – unlike aid or foreign debt, which come with a political burden. The contribution of tax revenue to GDP has shown a significant increase in both developed OECD countries and developing countries. Various studies have shown that increased tax revenue (in terms of percentage of GDP) is associated with economic openness, democratization, stronger institutions and civil society, and the reduction of corruption.[13]

At the same time, the principle of justice in taxation cannot be neglected. Adam Smith (often called the father of modern economics) said in *The Wealth of Nations*, published in 1776, that the first principle of justice was that taxation by the state should be in accordance with the capabilities and incomes of taxpayers, without discrimination. The core part of this study analyses whether Indonesia, South Africa and Brazil have maximized their tax revenue potential so as to be able to fund social spending in order to reduce social inequality, and whether these three countries currently have taxation policies that offer equality for their citizens.

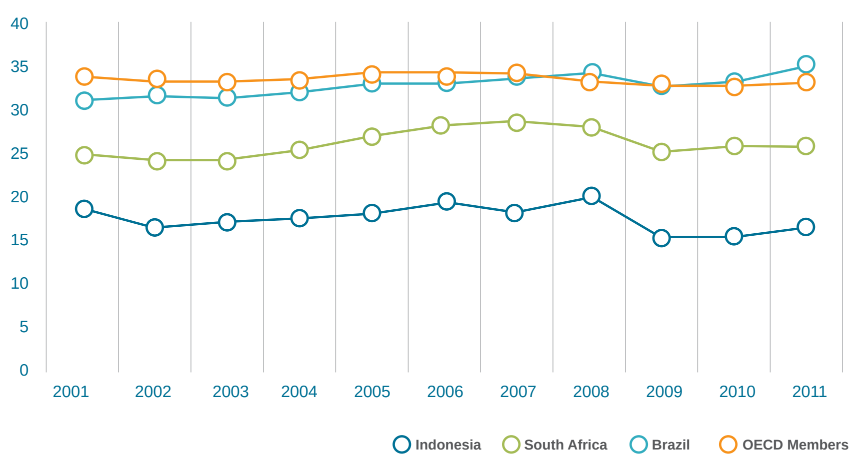
13 Paola Profeta and Simona Scabrosetti (2010) *The Political Economy of Taxation: Lessons from Developing Countries*, pp.15-16, p.45. See also Deborah Brautigam (2008) 'Introduction: taxation and state-building in developing countries', in Deborah Brautigam, Odd-Helge Fjeldstad and Mick Moore, *Taxation and State-Building in Developing Countries: Capacity and Consent*, Cambridge University Press, pp.1-2.

## 2.1 Tax revenue performance

### 2.1.1 Overall performance

In measuring performance on tax revenue, a frequently used indicator is the total tax ratio, which is the ratio of tax revenue to GDP. In general, the greater a country's tax ratio, the better the performance of the state revenue agency in collecting taxes. The tax ratio can also indicate the extent of any tax gap, or how much tax potential is not being realized. The tax ratio approach shows that the revenue performance of taxation institutions in these three countries is far from optimal in comparison with that of developed countries.[14] Indonesia lags the furthest behind: in 2001 the country's tax ratio was 18.3% and showed a stagnating trend, while in 2011 it was even lower at 16.2%.[15] South Africa's tax ratio is somewhat better: in 2001 it reached 24.8%, with an increasing trend.[16] It declined in 2008 and 2009,[17] but in 2011 it stood at 26.1%. Brazil has the best performance on taxation of the three countries. Its tax ratio has improved steadily since 2001, when it stood at 31.0%, to 34.8% in 2011. In 2010 and 2011, Brazil's tax ratio exceeded the average for OECD countries (see Figure 2.1).[18]

**Figure 2.1: Tax ratios of Indonesia, South Africa, Brazil and OECD countries**




14 In this study, the OECD countries are taken to represent developed countries as a whole.

15 The tax revenue used to calculate Indonesia's tax ratio consists of central taxation revenue plus non-tax revenue (NTR). The source of data is central government financial statements.

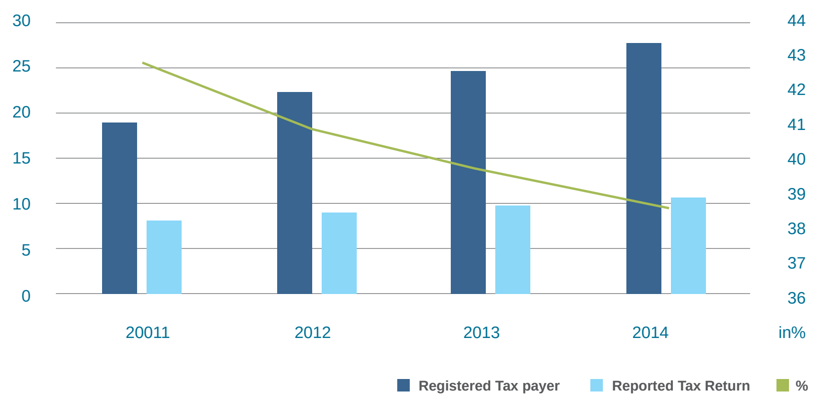
16 Source for South Africa's tax ratio: data.worldbank.org.

17 The decrease in the tax ratio in these years was due largely to the global recession.

18 Social contributions are actual or imputed payments to social insurance schemes to make provision for social insurance benefits. They are included in calculations of the tax ratio for Brazil and OECD countries. If social contributions are excluded, Brazil's tax ratio in 2010 was 25.91%. See José Roberto Rodrigues Afonso, Julia Morais Soares and Kleber Pacheco Castro (2013) *Evaluation of the Structure and Performance of the Brazilian Tax System*. Inter-American Development Bank.

These data show, however, that the revenue performance of both Indonesia and South Africa still lags significantly behind that of OECD countries. There could be two reasons for their low tax ratios – poor enforcement by tax authorities or lack of voluntary compliance by taxpayers. Not all taxpayers pay the taxes they should: non-compliance can take the form of underpayment of taxes due, under-reporting of income or not reporting it at all. Indeed, data from Indonesia show that only 10.7 million of 27 million registered taxpayers completed a tax return in 2014.

**Figure 2.2: Compliance on tax return reporting in Indonesia**




A number of studies have attempted to establish the reasons for non-compliance by taxpayers around the world. Ahmed Riahi-Belkaoui (2008), for example, empirically demonstrated a link between tax compliance, corruption and bureaucracy.[19] Belkaoui shows that tax compliance has a positive correlation with the control of corruption and, conversely, a negative correlation with the degree of bureaucratization. Indonesia recorded the lowest level of control of corruption amongst 30 developed and developing countries surveyed. It was the third most bureaucratic country and was ranked 19th for its levels of tax compliance. Of the 174 countries surveyed by Transparency International for its Corruption Perception Index in 2014,[20] Indonesia was ranked 117th, while South Africa and Brazil were ranked 67th and 69th respectively.[21]

19 Ahmed Riahi-Belkaoui (2008) 'Bureaucracy, Corruption, and Tax Compliance' in Robert W. Gee (ed.) *Taxation and Public Finance in Transition and Developing Countries*, Springer, pp.3-10.

20 See: http://www.transparency.org/cpi2014/results

21 Corruption in Indonesia affects not only tax compliance, but also perceptions of the overall business climate. The World Economic Forum's Global Competitiveness Index 2014 ranked corruption top amongst the most problematic factors for doing business in the country.World Economic Forum (2014) *The Global Competitiveness Report 2014–2015*.

### 2.1.2 Performance by sector

By sector, the lowest tax ratios in Indonesia are seen in agriculture, horticulture, forestry, hunting and fishing, services and construction. This reflects uneven tax compliance in each of these sectors, especially agriculture, which is notoriously difficult to tax – although Indonesia is not the only country struggling to generate tax revenue from such sectors.[22] Many of the major companies active in them allegedly evade taxes, and some forest and plantations products are exported illegally.[23]

**Table 2.1: Tax ratio in Indonesia by sector, 2009–2013**[24]

| Sector | 2009 | 2010 | 2011 | 2012 | 2013 |
|---|---|---|---|---|---|
| Agriculture, horticulture, forestry, hunting and fishing | 1.30% | 1.09% | 1.22% | 1.14% | 1.12% |
| Mining and extraction | 14.21% | 13.78% | 14.00% | 10.42% | 10.57% |
| Processing industries | 10.66% | 11.76% | 13.37% | 14.00% | 12.14% |
| Electricity, gas and water | 13.11% | 17.16% | 18.30% | 13.49% | 13.52% |
| Construction | 2.25% | 1.74% | 2.02% | 2.34% | 1.66% |
| Trade, hotels and restaurants | 6.10% | 6.36% | 6.80% | 7.07% | 5.22% |
| Transportation and communications | 7.75% | 7.36% | 7.19% | 7.75% | 5.81% |
| Finance and financial services companies | 18.17% | 16.01% | 16.42% | 16.96% | 13.28% |
| Services | 1.23% | 1.28% | 1.20% | 1.29% | 0.96% |

Indonesia imposes a presumptive final tax of between 2% and 6% on the turnover of construction services companies.[25] This is done because construction businesses have difficulty in determining their profits according to the normal method of income tax calculation. This policy needs to be reviewed, however, as most construction companies are capable of keeping good accounts.

In South Africa, the sectors where tax performance needs to be examined are those related to natural resources. Natural resources account for 30% of the total value of South Africa's exports, but the country earns less than 10% of its total tax revenue from this sector.[26]

22 Three of the most generally difficult sectors to tax are agriculture, services and small and medium-sized enterprises (SMEs). See Richard M. Bird (1983) *Income Tax Reform in Developing Countries: The Administrative Dimension*, in *Bulletin for International Fiscal Documentation* 37:1, pp. 3-4.

23 See C. Nellemann (2012) *Green Carbon, Black Trade: Illegal Logging, Tax Fraud and Laundering in the World's Tropical Forests*, INTERPOL/United Nations Environment Programme.

24 Calculated tax consists of income tax and value-added tax (VAT).

25 A presumptive tax is one that is calculated using indirect methods other than the taxpayer's own accounts, such as income reconstruction or by applying baseline taxation across the whole tax base. It is thought to be effective in reducing tax avoidance, while equalizing the distribution of the tax burden.

26 Data taken from the IMF African Department Database and processed and cited by Alun Thomas and Juan P. Treviño (2013) *Resource Dependence and Fiscal Effort in Sub-Saharan Africa*, IMF Working Paper No. WP/13/188.

## 2.2 Composition of tax revenues

In addition to overall revenue performance, in analysing aspects of inequality it is important to look at the structure of tax revenues. Data on revenue performance show that Brazil has the highest levels of tax collection, followed by South Africa and Indonesia. Brazil and South Africa meanwhile are among the countries with the highest levels of inequality. Therefore the performance of state revenue collection is not enough on its own to measure whether a country's taxation system is sufficient to prevent inequality.

Indicators that can be used to determine whether or not a tax system is just include the proportions of direct and indirect taxes. Direct taxes have great potential to reduce inequality because they are progressive and are based on the subject's ability to pay. The more capable the tax subject, the bigger the tax burden incurred (the income tax policies of the study countries are examined in section 2.3.1). Conversely, for poorer people the tax burden is smaller. Indirect taxes, by contrast, potentially cause imbalances because they are regressive, i.e. they have no regard for the economic status of the taxpayer. Indirect taxes are imposed on objects, the most common forms being value-added tax (VAT) and goods and services tax (GST).[27] A study in South Africa estimated that VAT accounts for 86% of the tax burden borne by a person with an income of ZAR 1,799, while for someone with an income of ZAR 10,241 the VAT burden accounts for only 18% of total tax paid.[28]

In developed OECD countries, income tax is the main focus of state revenue (see Figure 2.3). In most OECD countries, the regressive impact of indirect taxes is mitigated by personal income tax (PIT) systems that are progressive and help provide good social security systems. In developing countries, however, the redistributive effect of income tax is not optimized; one reason for this is that the structure of taxation is dominated by indirect taxes.[29]

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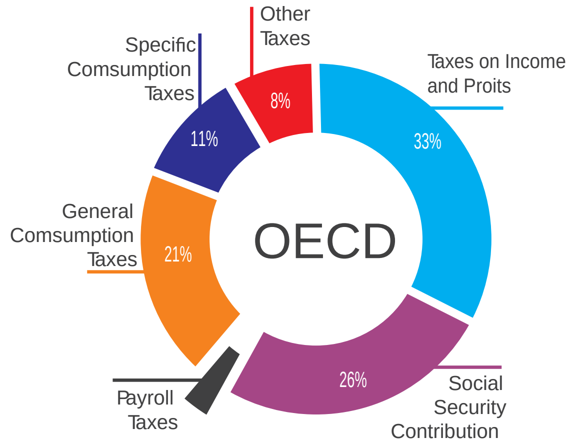
27 VAT is widely used because it is a simple, effective and fair source of revenue for a state with limited administrative capacity. See Michael Keen (2013) 'Taxation and Development – Again', in *Critical Issues in Taxation and Development*, Clemens Fuest and George R. Zodrow (eds), Massachusetts Institute of Technology, pp.20-21.

28 Imraan Valodia and Terence Smith, *Gender and Taxation In South Africa*, University of KwaZulu-Natal, Durban, p.25. http://www.levyinstitute.org/pubs/CP/May2006_symposium_papers/paper_Valodia.pdf

29 Eric M. Zolt and Richard M. Bird (2005) *Redistribution Via Taxation: The Limited Role of The Personal Income Tax In Developing Countries*, UCLA School of Law.

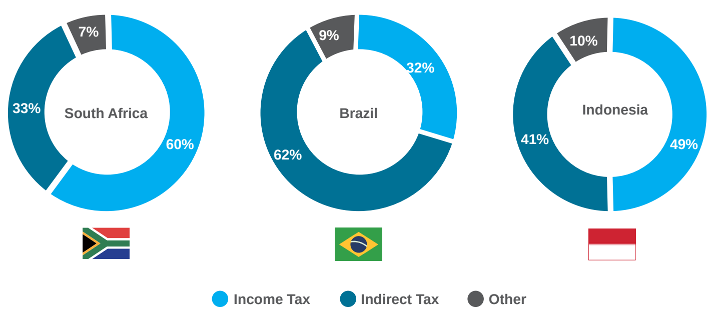
**Figure 2.3: Proportion of revenues in OECD countries, 2010**




Source: OECD, *Revenue Statistics in Latin America 1990–2010: Brazil*[30]

In a number of emerging economies, indirect taxes, especially VAT, are a vital source of revenue. The IMF and OECD sometimes recommend that states should implement VAT because it is efficient, generates large amounts of revenue and is relatively easy to administer.[31] Although VAT is not the dominant form of indirect taxation in Indonesia or South Africa, the proportion of revenue it contributes in these countries continues to increase. VAT revenue in South Africa has slowly risen, from 25% in 2009 to 26% in 2013. In Indonesia, the proportion of VAT to total receipts increased from 31% in 2009 to 36% in 2013.

**Figure 2.4: Composition of tax revenues in Indonesia,[32] South Africa[33] and Brazil,[34] 2010**




30 See: http://www.oecd.org/ctp/tax-global/Brazil country note_EN_final.pdf

31 Fiscal Affairs Department, IMF (2011) *Revenue Mobilization in Developing Countries*, http://www.imf.org/external/np/pp/eng/2011/030811.pdf; and OECD (2010) *Tax Policy Reform and Economic Growth*, OECD Publishing, http://dx.doi.org/10.1787/9789264091085-en, p.22.

32 Source: Government Financial Report 2010.

33 Source: South Africa Tax Statistics 2013. Figure 2.4 shows data for the 2009/10 tax year.

34 José Roberto Rodrigues Afonso, Julia Morais Soares and Kleber Pacheco Castro (2013) *Evaluation of the Structure and Performance of the Brazilian Tax System*, Inter-American Development Bank, p.21. Social contributions are excluded.

Of the three countries, Brazil relies the most on indirect taxes: in 2010, such taxes accounted for 62% of the country's total tax revenue. Income tax, which in most countries makes up the biggest slice of revenue, accounted for only 29% in Brazil. The country's huge dependence on indirect taxes is likely to be one of the reasons why inequality is so great, despite it having a relatively high tax ratio.

In Indonesia and South Africa, income tax is the main source of revenue, and in the past five years in both countries has accounted for approximately half of total tax revenues. In South Africa, income tax revenue exceeded 60% of the total in 2009, before declining to 55% in 2013. In Indonesia, income tax accounted for 51% of revenues in 2009, though this had declined to 47% in 2013.

In developing countries, the proportion of corporate income tax (CIT) often outweighs revenue from personal income tax (PIT). Except for some large-scale industries, in particular those based on natural resources such as mining, oil and gas, corporate income tax is easier to levy because businesses are obliged to produce audited financial statements. This imbalance might also indicate a lack of compliance by individual taxpayers.

The collection of PIT revenue in developing countries has not been optimal. Of the three countries studied, only South Africa collects a majority of its revenues from individual income tax; in Indonesia and Brazil corporate income tax is the main source of revenue. In Indonesia in 2014 the ratio of PIT to CIT revenue was 24:33. In Brazil, the difference was even more significant, with a ratio of 7:23 (see Table 2.2).

Emerging economies face many obstacles to efficient administration of their tax systems. Weak tax administrations and widespread tax evasion are two reasons for low levels of revenue from PIT. The problem is compounded by the size of the informal sector, which is 'invisible' to the tax authorities and where people do not pay tax on income. In Latin American countries, the estimated tax gap (i.e. the difference between what revenues should be and what they actually are) is often more than 50%.[35]

In terms of individual taxation, if taxpayers consist only of a certain group of people, then that country's tax system cannot be regarded as fair – for example, if taxpayers are mostly middle-class employees while business people and professionals with high levels of income do not pay their fair share of taxes. Indicators that can be used to analyse fairness include the individual income ratio obtained from a country's pay-as-you-earn (PAYE) or withholding

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35 J.P. Jimenez, J.C. Gómez Sabaini and A. Podestá (2010) *Tax Gap and Equity in Latin America and the Caribbean*, Fiscal Studies, No. 16, published in *Public Finance and Administrative Reform Studies*, ECLAC and GTZ, Eschborn.

tax system[36] and the individual income tax paid by high-earning self-employed workers. Data from the three countries show that individual income tax receipts are dominated by revenue collected via the PAYE system. The ratio of PIT revenue paid by employees via a PAYE system to that of payments by self-employed/professional workers is 30:1 in South Africa, 23:1 in Indonesia and 4:3 in Brazil (where indirect taxes account for a much bigger proportion of the total). Table 2.2 shows that individual income tax payments are dominated by PAYE contributions.

**Table 2.2: Breakdown of income tax revenue in Indonesia, South Africa and Brazil**

| | Indonesia[i] | South Africa[ii] | Brazil[iii] |
|---|---|---|---|
| Individual | 24% | 62% | 14% |
| PAYE | 23% | 60% | 8% |
| Self-employed / professional | 1% | 2% | 6% |
| Corporate | 33% | 36% | 46% |
| Others | 43% | 2% | 41% |
| Total | 100% | 100% | 100% |

The imbalance in revenues between PAYE and self-employed taxpayers is exacerbated by a lack of enforcement. Self-employed workers with high incomes and low levels of compliance, whose incomes are more difficult for tax authorities to track, have long been the main actors in tax evasion.[37]

## 2.3 Analysis of taxation policy

There are many factors that can affect a government's choices in formulating tax policy. The first is costs incurred versus benefits accrued. The implementation of tax policy generally involves four types of cost: administrative costs, compliance costs, cost-efficiency and political cost. In most emerging economies, the costs of collecting income tax are higher than for indirect taxes. For taxpayers too, adherence to paying income tax is more difficult than paying indirect taxes. In term of effectiveness, a progressive tax system can improve fairness, but it can also lead to inefficiency. Furthermore, behavioural economists have long stressed that perceptions of fairness play an important role in tax evasion.[38]

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i Data for revenues in fiscal year 2014. Source: Tax Revenue Report, Directorate General of Treasury, as of 5 January 2015.
ii Data for revenues in fiscal year 2013. Source: South Africa Tax Statistics 2013.
iii Data for revenues in fiscal year 2010. Source: Afonso et al. (2013) Evaluation of the *Structure and Performance of the Brazilian Tax System*, op. cit., p.21.

36 A PAYE system obliges employers to deduct income tax directly from employees' salaries, which means that employees cannot avoid paying income tax. By contrast, for business people or professionals who declare their own tax liabilities, there are ample opportunities not to report income properly.

37 Tax Justice Network Africa/Christian Aid (2014) *Africa rising? Inequalities and the essential role of fair taxation*, p.40.

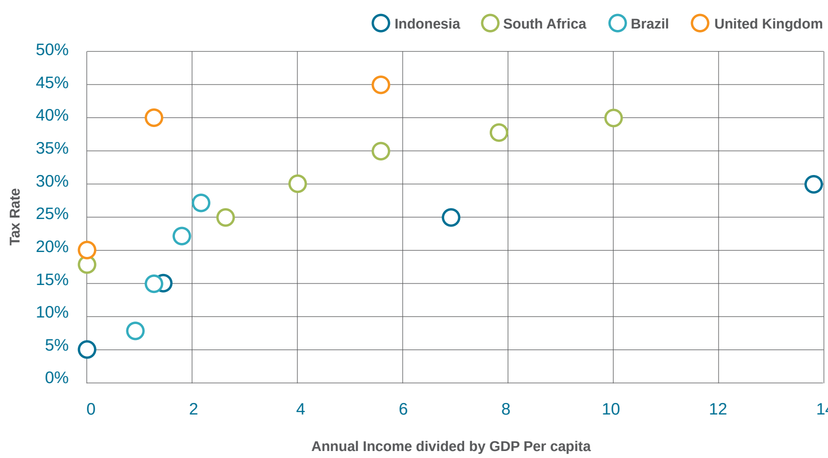
38 Eric M. Zolt and Richard M. Bird (2005) *Redistribution via Taxation: The Limited Role of the Personal Income Tax In Developing Countries*.

A large proportion of direct taxes does not necessarily mean that a country's tax system is fair, nor does a large proportion of indirect taxes necessarily make it unfair. Even if direct taxes dominate, a system cannot be considered equitable if only certain groups of people are paying taxes, such as employees through withholding tax or PAYE schemes while individual income tax revenues from businesses remain very small. Indirect taxes may exclude certain basic items (tax exemptions) while levying an additional amount on goods consumed by HNWI, for example in the form of a tax on luxury goods.

### 2.3.1 Income tax

Income tax is a progressive[39] type of tax, especially individual income tax, which is calculated annually on the basis of all taxable income for that year. Indonesia, South Africa and Brazil all impose stratified rates of income tax up to a certain limit – the higher the income, the higher the rate charged. Some exceptions apply: individual income tax systems take account of taxpayers' circumstances, such as the number of dependants they have or their insurance premiums.

**Figure 2.5: Individual tax rates based on GDP income per capita, 2014[40]**




39 'Progressive' taxation means the higher the income, higher the tax burden. Conversely, 'regressive' means the higher the income, the lower the tax burden.

40 Figure 2.5 assumes that a taxpayer has no dependants.

In Indonesia, individual income tax is applied at four different rates, or bands. The basic rate is a 5% tariff payable by those who have an annual taxable income of up to IDR 50 million, or 1.4 times GDP per capita.[41] The highest tax rate is 30%, imposed on individuals with an income of more than IDR 500 million, or approximately 13.8 times GDP per capita. Taxable income is determined after a number of deductions from gross income, including a personal allowance of IDR 24.3 million and an extra IDR 2 million for each dependant (up to a maximum of three) and additional to marital status. Married women are considered not to have dependants, as they are included in the calculation of a husband's taxes.

Brazil also has four different tax bands, with the lowest rate of 7.5% applying to taxpayers with an annual income of BRL 20,529, or 0.8 times GDP per capita. The highest rate of 27.5% is levied on individuals whose incomes exceed BRL 51,259, approximately 2.1 times GDP per capita. Unlike Indonesia, Brazil does not limit the number of dependants a taxpayer can claim for, but instead limits total deductions to BRL 14,542: besides dependants, this includes medical, social and education costs. Annual incomes of below BRL 20,529 are not taxed.

South Africa has the most tax bands, with six, and also higher rates of tax than Indonesia and Brazil. Its lowest rate is 18%, which is applied to incomes of up to ZAR 165,600, or about 1.1 times GDP per capita. The highest rate is 40%, applicable to taxpayers whose incomes exceed ZAR 638,600, or about 10 times GDP per capita. South Africa allows certain costs to be deducted from taxable income, including medical expenses. Taxpayers also receive the following allowances that reduce taxable income: ZAR 12,080 for those aged up to 65 years, an additional ZAR 6,750 for those aged 65–75 and a further ZAR 2,250 for those aged over 75. Individuals younger than 65 with an income of less than ZAR 67,111 are not subject to tax.

Optimal progressiveness and a fair tax system can be achieved by increasing marginal tax rates for the highest levels of income.[42] However, an examination of the highest tax brackets in the three countries shows that their individual income tax systems have a long way to go in terms of progressiveness. The highest tax rates in all three countries are lower than in developed countries, although the levels of income to which the top rates apply are relatively high. By comparison, the average top tax rate for OECD countries in 2013 was 42%,[43] with an

41 Calculated by the authors: the present study uses a GDP per capita comparison as it describes the tax burden relative to the economic capacity of the population.

42 Peter Diamond and Emmanuel Saez (2011) *The Case for a Progressive Tax: From Basic Research to Policy Recommendations*, in *Journal of Economic Perspectives*, Vol. 25, No. 4 (Fall 2011), pp.165-190.

43 This refers to tax rates alone; when elements of social contribution are included, the rate rises to 46%. See: http://stats.oecd.org/index.aspx?DataSetCode=TABLE_I7

average upper income limit of 2.38 times GDP per capita.[44] One OECD country, the United Kingdom, has a maximum rate of 45%, applicable to the highest-earning individuals with incomes of 5.6 times GDP per capita. In South Africa and Indonesia, the top rates of income are respectively 10 times and 13.8 times GDP per capita. Of the three countries, Brazil has the lowest income limit for the highest tax rates, at only 2.42 times GDP per capita.

The personal taxation system in South Africa used to be more progressive. More than a decade ago, the country had tax brackets of 42% and 45%. However, as well as a reduction in rates, the amount of tax that can be obtained from personal taxpayers has decreased. Analysis by the Alternative Information and Development Centre (AIDC) shows that the same annual income that in 1994/95 was taxed at 33.8% was effectively taxed at only 18.2% in 2010/11.[45]

Progressiveness in the tax system is not only a matter of how much HNWI should pay, but also of reducing the tax burden on poor people. To measure this, an analysis was conducted utilising annualized data for full-time workers paid the national minimum wage[46] in Indonesia, South Africa and Brazil and the thresholds for income tax. In Indonesia and Brazil, workers on the minimum wage are not taxed on their earnings; in South Africa, however, workers on the minimum wage, equivalent to USD 7,649 annually, exceed the non-taxable threshold, which means that they are taxed at a rate of 18% on the portion of their income that exceeds the threshold (see Table 2.3).

**Table 2.3: Minimum wages versus non-taxable income (in USD, 2014)**

| | Minimum wage | Non-taxable income[iv] | Subject to tax? |
|---|---|---|---|
| Indonesia | 1,585 | 2,045 | Tax-exempt |
| Brazil | 3,697 | 8,736 | Tax-exempt |
| South Africa | 7,649 | 6,187 | Taxed at 18% rate |

Source: PwC Personal Taxation Guide 2013–2014, CEIC Database; Statistics South Africa: http://www.statssa.gov.za; Inter-Union Department of Statistics and Socio-Economic Studies (DIEESE), *Brazil*: http://www.dieese.org.br

Threshold systems such as these can potentially increase inequality. The highest marginal rates are still low and are set at too high a level of income, so many high-earning individuals are taxed at a relatively low rate, and the problem is compounded by poor compliance. Due to the low proportion of individual income tax revenue generated from self-employed/professional workers, these three countries are also amongst those losing the most through international tax evasion schemes.

iv Figures in the non-taxable income (NTI) column are calculated as follows: (i) Indonesia – personal allowance (not including other deductions); (ii) Brazil – income subject to zero tax rate (after a maximum deduction of 20% of gross income); (iii) South Africa – the threshold at which income becomes subject to tax.

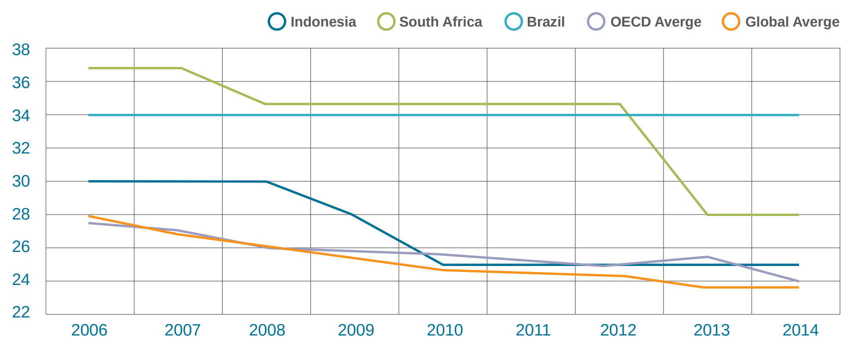
44 2010 data, cited in Inter-American Development Bank (2013) *More Than Revenue: Taxation as a Development Tool*, Development in the Americas Series, p.117.

45 Cited in Tax Justice Network Africa/Christian Aid (2014) *Africa rising? Inequalities and the essential role of fair taxation*, p.57.

46 These annual minimum wage rates were based on monthly minimum wage data obtained from CEIC and calculated by the authors.

As with individual income tax, high corporate tax rates do not necessarily mean that a tax system is progressive. For example, high tariffs can encourage capital to shift to countries with lower rates,[47] and studies have shown that the burden of corporate income tax is actually borne mostly by the workforce; for example, extra costs tend to result in cuts to jobs or wages, not reductions in dividends for the owners of capital.[48] Research by Clausing[49] shows that corporate tax revenues are higher in countries with lower tax rates. Furthermore, emerging economies often provide tax incentives that are considered ineffective: the benefits received by the country do not compensate for the tax revenue foregone.[50]

**Figure 2.6: Corporate income tax rates, 2006–2014 (%)**




Source: KPMG, *Corporate tax rates table*. http://www.kpmg.com/global/en/services/tax/tax-tools-and-resources/pages/corporate-tax-rates-table.aspx

In contrast with individual income tax rates, corporate income tax rates in Indonesia, Brazil and South Africa are relatively high compared with OECD countries and the world average. Indonesia has had a corporate income tax rate of 25% since 2009,[51] while South Africa's current rate is similar at 28% (though both have fallen since 2006). Brazil has a much higher rate, at 34%; this consists of a basic rate of 15%, which increases to 25% if corporate profits exceed BRL 240,000,[52] plus a social contribution of 9%.

47 There is cross-country evidence that effective corporate tax rates have a large and significantly adverse effect on corporate investment and entrepreneurship. Simeon Djankov, Tim Ganser, Caralee McLiesh, Rita Ramalho and Andrei Shleifer (2009) *The effect of corporate taxes on investment and entrepreneurship*. http://espanol.doingbusiness.org/methodology/~/media/FPDKM/Doing%20Business/Documents/Methodology/Supporting-Papers/DB-Methodology-Effect-of-Corporate-Taxes-on-Investment-and-Entrepreneurship.pdf

48 For example, Hassett and Mathur (2006) in *Taxes and Wages*, Working Paper 128 (Washington: American Enterprise Institute) find a strong negative correlation between wages and the rate of corporate income tax, using examples from many countries, including some in sub-Saharan Africa. Cited by Michael Keen and Mario Mansour (2009) *Revenue Mobilization in Sub-Saharan Africa: Challenges from Globalization*, IMF Working Paper WP/09/157. http://www.imf.org/external/pubs/ft/wp/2009/wp09157.pdf

49 K. Clausing (2007) *Corporate Tax Revenues in OECD countries*, in *International Tax and Public Finance* 14(2), pp.33-115.

50 See Ana Corbacho, Vicente Fretes Cibils and Eduardo Lora (eds) 'Corporate Income Tax: The Art of Competing for Investment and Increasing Revenues', in Inter-American Development Bank (2013) *More than Revenue: Taxation as a Development Tool*, pp.135-157.

51 For companies with a turnover of less than IDR 50 billion, the rate charged is 12.5%, applicable to a maximum taxable profit of IDR 4.8 billion. For companies with a turnover of less than IDR 4.8 billion, Indonesia implements a final, presumptive tax rate of 1% of turnover.

52 Presumed profit, where taxpayers calculate their corporate income taxes (at the same rate applied to the actual profit system) based on the application of a deemed profit margin. Brazilian entities may elect to compute corporate taxes based on this presumed profit mechanism; provided they (a) do not have total gross revenues in the preceding year higher than BRL 72 million; (b) are not financial institutions, similar entities or factoring companies; (c) do not earn foreign profits,

### 2.3.2 Indirect taxation

In Indonesia, the main indirect taxes applied are VAT and excise taxes. Businesses with a turnover of more than IDR 4.8 billion are required to register for VAT. The VAT rate is 10%, with exemptions for some goods and services; exempted goods include rice, grain, corn, sago, soy, salt, meat, eggs, milk, fruits and vegetables. Indonesia has an additional sales tax on luxury goods (i.e. a factory gate tax), which is levied at rates of between 10% and 200%[53] and applies generally to goods that are consumed by high-income people or are seen as indicating status.

The indirect tax system in Brazil is quite complex as it consists of various types of tax and is administered at both central and local levels. It includes the following:

1. Imposto sobre Circulação de Mercadorias e Serviços (ICMS), a tax on goods and services administered by the state. ICMS is payable on the transfer of goods and is also levied on inter-city and inter-state transport services, communication services and electricity supply. The general rate is 17%, with a range of 7–12% for inter-state delivery of goods;
2. Imposto sobre Produtos Industrializados (IPI), a production tax levied on all goods imported or manufactured in Brazil. IPI that has already been paid on raw materials can be credited against finished goods. The tax is administered by the central government and rates range from 0% up to 330%, including the taxation of luxury goods;
3. Imposto sobre Serviços (ISS), a tax on services administered at the municipal level, with a rate of 5%;
4. Contribuição para o Financiamento da Seguridade Social (COFINS), which is the portion of tax earmarked as a social contribution,[54] charged at a rate of 7.6%;
5. Programa de Integração Social (PIS), an indirect tax earmarked for social integration programmes and set at a rate of 1.65%.

As it is dominated by indirect taxation, Brazil's tax system overall is very regressive, despite progressive elements in its income tax system. In addition, the system of earmarking taxes for specific purposes means that Brazil lacks flexibility in its budget and that public funds may be used inefficiently.[55]

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income or gains (i.e. directly or through foreign subsidiaries); and (d) do not qualify for an exemption or reduction of corporate income tax. See: http://www.pwc.com/en_US/us/tax-services-multinationals/newsletters/latin-american-tax/assets/pwc-brazilian-presumed-profits-method-cap.pdf

53 Law No. 42 of 2009 on VAT and Luxury Tax.

54 The Brazilian system earmarks certain taxes for specific purposes e.g. COFINS for social contributions and PIS for integration programmes.

55 For more on Brazil's VAT system, see José Teófilo Oliveria and Ana Carolina Guiberti (2009) 'Tax Structure and Tax Burden in Brazil: 1980–2004' in Roger Gordon (ed.) *Taxation in Developing Countries: Six Case Studies and Policy Implications*, Columbia University Press, New York, pp.255-290.

South Africa levies VAT at a rate of 14%. Exports, certain foods and certain other items are subject to a 0% rate, as well as certain services (mostly financial services, property and public transportation). South Africa also levies additional charges for luxury items, with rates ranging up to 60%.[56]

## 2.4 Gender justice in taxation policy

'Inequality' has a broad meaning and is not limited to injustices of economic capability. In general, inequalities can be divided into 'vertical inequality' and 'horizontal inequality'. Economic inequality is a type of vertical inequality,[57] while horizontal inequality is based on specific differences between groups, including gender, religion and ethnicity. All types of inequality are currently being addressed by a number of high-level UN panels working on the post-2015 development agenda.[58]

The type of horizontal inequality highlighted in this study is gender inequality, which has been chosen for several reasons. A number of recent studies at the global level of tax policies specifically aimed at women have indicated an increasing level of interest in this area;[59] for example, the World Bank's *World Development Report 2012* confirmed a compounding effect between gender and other forms of inequality.[60] Individual women face a social construct of gender perspectives that often leaves them marginalized economically, politically and culturally, while women as a group are often marginalized economically and politically. In Indonesia, welfare for mothers and children is neglected in state budgets and is not a primary policy.[61] Analysis of public policy can help to mainstream welfare policies that benefit women and children through the formulation of good tax policy that is both equitable and participatory.

One indicator used to analyse gender imbalances in the tax system is the units on which taxation is based. A system based on family units treats the family as a single economic and legal entity, with a man as the head of the household and the rights and obligations of a wife who works treated as part of the husband's tax obligations. A system based on individual units treats women separately, with taxation rights and obligations independent of their husbands. From the perspective of gender equality, the concept of individual units

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56 PwC, *Overview of VAT in Africa – 2014*, p.153.

57 The term 'vertical' here refers to economic capacity.

58 Tax Justice Network Africa/Christian Aid (2014) *Africa rising? Inequalities and the essential role of fair taxation*, p.21.

59 Ann Mumford (2010) *Tax Policy, Women and the Law*, Cambridge; Kim Brooks, Asa Gunnarson, Lisa Philipps, Maria Wersig (eds) (2011) *Challenging Gender Inequality in Tax Policy Making*, Hart Publishing; Caren Grown and Imraan Valodia (eds) (2010) *Taxation and Gender Equity*, Routledge. See also Anthony C. Infanti and Bridget J. Crawford (eds) (2007) *Critical Tax Theory*, Cambridge.

60 World Bank (2012) *World Development Report 2012: Gender Equality and Development*.

61 Independent Budget Commission (2012) The 2012 state budget is still conservative and residual.

is preferable, as this treats women equally, giving them the same rights and obligations as men. Another useful indicator is tax deductions. For women, relevant deductions include those for dependants and for working wives who are the main breadwinners.

Of the three countries under review, only Indonesia bases its taxation system on family units. A married woman who works and who has her own Taxpayer Identification Number (TIN) needs to combine her income with that of her husband to calculate the income tax that they should jointly pay, which is levied in proportion to their respective net incomes. As a result, married women who work and who have their own TIN potentially face a higher tax burden due to the progression of income tax rates. The systems in South Africa[62] and Brazil are based on individual units, which means that married women are taxed separately from their husbands.

The differences between family and individual taxation also affect gender equality in terms of employment. Changing from a taxation system based on family units to one based on individual units can increase the amount of labour in aggregate. A study by the IMF has shown that women are more responsive to taxes than men,[63] and this is reinforced by another study that shows that a reduction in the tax burden on the second earner contributed to an increase in the number of women workers in Canada between 1995 and 2001.[64]

In Indonesia, different treatments are applied to wives with income from a single employer and those who are self-employed. Income from an employer is not combined with the husband's income, while income from self-employment is. This means that wives who are self-employed may be taxed at a higher rate when their income is added to that of their husbands. A family in which a working wife is not an employee potentially faces a higher tax burden than one where she is.

In South Africa, VAT is a heavier burden on men than on women, by a margin of about 8%. For each ZAR 1 spent, it is calculated that families with a male head pay 9.23 cents in VAT while families with a female head pay 8.13 cents.[65] A rate of 0% applies on food and paraffin, which benefits poor families and households headed by women. Another contributing factor is consumption behaviour: indirect taxes are higher on alcohol and tobacco and on motor fuel, and this tends to affect men more.

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62 This provision came into force in 1994, having been proposed by the Commission of Enquiry into Certain Aspects of the Tax Structure of South Africa (KATZ), which was set up by the new government. See Imraan Valodia and Terence Smith, *Gender and Taxation in South Africa*, University of KwaZulu-Natal, Durban.

63 IMF (2012) *Fiscal Policy and Employment in Advanced and Emerging Economies*, Board Paper, Washington DC. Cited in Katrin Elborgh-Woytek et al. (2013) *Women, Work, and the Economy: Macroeconomic Gains from Gender Equity*, p.13.

64 E. Tsounta (2006) *Why Are Women Working So Much More in Canada? An International Perspective*, IMF Working Paper 06/92, Washington DC.

65 See: http://sds.ukzn.ac.za/files/GenderTaxSA_policy_brief_final.pdf

Indonesia’s taxation policy is gender-neutral and does not exempt goods from tax on gender lines. However, this means that there is no clear vision promoting fairness and equal treatment for women. Basic goods needed by women and children should be excluded from taxation to protect their access to them.

## 2.5 The informal sector, tax avoidance and tax evasion

### 2.5.1 The informal sector

The informal sector is a growing problem for state revenue collection in many emerging economies, as it is difficult to monitor and to tax. The informal sector includes not only small businesses but also large enterprises that are not registered. In general, informal sectors can be divided into two categories: (i) legal activities, which generally consist of income not reported by employers, wages of informal employees and exchange transactions; and (ii) illegal activities, such as drugs, prostitution and smuggling. Table 2.4 shows informal sector classifications and related activities that can lead to a reduction in tax revenue.

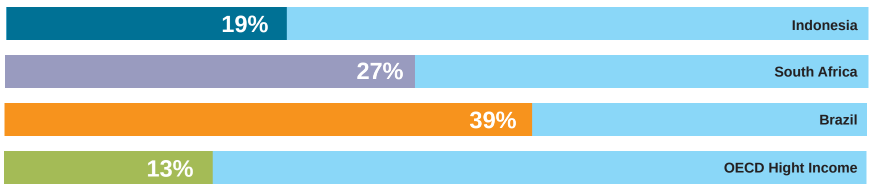
**Table 2.4: Taxonomy of activities in the informal sector**

| Type of activity | Monetary Transactions | | Non Monetary Transactions | |
|---|---|---|---|---|
| ILLEGAL ACTIVITIES | Trade with stolen goods, drug dealing and manufacturing; prostitution; gambling; smuggling and fraud | | Barter of drugs, stolen goods, smuggling etc. Produce or growing drugs for own use. Theft for own use | |
| | **Tax Evasion** | **Tax Avoidance** | **Tax Evasion** | **Tax Avoidance** |
| LEGAL ACTIVITIES | Unreported income from self-employment; Wages, salaries and assets from unreported work related to legal services and goods | Employee discounts, fringe benefits | Barter of legal services and goods | All do-it-yourself work and neighbor help |

Source: Christopher Bajada and Friedrich Schneider (2003) *The Size and Development of the Shadow Economies in the Asia-Pacific*, p.4.

Although the extent of the informal sector is difficult to measure, some indicators suggest that it is very large in India and Indonesia and in other developing countries such as Brazil, China and South Africa. In South Africa, according to the national Labour Force Survey of 2007, 19.5% of workers are in the informal sector.[66] In Brazil, most informal workers are unskilled, including workers in agriculture and construction. In Indonesia, the informal sector includes domestic workers, street vendors and sub-contracted workers.[67]

**Figure 2.7: Informal sectors in Brazil, South Africa, Indonesia and OECD High Income countries**




Source: Friedrich Schneider, Andreas Buehn and Claudio E. Montenegro (2010) *Shadow Economies All Over the World: New Estimates for 162 Countries from 1999 to 2007*, in *International Economic Journal*, Vol. 24, No. 4, December 2010, pp.455-457

A traditional view argues that workers resort to the informal sector when they are unable to get jobs in other sectors, but studies demonstrate that workers often choose the informal sector voluntarily because of the advantages and opportunities it offers.[68] From this, it can be concluded that the informal sector does not always correlate with low economic capability.

The informal sector does have a close correlation with taxation, however. The larger the informal sector, the greater the tax potential that cannot be optimized by tax authorities. At the same time, the weaker the application of law enforcement by tax authorities and the higher the tax burden, the bigger the informal sector tends to be.[69] For these reasons, an alternative way to reduce the size of the informal sector is to apply simpler tax administration and lower rates for taxpayers, with certain restrictions.

South Africa's tax policy classifies companies based on the size of their turnover, and those with small turnovers receive relief on tax rates. Companies with a turnover of less than ZAR 20 million are subject to a rate of 0% for the first ZAR 70,700 of profit, 7% for profits of between ZAR 70,701 and ZAR 365,000 and 21% for profits of between ZAR 365,001 and

66 Survey conducted by Statistics South Africa. Cited by Eliane El Badaoui and Riccardo Magnani (2013) *Tax Policies and Informality in South Africa*, p.2.

67 OECD (2011) *Special Focus: Inequality in Emerging Economies*, p.59.

68 Eliane El Badaoui and Riccardo Magnani (2013) *Tax Policies and Informality in South Africa*, p.2. This view is supported by E. El Badaoui, E. Strobl and F. Walsh (2008) *Is There an Informal Employment Wage Penalty? Evidence from South Africa*, in *Economic Development and Cultural Change*, Vol. 56, pp.683-710.

69 According to research by N. Loayza (1996) *The economics of the informal sector: a simple model and some empirical evidence from Latin America*, Carnegie-Rochester Conference Series on Public Policy, Vol. 45, No. 1, pp.129-162. The same conclusion is reached by D.S. Saracoglu (2008) *The informal sector and tax on employment: A dynamic general equilibrium investigation*, in *Journal of Economic Dynamics and Control*, Vol. 32, No. 2, pp.529-549.

ZAR 550,000. The normal tariff of 28% applies to profits above ZAR 550,000.[70] In addition, the government provides administrative relief for 'very small companies' by calculating direct taxation on the basis of turnover (i.e. presumptive tax). Companies with an annual turnover of less than ZAR 1 million can take advantage of this scheme, with rates ranging from 0% to 6% depending on turnover.

Since 2007 Brazil has applied a simple tax system known as *Simples Nacional*. The system allows qualifying companies to pay all types of tax due (income tax, IPI, social contribution, PIS, COFINS, ICMS and ISS) in a single combined payment, with progressive rates charged based on turnover. The system is quite successful and encourages companies to participate in the formal sector.[71]

In 2013 Indonesia adopted special rules for individuals and corporations with a turnover of less than IDR 4.8 billion, under Government Regulation No. 46/2013. Under these rules, eligible businesses are required to use a system that calculates tax presumptively at final rate of 1% of turnover each month. Implementation of this policy was expected to ease the administrative burden for companies, but in fact it has led to many problems. A final flat-rate tax of 1% can be unfair because unprofitable business are still obliged to pay taxes, and some types of business with small margins are more burdened by this system compared with the previous one. Furthermore, it is possible that a tax subject may have to pay taxes under two systems simultaneously: under the final scheme of 1% of income from a business and via the normal tax regime on income that is excluded from the 1% scheme. Therefore it is doubtful that this policy will result in a large reduction in the informal sector or will reduce the tax administration burden to any great extent.

### 2.5.2 Tax avoidance and tax evasion

#### 2.5.2.1 Losses arising from international tax evasion

As mentioned in the introduction, taxation has a vital role to play in maintaining sustainable revenue for governments, especially in improving their fiscal capacity to fund social spending and to reduce inequality. Optimization of tax revenue potential is hindered by low levels of compliance by taxpayers and by the poor administrative capacity of tax authorities. Studies consistently rank Indonesia, South Africa and Brazil high on the list of countries suffering the largest losses as a result of international tax evasion schemes, which are largely used by High Net Worth Individuals (HNWI) and multinational corporations (MNCs).

70 Tax year 2014–2015, source: PwC Worldwide Tax Summaries.

71 FGV Projetos, *Taxation Of Micro And Small Businesses In Brazil.*

Globalization is making it increasingly easy for capital to flow across country borders. For emerging economies, this can mean positive signs in terms of increasing inbound flows of foreign direct investment (FDI). However, it means that profits generated from investments can just as easily flow out of the country. Taking advantage of certain international taxation schemes, investors – both individuals and multinational companies – can shift income earned in one country to another country that has lower tax rates, or to tax havens where there is little or no real economic activity.[72] Reducing tax liabilities by shifting profits from one country to another is known as base erosion and profit shifting (BEPS).

Numerous reports have estimated that the amount of wealth hidden out of reach of tax authorities is very large. A report by Tax Justice Network estimated that, by the end of 2010, at least USD 21 trillion of financial assets owned by HNWI were sheltered in tax havens.[73] This amount included only financial assets and not real estate, yachts or other non-financial assets. The report put both Brazil and Indonesia in the top ten countries of origin for assets sheltered in tax havens: Brazil in fourth position with a total value of USD 529 billion and Indonesia in ninth with a total of USD 331 billion (see Table 2.5).

**Table 2.5: Total financial assets in tax havens by country of origin, 2010**

| Rank | Country | Total (USD billion) |
|---|---|---|
| 1 | China | 1,189 |
| 2 | Russia | 798 |
| 3 | South Korea | 779 |
| 4 | Brazil | 529 |
| 5 | Kuwait | 496 |
| 6 | Mexico | 417 |
| 7 | Venezuela | 406 |
| 8 | Argentina | 399 |
| 9 | Indonesia | 331 |
| 10 | Saudi Arabia | 308 |

Source: Tax Justice Network (2010)

A study by Global Financial Integrity, published in December 2014, estimated that illegal flows from developing countries amounted to USD 991.2 billion in 2012,[74] deriving mostly from mis-invoicing for imports and exports. According to this study, Indonesia, South Africa and Brazil are all in the top ten countries for illicit financial flows (IFFs): Brazil ranks sixth with a total of USD 217 billion, Indonesia seventh with USD 188 billion and South Africa tenth with USD 122 billion. Such huge amounts make IFFs the biggest outflows of domestic resources, compared with lending to rich countries, interest payments and (legal) profit outflows.[75]

72 'Tax haven' is defined as a state where income tax rates are very low or zero, and there is a high level of data secrecy.

73 The report did not attempt to establish whether these assets were owned by individuals or by companies. See Tax Justice Network (2010) *The Price of Offshore Revisited*, press release, 19 July 2010, p.6.

74 Dev Kar and Joseph Spanjers (2014) *Illicit Financial Flows from Developing Countries: 2003–2012*, Global Financial Integrity. http://www.gfintegrity.org/report/2014-global-report-illicit-financial-flows-from-developing-countries-2003-2012/. IFFs are movements of money or capital from one country to another that are illegally earned, transferred and/or utilized. One example would be the falsification of documents to evade taxes.

75 Eurodad (2014) *The State of Finance for Developing Countries*.

**Table 2.6: Top ten countries for illicit financial flows 2003–2013**[76]

| Rank | Country | Total (USD billion) |
|---|---|---|
| 1 | China | 1,252 |
| 2 | Russian Federation | 974 |
| 3 | Mexico | 514 |
| 4 | India | 440 |
| 5 | Malaysia | 395 |
| 6 | Brazil | 217 |
| 7 | Indonesia | 188 |
| 8 | Thailand | 172 |
| 9 | Nigeria | 157 |
| 10 | South Africa | 122 |

Source: Dev Kar and Joseph Spanjers (2014) *Illicit Financial Flows from Developing Countries: 2003–2012*

Tax can be evaded in various ways. HNWI can hide their assets in tax haven countries where high levels of secrecy protect them from tax authorities. MNCs can use their networks of affiliated companies around the world to take advantage of loopholes in bilateral tax treaties between countries (including tax havens),[77] so that the group's overall tax burden is greatly reduced.

### 2.5.2.2 Base erosion and profit shifting (BEPS)

Indonesia, South Africa and Brazil have some of the biggest domestic markets in the world[78] and are seeing a continuous expansion of their middle classes. This means that these countries have very large potential as sources of sales and revenue for MNCs, and a huge profit potential. However, by making use of the tax schemes described above, MNCs can shift their profits to other countries using a practice now commonly referred to as base erosion and profit shifting (BEPS). The OECD defines BEPS as tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low- or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

Neither developed nor developing countries can counter BEPS activities by MNCs on their own: an international approach is needed to tackle the problem. To this end, in July 2013 the OECD issued its BEPS Action Plan to address perceived flaws in international tax rules.[79] The 48-page Action Plan was negotiated and drafted with the active participation of OECD

76 The study does not classify the source or payee of funds as either an individual or an entity. Dev Kar and Joseph Spanjers (2014) *Illicit Financial Flows from Developing Countries: 2003–2012*, p.13.

77 A tax treaty is a bilateral agreement between two countries concerning issues such as double taxation of passive and active income.

78 A survey by Global Intelligence Alliance ranks Brazil the second largest domestic market, Indonesia fifth and South Africa sixth.

79 OECD (2013) *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing. http://dx.doi.org/10.1787/9789264202719-en

member states and contains 15 separate action points or workstreams, some of which are further split into specific actions or outputs. The plan focuses squarely on addressing issues in a coordinated, comprehensive manner, and was endorsed by G20 leaders and finance ministers at a summit in St. Petersburg in September 2013. Among the critical issues covered in the BEPS Action Plan that relate to developing countries are the digital economy, transfer pricing and transparency of information.

**The digital economy:**[80] The rapid development of information technology (IT) in recent years has created a new business model in the form of the digital economy. One aspect of the digital economy is a reduction in the relevance for transactions of space and time. For example, a company incorporated in country A may sell its products in country B through a website server established in country C, without ever having to set up a physical store. Moreover, tradable goods can now be in digital form, such as software applications or e-books, and so have no physical presence. Indonesia, South Africa and Brazil all have large markets and are seeing rapid IT development, which allows MNCs to generate huge profits in these countries via the digital economy without conducting substantial business activities there.

The digital economy raises new challenges for developing countries in terms of levying taxes. As well as the difficulty of administration, in the context of cross-border trade there is the issue of how taxation rights are defined. The international taxation system, especially under the OECD model, adheres to an 'arm's length' principle that taxable profits should be based on a company's functions, assets and risks (FAR). In the digital economy, FAR may be minimal in the market country, even though profits are largely generated there. Ultimately, market countries, where the revenue is generated, have fewer taxation rights than the countries where companies are based.

Furthermore, for a country to have the right to tax business income, the international taxation system requires the company to have a 'permanent establishment' in that country. This is defined as a fixed place of business through which the activities of an enterprise are wholly or partly carried out, which means that market countries like Indonesia, South Africa and Brazil have a disadvantage in the digital economy, which is less tangible.

**Transfer pricing:**[81] Transfer pricing is a pricing policy that involves inter-company transfers within a group of MNCs (intra-group).[82] In the context of taxation, it is often associated with a company's actions in setting prices so that the transfer tax payable in one country can

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80 OECD BEPS Action Plan, 'Action 1: Address the tax challenges of the digital economy'.

81 Transfer pricing is mentioned under Actions 8, 9, 10 and 13 of the BEPS Action Plan.

82 Robert Feinscreiber (2004) *Transfer Pricing Methods: An Application Guide*, John Wiley & Sons, p.3

be transferred to other countries. Research by Christian Aid suggests that in Indonesia loss of revenue to the state through the abuse of transfer pricing is very high.[83] Amongst G20 countries, Brazil, Indonesia and South Africa are ranked respectively fourth, fifth and sixth for the amount of tax revenue lost due to transfer pricing.

**Table 2.7: Tax revenue lost due to mispricing of bilateral trade with the EU and the USA (GBP millions)**

| G20 developing countries | 2005 | 2006 | 2007 | 3-year total |
|---|---|---|---|---|
| **Total** | **9,520** | **13,268** | **16,685** | **39,473** |
| **China** | 4,759 | 6,437 | 8,963 | 20,160 |
| **Mexico** | 2,948 | 3,358 | 4,200 | 10,507 |
| **India** | 676 | 2,112 | 815 | 3,603 |
| **Brazil** | 612 | 746 | 1,982 | 3,339 |
| **South Africa** | 168 | 365 | 370 | 903 |
| **Indonesia** | 255 | 158 | 262 | 675 |
| **Argentina** | 102 | 92 | 93 | 287 |

Source: Christian Aid (2009) *False profits: robbing the poor to keep the rich tax-free*, p.12

**Transparency of information:**[84] As described above, international tax evasion schemes can be utilized by MNCs with a presence in different jurisdictions, and can involve the use of tax havens that have low tax rates or impose no tax at all. Cooperation between tax administrations is critical in the fight against tax evasion, and a key aspect of that cooperation is the exchange of information. In 2014 the OECD created a single common global standard for the automatic exchange of information (AEOI) – the Common Reporting Standard (CRS) or, more formally, the Standard for Automatic Exchange of Financial Account Information. This was designed by the OECD in conjunction with the G20 and other jurisdictions, with input from representatives of the financial industry, and is available for all jurisdictions to use. However, AEOI requires a proper tax administration system and advanced IT capability to ensure that information flows in the way it is meant to, and unfortunately not all countries can meet these requirements. If no action is taken, less developed countries will be unable to implement the standard.

### 2.5.2.3 Beyond the BEPS Action Plan: issues raised by developing countries

Lack of involvement in the formulation of global initiatives: The OECD states that many low- and middle-income countries have signed up to the Action Plan; however, their involvement

83 Christian Aid (2009) *False profits: robbing the poor to keep the rich tax-free*. https://www.christianaid.org.uk/Images/false-profits.pdf

84 This is coveerd in the OECD BEPS Action Plan under 'Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance'.

is limited to its implementation – they were not involved in formulating it. Unsurprisingly, this lack of involvement means that the Action Plan tends to favour developed countries, and in some areas it is unlikely to propose solutions that are either effective or appropriate for developing countries.

Similarly, in the area of transparency of information, developing countries were not involved or consulted at the design stage of the CRS.[85] It would have made more sense to have worked through a truly international and representative institution such as the UN Committee of Experts on International Cooperation in Tax Matters (UN Tax Committee), or even to have established a new and representative international tax body that included both developed and developing countries on an equal basis. The Global Forum, an organization that encompasses both developed and developing countries and is responsible for monitoring the exchange of information, is dependent on and is essentially controlled by the OECD. The Global Forum was asked to help develop and monitor the new global standard on information exchange; it formed a specific working group and in February 2014 carried out a survey of member and non-member countries. However, the deadline for responses to the survey was 26 February 2014, and the OECD had already published its standard on 13 February, two weeks earlier. This clearly demonstrates a lack of serious interest in consultation.[86] Involving developing countries in the debate about international tax issues and the formulation of policies will aid efforts to tackle these issues, since it adds legitimacy and encourages global support.

**Criticism of the 'arm's length' principle:** The OECD has acknowledged that the BEPS Action Plan was not intended to change provisions of the existing international taxation regime. In the context of transfer pricing, this means that the Action Plan continues to take an 'arm's length' approach to determining taxation rights for transactions between affiliated companies in different countries. This approach involves estimating the proportion of profit by calculating a company's functions, assets and risks. The greater the third element – risk – the greater the proportion of income that is eligible to be taxed by the country where that high-risk-company is based.

As IT continues to develop rapidly, it becomes increasingly easy to execute cross-border transactions. MNCs established in one country can easily sell products in other countries across a whole continent without having to set up branch companies. The concept of international taxation is currently very detrimental to developing countries with large domestic

85 Andres Knobel and Markus Meinzer (2014) *Automatic Exchange of Information: An Opportunity for Developing Countries to Tackle Tax Evasion and Corruption*, Tax Justice Network. http://www.taxjustice.net/wp-content/uploads/2013/04/AIE-An-opportunity-for-developing-countries.pdf

86 Ibid.

markets, such as Brazil, Indonesia and South Africa, as income may be generated in their jurisdictions through trading activities while the profits are repatriated to the country in which a company operates.

Given these circumstances, it is important for developing countries to evaluate themselves what measures would be suitable for them to adopt, either alone or, preferably, jointly with other developing countries. They need to investigate more radical measures that could potentially be more effective and easier to administer.

As far as the division of taxation rights is concerned, one method to consider is assessment of multinational corporations on a unitary basis[87] using a system of global formulary apportionment (GFA). This is a method of allocating profits (or losses) made by corporations to jurisdictions in which they have a taxable presence. It is widely seen as being a better approach in principle and in many ways a more practical and effective alternative, though it is not without difficulties. This type of approach can be based on existing methods, especially the profit split method[88] in transfer pricing, and facilitated by a move towards country-by-country reporting, which is part of the OECD Action Plan.

The implementation of formulary apportionment by a number of countries on a regional basis may diminish the competition concerns that might arise if countries were to adopt reforms independently. Further, GFA requires coordination between states to support country-by-country reporting so that proportions of profits can be calculated correctly and fairly, and in the interest of developing countries.

**The issue of beneficial ownership:** A major problem faced by developing countries is tax evasion. By shifting their assets and ownership to more favourable tax regimes or to tax havens, HNWI can improve their own tax efficiency, but to the disadvantage of developing countries. It is very difficult for developing countries to combat this practice due to the lack of information about the beneficial ownership of assets. Tax evaders often use tax planning schemes to separate legal ownership from beneficial ownership,[89] and the financial secrecy of tax haven regimes protects them from investigation and the exchange of information.

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87 This means that MNCs are taxed based on their global profits, with the global profit allocated according to a specific formula.

88 The profit split method is used to evaluate controlled transactions to determine if the allocation of profits and losses between the related parties was conducted at arm's length, based on the relative value of their contributions to the profit or loss.

89 'Legal ownership' means that an entity has an enforceable claim or title to an asset or property, recognized by law. 'Beneficial ownership' means that an entity enjoys the possession and/or benefits of ownership (such as receipt of income) of a property, even if its ownership (title) is in the name of another entity (called a 'nominee' or 'registered owner'). Use of a nominee (who may be an agent, a custodian or a trustee) does not change the position regarding tax reporting and tax liability, and the beneficial owner (also called the 'actual owner') remains responsible.

Developing countries need to improve cooperation to combat this kind of tax evasion by strengthening their tax laws and tax systems i.e. by mandatory declaration of foreign assets and investments, increasing cooperation on the exchange of information with other developing countries and adopting a general anti-avoidance rule (GAAR),[90] especially by tax authorities, to review the use of artificial tax planning structures and to test whether or not they have any real economic substance.

90 A set of broad and general principles-based rules enacted in the tax code aimed at counteracting avoidance of tax


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# 3 CONCLUSION AND RECOMMENDATIONS

## 3.1 Conclusion

Indonesia, South Africa and Brazil are emerging economies with relatively strong economic performances, although this is accompanied by high levels of economic inequality, which can lead to a variety of problems, including unsustainable economic growth. To address the widening inequality gap, their governments can use taxation policy as an effective tool of fiscal policy, and taxes can serve as a source of sustainable funding for public expenditure and as a tool for income redistribution.

The data indicate that the revenue performance of these countries has lagged behind that of developed countries, and the composition of their tax revenues does not indicate progressive systems. The Brazilian system is very regressive due to the preponderance of indirect taxes. Equally in South Africa and Indonesia, although direct taxation accounts for the majority of revenues, individual income tax is raised largely from taxes paid by employees, with very little contribution from self-employed individuals. This indicates that voluntary tax compliance by individual taxpayers is very low, as the system relies largely on PAYE or withholding mechanisms.

Taxation policies in these three countries do not fully reflect equality. Brazil relies heavily on a very complex system of indirect taxation, which reduces taxpayers' willingness to comply. This is compounded by an earmarking system that reduces flexibility in budget allocation. In terms of individual income tax, the three countries have maximum rates that are relatively low compared with those of developed countries. In Indonesia and South Africa, the income levels set for the maximum rate of individual income tax are too high. Furthermore, the taxation policies of all three countries fail to observe principles of gender justice.

One cause of low levels of tax revenue is the huge extent of tax evasion and tax avoidance by HNWI and multinational corporations who take advantage of artificial international taxation schemes and tax haven jurisdictions. Studies looking at the extent of assets sheltered in tax havens, the magnitude of illicit financial flows and losses due to transfer pricing practices have consistently put these three countries in the top ten globally for lost revenue. Tax evasion is also an issue that concerns the informal sector, which makes a large contribution to GDP but a very small contribution to tax revenue.

To combat international practices of tax evasion, multilateral cooperation is required, involving as many countries as possible. One way to do this to encourage implementation of the action points relating to transfer pricing, the digital economy and the exchange of information contained in the OECD BEPS Action Plan. However, despite its comprehensive nature and the wide support it has gained from non-OECD countries, the Action Plan as it stands does not do enough to counter tax evasion in developing countries. By involving developing countries more in their formulation, future action plans will be more legitimate and will win greater support, making them more likely to succeed.

## 3.2 Policy recommendations

Based on the research undertaken for this paper, the authors make the following recommendations:

- In terms of revenue performance, tax revenue potential should be maximized so that public and social spending can be increased to help reduce inequality. They should not rely heavily on indirect taxes for their revenues, due to their regressive nature. For personal income tax, compliance by self-employed individuals needs to be improved, rather than continuing to rely on the PAYE system.

- The highest marginal rates for individual taxpayers need to be raised to strengthen the progressive nature of the countries' personal income tax systems. At the same time, the highest marginal levels of income need to be reduced.

- Corporate tax rates are relatively high and need to be reviewed. This is important to prevent capital shifting to other countries where rates are lower.

- There is a need to reassess the cost-benefit aspects of tax incentives, to evaluate the actual benefits of offering tax incentives compared with the loss of revenue incurred.

- Personal income tax systems should be based on individual tax units rather than on family units so that women are not adversely affected by higher marginal tax rates.

- To prevent gender inequality, when designing tax policies (including tax expenditures) differing basic needs according to gender should be taken into consideration.

- To reduce the size of the informal sector, lower tax rates can be applied and administration made easier to encourage compliance.

- Beyond the current BEPS Action Plan, developing countries should be more involved in discussing and formulating future action plans. Developing countries should also aim to improve regional cooperation, review the application of tax treaties and the ways in which such treaties can be abused, support the introduction of unitary taxation regimes and global formulary apportionment with country-by-country reporting as an alternative to the ‘arm’s length’ principle, and force developed countries to provide assistance in the implementation of information exchange, as well as enhancing the transparency of beneficial ownership in international tax schemes so that artificial profit shifting can be reduced.

- It is also suggested that developed countries should assist developing countries so that they can put such policies into practice, with proper administration.

- The issue of beneficial ownership must be addressed in political discourse to raise awareness and to encourage real cooperation between developed and developing countries in order to standardize the automatic exchange of information and to review tax planning structures that do not have economic substance.

Cross country research on tax policy and inequality: comparative study of Indonesia, South Africa and Brazil / Yustinus Prastowo, Sugeng Bahagijo, Siti Khoirun Nikmah

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