

13 July 2013

MEMORANDUM FOR

Mr. George Mavraganis
Deputy Minister of Finance

Mr. Stylianos-Ioannis Koutnatzis
Legal Advisor to the Ministry of Finance

From: Bob Conrad

Subject: Various Matters

Thank you for meeting with me during my recent visit. I hope the discussions and the materials I have supplied to date are helpful. Some additional items related to our meetings and planning are discussed below.

I. Quick Revenue Increases

You asked me to consider ideas for rapidly increasing tax revenues. Unfortunately, I believe, with two possible exceptions, the time for rapid revenue increases has passed. Early reform efforts in Greece put some emphasis on VAT enhancements because the VAT can be a steady revenue source, changes in rates can accrue revenue rapidly because the tax is basically a tax on continuous consumption, and compliance activities can be targeted. Thus, any short-term gains should have been realized by now. The income tax reforms, however, cannot be expected to increase revenue rapidly, unless there is a significant expansion of periodic payments via withholding. The income tax is an annual tax and one cannot expect rapid revenue increases during a transition year. In addition, the reformed income tax should be relatively more elastic than the VAT. Thus, even if compliance increases, rapid revenue increases cannot be expected given the deterioration of the economy, unless there has been a significant increase in the statutory base. Finally, I understand that a new tax on real property is being drafted. This tax might be helpful in the near term, only after implementation, but over time a tax on real property will account for less than 2% of GDP, in part because administration can be cumbersome (and differs from methods employed in VAT and income taxes).

The two options that might be considered, if they have not already been tried, relate to excise taxes and expanding the base for withholding. With the first option, revenues can be increased in a somewhat rapid fashion by changing excise tax rates and improving administration. Excise taxes are relatively inelastic, so short-term revenue increases can be expected if evasion, smuggling and corruption are held in check. My impression is that other advisers would have noted this possibility to your government in the past. If not, then I will be happy to supply further details. The second option, expanding withholding (perhaps even to capital gains), can increase revenues in two ways. First, the tax payments are accelerated to the time of payment (or perhaps accrual), which is generally earlier than the time of annual reporting. Second, compliance might be increased because the government receives the tax revenue before (or at the same time as) the taxpayer receives the funds. Compliance by withholding agents is generally higher relative to the general population because the tax does not affect the withholding agent (it is not their tax liability and does not affect their income) and, in many countries, the withholding agents are personally liable for the withheld tax, as they

should be as a matter of policy.¹ In addition, there are generally fewer withholding agents than total taxpayers so auditing can be more efficient. One caveat to this approach is that various EU directives and court decisions might restrict the extensive use of withholding. Nevertheless, expansion of withholding might still be possible and I encourage you to consider this alternative to every extent.

In summary, there are unfortunately few methods to rapidly increase revenues. I discourage the use of schemes such as tax amnesties. Evidence suggests that such gimmicks might be counterproductive over the longer term. I also discourage the use of short-term crack-downs and high profile prosecutions. These schemes can be counterproductive too if taxpayers do not believe that monitoring methods and tax administration in general has significantly improved. If taxpayers believe the contrary, then such efforts might lead to increases in corruption as well as more evasion and efforts to avoid becoming part of the tax system.

At this point, I believe what is needed is a basic set of incremental improvements in policy and administration. Such change is difficult in the best of times and especially difficult in the current Greek circumstances. It is, however, the best option and will gradually increase public confidence and compliance. This approach will enable you and your colleagues to gain experience by application and, if expectations are handled, can lead to improvements in policy, compliance, and revenues.

Of course, I will be happy to supply additional specific suggestions on this incremental approach should you desire.

II. Economic and Tax Crimes

We had a discussion on Tuesday evening about the reorganization of your unit on tax and economic crimes. I have not received the law you mentioned. I am not expert in this area but am willing to review the law and make suggestions if I can. As well, I know individuals who have extensive experience in this area and might suggest that you contact them for comment.

III. Accounting Standards and Modified Law of Books and Records

The new income tax will depend on both Greek accounting standards and the Modified Law of Books and Records. That is, much of the tax base derivation will depend on standard accounting provisions. These computations include, but are not limited to: the definition of accrual, foreign exchange gains and losses, accruals for items like prepaid expenses, reserves for insurance companies, amortization of things like research and development, perhaps some source rules, and other items. The standards used by accountants sometimes differ from economic classifications and options are sometimes provided in generally accepted accounting standards. For instance, foreign exchange gains and losses might be measured on either an accrual or a cash basis. Some expenses such as wages and consumable costs used in research and development might be capitalized or expensed. Long-term contracts might be treated on a proportion-of-completion basis or a payment basis. While these points might seem purely technical in nature, they can significantly affect effective tax rates within and between industries. In fact, such differences can change a tax into a subsidy, depending on the facts and circumstances. Thus, I believe your group would be well served by further developing their

¹ For instance, in the United States corporate management is held personally liable for wage withholding taxes. This provision provides strong incentives for entities with employees to comply with withholding rules.

capabilities to monitor and evaluate the economic effects resulting from alternative accounting treatments with the intent of developing specific rules in secondary legislation.

IV. Revenue Estimating

The tax administration reform (the VAT in particular) has been ongoing and your new income tax has provisions for the use of indirect methods to measure income. The data used to monitor the VAT and to develop such risk scores is similar to the information necessary to develop revenue and receipts estimating models. These models can be used to estimate future revenues, to monitor the tax system, and can be an analytical tool for the evaluation of alternative policies. I will be happy to provide information and support on how to begin developing this important in-house capability.

V. Internal Appeals Processes

You mentioned that the new procedures law will have a new or revised internal appeal process. The appeals process is important because it might be possible to settle many tax disputes before appeal to the court system; a system which can be cumbersome and time consuming. You noted a concern about whether a body internal to the tax administration, and composed of tax administration employees, will have the standing sufficient to act in an independent manner. Your concern is valid because a body that is not impartial and cannot act independently will be perceived as simply another impediment to a fair hearing.

I am not expert in this area but would be happy to comment on the relevant provisions of the applicable law. In addition, I might have access to others who might be knowledgeable about how to establish independent procedures in situations where reform is ongoing.

VI. Future Cooperation

I will be happy to provide appropriate assistance and input if you desire. The types of inputs I can provide include:

- Providing various economic analyses (present value analysis, computations of marginal effective tax rates, measures of distortions, the measurement of revenue effects, and other analyses) of various tax proposals;
- Commenting on legislation;
- Developing drafting instructions for tax provisions, secondary legislation, and instructions in areas where I have some technical proficiency;
- Supplying comparative materials on policies in different parts of the world;
- Developing proposals for further improvements in your tax regime; and
- Developing revenue systems.

The choice is yours, however. I appreciate the constraints under which you operate and I hope I am perceived as a person who can assist you in relaxing those constraints while working cooperatively to improve the Greek tax environment.

I am always available via e-mail and can be responsive on a timely basis. Occasional visits, at your discretion, are also a possibility.

Please let me know your preferences.

I hope the information contained here as well as in the other memoranda I have supplied is helpful to you.

Thank you again for your warm welcome and support.