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Introducing a self-assessment tax regime in Iraq

Policy Paper

Strengthening Public Finances and Financial Markets (FFM) in Iraq

Implemented by
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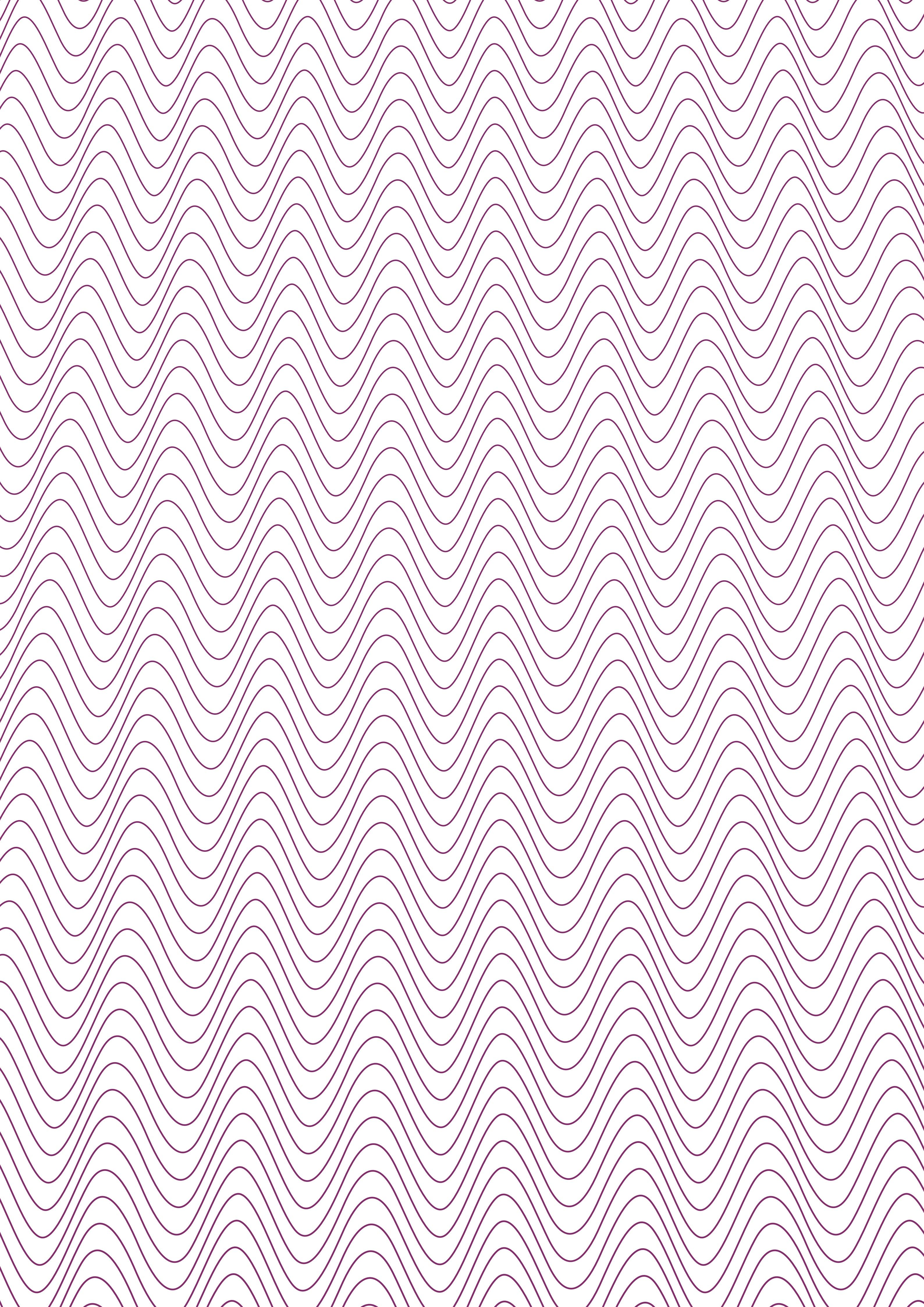

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Project
Strengthening Public Finances and Financial
Markets (FFM) in Iraq

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List of abbreviations

BMZ	German Federal Ministry for Economic Cooperation and Development
CRA	Companies Registration Authority
EU	European Union
GCT	General Commission for Taxes
GDP	Gross domestic product
GIZ	*Deutsche Gesellschaft für Internationale Zusammenarbeit GmbH*
IMF	International Monetary Fund
IQD	Iraqi Dinar
ITAS	Integrated Tax Administration System
MoT	Ministry of Trade
OECD	Organisation for Economic Co-operation and Development
OECD DAC	Development Assistance Committee of the Organisation for Economic Co-operation and Development
TAFFI	Technical Assistance Facility for Iraq
VAT	Value added tax

1. Introduction

The Government of Iraq has defined comprehensive reform measures to embark on an inclusive development path, based on stable and accountable institutions. The aim is to diversify domestic revenue mobilisation away from near complete dependence on oil revenue and a single-product economy, by boosting non-oil revenue sources, and to develop appropriate tax policies to harness such sources effectively.

Increasing non-oil revenue generation is an ambition that is attracting more attention than ever in most countries, especially those with fragile environments. The recent policy direction from the Iraqi Council of Ministers on the introduction of a self-assessment tax regime in the country has underscored the government's proactive attitude towards non-oil revenue diversification. This discussion paper identifies some key challenges that could affect the successful implementation of a self-assessment tax regime for domestic revenue mobilisation and provides some recommendations on how the Government of Iraq can proactively address these challenges to sustainably finance the country's development needs.

The paper further provides a fundamental understanding of what a self-assessment tax regime is, explains the need for change and describes the legal and regulatory frameworks required for the introduction of a self-assessment system. It focuses on weaknesses and challenges and seeks to broaden policy-makers' understanding of tax reforms and the implications for the government's fiscal space on the one hand and for taxpayers on the other. The paper also suggests a progressive approach so that critical institutional measures can be put in place to ensure effective and efficient implementation.

2. Background: Iraq's non-oil revenue generation system

Iraq became an independent country on 3 October 1932. This opened an unprecedented window of opportunity to diversify the economy, boost economic growth and development and enhance social cohesion.

Iraq is located in western Asia and is bordered by Jordan to the west, Syria to the north-west, Turkey to the north, Iran to the east and Kuwait and Saudi Arabia to the south. The country is currently divided into 18 governorates, with Baghdad as the capital. The official languages of Iraq are Arabic and Kurdish, and the currency is the Iraqi dinar (IQD)

Iraq has a single-product economy based on oil exports which account for over 90% of government revenue and over 80% of foreign exchange earnings. The non-oil tax revenue system is weak, with staff largely untrained and accountability for revenue collection extremely weak.

Almost two decades after the 2003 war, Iraq remains caught in a fragility trap, facing increasing political instability, growing social unrest, poor economic management, a lack of reform and weak institutional capacity. The economy is characterised by a large, dominant public sector and a much smaller, politically connected private sector. Iraq's economy remains highly centralised and heavily dependent on state-owned enterprises, which have a complicated and largely opaque impact on the government's finances.

The country's tax infrastructure is weak, the regulatory frameworks are outdated, and human resource capacity is inadequate. The non-oil revenue diversification programme has been attracting donor attention in recent times, and the government's ability to lead strategic reform of domestic revenue mobilisation is critical to its success. The Government of Iraq must therefore embark on modernising the non-oil revenue generation system by bringing about a comprehensive policy shift on resource mobilisation, accountability, and distribution.

The initiative must be supported by development partners and aim to improve the government's fiscal capacity so that it can address the development challenges facing the country, such as poor education, shortcomings in health and sanitation, inadequate economic infrastructure owing to insufficient budgetary allocations, weak non-oil revenue generation, increasing volatility in the world oil market and the impact of emerging global conflicts.

The government's medium-term strategy to progressively increase non-oil revenues to support critical expenditures while reducing reliance on oil revenue is gaining attention from international partners. Given limited capacity and a low base, with non-oil revenues accounting for around 8% of total revenues,[1] the introduction of the self-assessment tax regime is a measure that will raise tax revenue, enhancing the efficiency of tax administration for better controlled revenue collection. Due to past difficulties in sustaining non-oil revenue reforms, which were introduced in annual budget laws, it is crucial for policy-

[1] International Monetary Fund (IMF), *Iraq: 2022 Article IV Consultation – Press Release; and Staff Report*, IMF Country Reports 23/075, February 2023

makers to develop specific tax regulations and instructions to support the implementation of the self-assessment tax regime. Donors and partners, such as the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH, the Technical Assistance Facility For Iraq (TAFFI) and other international partners, could support the design of a revenue mobilisation strategy, taking into account the effect of introducing the self-assessment tax regime.

An international conference on reforming the tax system in Iraq is scheduled to be held on 6 December 2023, sponsored by Prime Minister Mohammed Shia al-Sudani and with the support of international partners, on the theme '*Towards a transparent and fair tax system*'. It is a clear commitment from the Government of Iraq to reform its domestic revenue mobilisation strategy.

3. Overview of a self-assessment tax regime

The legitimacy of any post-conflict government in the eyes of its citizens is largely dependent on its ability to mobilise revenue in a transparent and accountable manner and distribute resources equitably to deliver services to its citizens. The incorporation of transparent revenue mobilisation measures in tax policy reform, the equitable allocation of resources and expenditure management are bound together by political imperatives as well as by economic logic. For the state to generate revenue, it must be seen to be legitimate in the eyes of its citizens, and to secure this legitimacy, the state must allocate the scarce resources available in an equitable manner and control expenditure effectively in order to create fiscal space for post-conflict reconstruction.

Non-oil revenue consists of various types of taxes, each with its own set of economic and political consequences. When embarking on tax reform in a typical post-conflict environment, decision-makers must critically evaluate the impact of each type of tax on the country's political and economic landscape. This is crucial because each tax has its own burden and economic implications. Therefore, a political analysis must be carried out on the following: (i) the economic and social effects of each type of tax and how it could influence the political atmosphere in the country, (ii) careful analysis of how the imposition of each tax could lead to changes in the political landscape and support and (iii) evidence-based revenue forecasting methodologies designed to scientifically estimate the resource envelope required to meet overall budgetary needs and avoid tax distortion in the fiscal year budget and resource allocation. This leads to a critical analysis of the implications of introducing a self-assessment tax regime in Iraq as part of the government's new policy measures to robustly enhance non-oil revenue.

In a self-assessment tax regime, the tax authority relies on the good faith of the taxpayer, as full responsibility for determining liability for all kinds of tax, especially corporate income tax, is shifted to the taxpayer. The taxpayer is under a legal obligation to estimate expected profit for the year of assessment and pay any tax arising from projected income to the tax authority in accordance with applicable tax laws and regulations.

Self-assessment can apply to all registered taxpayers under the tax regime, regardless of the nature of the business and turnover. However, it is important to recognise that in the initial stages of the introduction of a self-assessment tax regime in Iraq, there should be a turnover threshold for businesses and mechanisms for continued evaluation and expansion to include more businesses over time.

3.1. Characteristics of a self-assessment tax regime

In a self-assessment system, as the name indicates, the tax assessment obligation is transferred to the taxpayer in accordance with current tax laws and regulations. The taxpayer is, by law, authorised to determine and estimate their tax liability and must pay the amount due to the tax authority as prescribed. The main characteristics of a self-assessment tax regime are as follows:

1. The taxpayer estimates annual profit, calculates the tax due and pays it by the due date to the tax authority

2. Self-assessment tax returns are filed on a quarterly and annual basis
3. The calculation of the tax due is based on a projected income statement for the year of assessment
4. The taxpayer can elect to file either quarterly or annual tax returns
5. The projected income statement must be filed at the beginning of the quarter or year of assessment, as provided by law and in accordance with international best practice
6. Taxpayers are able to amend returns already filed with the tax office before the end of the tax period
7. Taxpayers have the right to ask for an extension of time to file a return
8. Taxpayers are bound to pay the tax not in dispute, as shown on the projected income statement submitted, if no amended return is filed
9. The self-assessed tax amount is not a final tax bill but rather a payment on account

Filing returns under the self-assessment tax regime does not release taxpayers from their obligation to file returns for withholding and other relevant taxes within the stipulated time period, as prescribed by applicable tax laws and regulations.

3.2. Classification of taxpayers under a self-assessment tax regime

In most tax jurisdictions, the criteria for classifying businesses and individuals as 'large taxpayers' are based on turnover (companies) and economic activity (individuals), as determined by the tax authority. However, some businesses are classified as large taxpayers because they fall into one of the specialised industry categories, irrespective of their turnover. Examples include upstream and midstream petroleum companies, banking institutions, insurance companies, mining companies and members of groups of companies where at least one member qualifies as a large taxpayer.

Seemingly in sharp contrast to Resolution No. 12 (paragraph 5) of 17 September 2023 adopted by the Iraqi Council of Ministers on reforming the tax system and improving the business environment, the self-assessment tax regime to be introduced in accordance with a new decision adopted by the Council of Ministers will apply to all taxpayers, irrespective of whether they are a company or sole trader and without taking turnover or industry categories into account. The implementation of this new tax reform will pose serious challenges for the tax authorities as they do not have the capacity to roll out such an extensive reform. A second problem is that taxpayers, especially small and medium taxpayers, will have trouble filing returns which must be prepared by tax consultants and certified auditors. In view of this, this paper suggests that the self-assessment tax regime be rolled out progressively, based on turnover thresholds, as determined by law, to allow time for critical institutional structures and a proper taxpayer awareness programme to be put in place before full implementation.

3.3. Forms and notices

Self-assessment returns are special prescribed forms designed under tax law for supplying specific information on a business's income and expenditure within a certain period. There are two types: a quarterly return form and an annual return form. Under the self-assessment

regime, taxpayers can elect to file either quarterly or annual returns. In both cases, the tax due must be paid quarterly. It is obligatory for taxpayers to pay the tax due before the end of each quarter. However, taxpayers can apply for an extension following the procedures provided by current tax law. Best practice is as follows:

a. The application for an extension must be in writing

b. The reasons for requesting the extension must be stated

c. The application must be submitted before the return filing deadline

Circumstances warranting the granting of an extension of time to file a return

There are certain conditions under which an extension of time to file a return can be requested which apply both to self-assessment returns and other types of returns:

a. When the certified auditor or the approved tax consultant is outside the jurisdiction of the tax authority and therefore unable to prepare the return and file it on time

b. When the company's officer in charge of making the books of accounts available to the auditor is indisposed and there is no other officer authorised to provide them

c. When there is a natural disaster which has affected the business premises and resulted in the destruction of property and loss of records kept for tax purposes

d. When there is a court order restricting access to the business premises in the period in which the return is due

e. When the business faces serious cash flow challenges

The Commissioner General or authorised officers of the tax authority can extend the deadline for filing a return by written notice if they are of the opinion that the taxpayer has demonstrated reasonable grounds for the extension. The extension granted may be subject to certain conditions, including security for payment, as deemed appropriate by the Commissioner General or the head of the tax authority. When applying for an extension under any of the circumstances listed above, the company must prove beyond reasonable doubt that such circumstances exist.

Under Article 27 (Chapter 14) of Income Tax Act No. 113 of 1982 (Income Tax Act), taxpayers are required to file returns, but there is no specific provision as to how self-assessment returns should be filed. Furthermore, the penalty provisions set out in Article 56 (Chapter 28) of the Act are too general, and there are no specific provisions on offences under the self-assessment tax regime. For instance, the following offences under self-assessment require specific new provisions to make the system operational:

a. Penalty for underestimation:
    I. When underestimated by up to 50% of the actual tax payable
    II. When underestimated by between 51% and 70%
    III. When underestimated by more than 70%

b. Failure to file quarterly projected income statements by the due date

c. Failure to pay tax shown on quarterly returns by the due date

Quarterly return form

This form is purposely designed to be completed by the representative of the business on a quarterly basis showing projected income and expenditure for the quarter in which the income is expected to be generated for a particular year of assessment. Companies and businesses owned by individuals that fall under the self-assessment tax regime have a legal obligation to use this form to file their quarterly returns. The completed self-assessment form signed by the certified auditor or approved tax consultant must be submitted at the beginning of the quarter in which the expected income is to be generated. The quarterly self-assessment form must clearly show the following information:

a. Revenue generated in the period under review
b. All expenditure incurred in generating income
c. Any other revenue related to business operations generated in this period
d. The projected net profit for the quarter
e. The projected tax due for the quarter

Annual return form

Under the self-assessment regime, the taxpayer can also elect to file a projected annual income statement instead of a quarterly one. However, any tax due must be paid on a quarterly basis in accordance with applicable tax law and using the prescribed form. This annual income statement should not be confused with the certified annual audit report which must be submitted by the end of the fourth month of the year following the year of assessment.

Table 1: Tax filings and payments under the self-assessment tax regime

Type of return	Filing period	Filing due date	Tax payment deadline
Quarterly self-assessment return/projected income statement	First quarter	1 January	31 March
	Second quarter	1 April	30 June
	Third quarter	1 July	30 September
	Fourth quarter	1 October	31 December
Annual self-assessment return/projected income statement	First quarter	1 January	End of each quarter
Income statement for financial year/year of assessment	This is provided in Income Tax Act No. 113 of 1982 (Chapter 14, Article 27)		30 April of year following year of assessment

Note: The filing periods, filing due dates and payment deadlines for self-assessment returns are not currently provided for in the Income Tax Act. Therefore, for the self-assessment tax regime to be implemented successfully, Article 27 (Chapter 14) of the Income Tax Act needs to be urgently amended to include return filing requirements for taxpayers to whom the new tax regime applies. Taxpayers can elect to file an annual projected income statement at the beginning of the first quarter. Any tax arising from the annual project income statement must be paid on a quarterly basis.

3.4. Responsibilities of auditors representing taxpayers

Generally, in accordance with international best practice, taxpayers' returns, especially annual income statements filed after the end of the year of assessment, showing payments on account and accompanied by a signed certified auditor's report, are signed off by the director of the company. However, the Iraqi Council of Ministers passed a new resolution – **Resolution No. 12 of 17 September 2023** – on reforming the tax system and creating an enabling environment for businesses which includes the following provisions in paragraph 5, sections 1 and 2:

a. Individuals, entities, companies and businesses must submit their accounts and financial statements approved by a certified auditor to the General Commission of Taxes (GCT), which shall be the basis for calculating the tax due, subject to approval by the Auditing Oversight Board of the auditor's seal and signature.

b. With regard to the financial statements submitted by taxpayers to the GCT that are not subject to audit by a licensed auditor, pursuant to **Regulation No. 2 of 1985 on the commercial bookkeeping system for income tax purposes**, the provisions set out in paragraph 1 above shall apply, provided that the financial statements are prepared by accounting offices licensed by the Union of Accountants and Auditors.

c. The tax due shall be collected according to the information provided in accordance with (a) and (b) above; thereupon the taxpayer shall be discharged.

The new resolution is expected to form the basis for the introduction of the self-assessment tax regime in the country. The difficulty is that the Income Tax Act does not establish an accounting method for determining taxable income. In order to implement a self-assessment tax regime efficiently, the country needs to adopt an international accounting standard that allows the **depreciation of assets based on a pooling system rather than the current method which is based on industries.**

3.5. Evaluation of self-assessment tax returns

There are two specific windows of opportunity available to tax officers for the evaluation of returns submitted to the tax office by taxpayers, which would apply to businesses under the self-assessment tax regime. Normally, tax officers are not authorised by law to undertake tax audits on self-assessment taxpayers as regularly as on other taxpayers. The only option the tax authority has for evaluating returns is an internal desk review of the returns filed. Desk review is expected to be limited to withholding taxes that companies have a legal obligation to deduct and pay to the tax authority on behalf of other taxpayers. The real challenge is the capacity of the tax officers to go beyond desk review and conduct effective external tax audits to determine the taxpayer's final tax bill. This is critical because, under the self-assessment tax regime, taxpayers determine the amount of profit to be taxed. There is no guarantee that the taxpayer will produce an income statement that reflects a true and accurate picture of the business's operations during the year of assessment. It has been proven over the years that taxpayers, through their auditors and tax consultants, engage in tax avoidance schemes to reduce their tax burden in any way they can.

Review-based studies by different authors on tax avoidance behaviour from different perspectives, such as the tax planning behaviour of multinational enterprises (Cooper and

Nguyen, 2020; Wang et al., 2020), family firms (Khelil and Khlif, 2023), determinants (Sritharan et al., 2022) and corporate governance (Kovermann and Velte, 2019), support the argument that there is a real willingness on the part of taxpayers to employ certain tax avoidance schemes to reduce their tax burden. Therefore, it is imperative for the tax authority to develop effective anti-avoidance legislation to counter the increasing tax planning activities of taxpayers.

4. Key elements for the implementation of a self-assessment tax regime in Iraq

4.1. Legislative reform

Almost two decades after the 2003 war, Iraq remains caught in a fragility trap, facing increasing political instability, growing social unrest, poor economic management, a lack of reform and weak institutional capacity. The economy is characterised by a large, dominant public sector and a much smaller, politically connected private sector. Iraq's economy remains highly centralised and heavily dependent on state-owned enterprises, which have a complicated and largely opaque impact on the government's finances. The tax revenue generation system in Iraq is based on three laws, namely Income Tax Act No. 113 of 1982, as amended, Real Estate Tax Act No. 162 of 1959, as amended, and the Land Tax Act. The provisions of current tax laws are no longer relevant for today's complex global and international business transactions. This makes interpretation and application of the law to collect tax effectively very difficult and contributes to tax revenue erosion.

Apart from these three laws, there are also several instructions and directives from the Council of Ministers and the Ministry of Finance concerning the domestic revenue generation system. Most of these instructions and directives are not based on the provisions of current laws and some even override them.[2] This has created confusion among tax officers on the one hand and between the tax authority and taxpayers on the other. The excessive use of such instructions, which has the effect of completely amending existing tax law without the authority of parliament, is a very dangerous executive usurpation of the legislative function of parliament. This attempt by the courts or the executive to amend laws outside the control of the legislature was vehemently opposed by Lord Simmonds in the case of Magor and St Mellons Rural District Council vs Newport (1951). On appeal to the House of Lords, Lord Simmonds described Lord Denning's approach as: '*a naked usurpation of the legislative function … If a gap is disclosed, the remedy lies in an amending Act.*'

The relevance of the above case to the situation in Iraq is that, if there is a gap in tax law, it is the responsibility of those who made the law to amend it and that the attempt by the courts to amend tax law through interpretation and rulings is illegal. Similarly, action taken by the Iraqi Council of Ministers to issue tax instructions that override existing tax laws without the authority of parliament amounts to undermining the legislative function of parliament.

Another significant area of confusion is the tax liabilities of foreign contractors and their foreign employees when there are double taxation agreements or similar provisions. Granting a tax exemption in such situations simply reduces the tax paid in Iraq while increasing the tax paid in the home country of the multinational company.

There is no provision for a self-assessment tax regime in the current tax laws used to collect tax revenue, which means that **Council of Ministers Resolution No. 12 of 17 September 2023 (paragraph 5)** is not sufficient as a basis for the implementation of such a system. Furthermore, the current Income Tax Act has no effective implementing

[2] Council of Ministers Resolution No. 12 of 17 September 2023, paragraph 5

regulations to operationalise some of its key articles. In order to roll out the new tax regime in a coordinated manner, there is an urgent need for policy-makers to develop appropriate legislation to guide the implementation process.

Principles of taxation

The proposed legislative reform for the introduction of the self-assessment tax regime must follow international best practices and principles for modern tax administration. As postulated by Anyanfo (1996), the principles of taxation mean the appropriate criteria to be applied in the development and evaluation of the tax structure. Such principles are essentially an application of some concepts derived from welfare economists. In order to achieve the broader objectives of social justice, the tax system of a country should be based on sound principles. Jhingan (2004), Bhartia (2009) and Osiegbu et al. (2010) list the principles of taxation as equality, certainty, convenience, economy, simplicity, productivity, flexibility and diversity.

Equity principle: states that every taxpayer should pay tax in proportion to their income. The rich should pay more and at a higher rate than others with a lower income (Jhingan, 2004). Anyanfo (1996) states that only when a tax is based on the taxpayer’s ability to pay can it be considered equitable or just. Sometimes this principle is interpreted to imply proportional taxation.

Certainty principle: states that the taxes each individual is required to pay ought to be certain and not arbitrary. The time of payment, the manner of payment and the amount to be paid must all be clear and plain to the taxpayer and everyone else (Bhartia, 2009).

Convenience principle: states that the time and manner of taxation should be convenient to the taxpayer. According to Anyanfo (1996), this principle of taxation provides the rationale for the pay-as-you-earn system for collecting income tax.

Economy principle: states that every tax should be economical for the state to collect and the taxpayer to pay (Appah, 2004; Jhingan, 2004; Bhartia, 2009). Anyanfo (1996) argues that this principle implies that taxes should not be imposed if the cost of their collection exceeds the benefits.

Productivity principle: states that a tax should be productive in the sense that it should bring in sufficient revenue for the government. This is the main reason why governments in all parts of the globe continuously undertake tax reforms.

Simplicity principle: states that taxes should be clear, simple and understandable to the common taxpayer. Anyanfo (1996) argues that there should be no hidden agenda in tax law.

Flexibility principle: implies that there should be no rigidity in taxation.

Diversity principle: states that there should be a variety of taxes. Bhartia (2009) argues that it is risky for states to depend on too few sources of public revenue.

4.2. Tax audit capacity

One of the challenges facing the country in its post-conflict reconstruction and development is capacity gaps at the institutional and human resources level. Just as citizens have a responsibility towards the government and a duty to pay their taxes, the government has a

responsibility towards its citizens too. It is important for governments in post-conflict countries such as Iraq to invest enough tax revenue in their citizens to enable them to attain their potential in driving the post-conflict reconstruction agenda.

The fundamental issues to consider in building a sustainable tax system are what type of taxpayer registration system to adopt, the revenue accounting and monitoring system, a taxpayer awareness and education programme, audit and investigation, enforcement policy, exemption policy and import quotas.

Tax audit is an examination of a taxpayer's returns by the tax authorities to verify the accuracy of the information on income and deductions reported in their books of accounts and filings submitted to the tax office. Generally, a tax audit is carried out by tax officers in their tax jurisdiction. There is a specialised department within the tax authority to perform tax audit functions. Tax office staff currently lack the capacity to conduct tax audits, and since a self-assessment tax regime requires robust tax audit skills, the government must invest the necessary resources to support a rapid tax audit capacity development programme for tax officers.

In the context of post-conflict reconstruction, the objective of capacity development is to enable the government to mobilise available resources for economic development and poverty reduction. Capacity has been defined in many ways according to emerging needs in a particular environment. The Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD DAC) defines capacity as 'the ability of individuals, organisations and societies to make effective and efficient use of resources, in order to achieve their own goals on a sustainable basis' (OECD, 2007). The Dakar Framework for Action (2000) and the Paris Declaration on Aid Effectiveness (2005) also emphasise the significance of capacity development at all levels of government. In the case of Iraq, it is needed at national, regional and local government level and in civil society.

In a country such as Iraq, capacity development activities have, over recent decades, accounted for a large portion of donor aid to the country. In spite of this, the institutional and human resource capacities of its non-oil revenue system are still extremely weak and continue to deteriorate. Staff lack the basic technical know-how required to effectively apply relevant tax laws. In the tax revenue system, capacities for taxpayer registration, the issuance of tax identification numbers, tax returns filing, tax auditing, data exchange and revenue reporting and monitoring are either non-existent or very weak. This raises the question of whether we are providing the right capacity or just capacity. The Paris Declaration on Aid Effectiveness calls for a change in the approach to capacity development in post-conflict countries, with a shift away from mere technical assistance. It is now recognised that capacity development should not just focus on individuals but should also consider the capacity of the institutions in which individuals work. Again, the OECD DAC acknowledges the new approach to capacity development in its publication.

'Capacity development involves much more than enhancing the knowledge and skills of individuals. It depends crucially on the quality of the organisations *in which they work. In turn, the operations of particular organisations are influenced by the* enabling environment *– the structures of power and influence and the institutions – in which they are embedded.' (OECD, 2007 p. 7).*

4.3. Risk management capacity

Tax compliance risk management is a critical element of strategies adopted by modern tax authorities across the world. It can be defined as measures, techniques and tools implemented by the tax administration to improve the efficiency of the revenue generation system as efforts are made to manage compliance risks. The primary purpose of any tax authority is to collect taxes in accordance with applicable tax laws and regulations in a transparent and accountable manner in order to create confidence in the tax system and enhance the sustainability of revenue administration. Paying taxes is not something people enjoy doing, and some taxpayers, due to deliberate actions, ignorance about tax requirements or carelessness or because of weaknesses in the tax administration system, fail to meet their tax obligations. Tax authorities therefore need to develop measures and mechanisms to curtail the illicit transfer of profits across borders and combat tax fraud and non-compliance.

The growing complexity of tax administration as the world has gradually moved toward global standards and sophisticated business structures, coupled with complex financial reporting standards, has increased the risks the tax authorities are facing in mobilising all forms of revenue. Tax authorities are under increasing pressure from the government to generate more revenue to meet budgets and development priorities. In order to address all these challenges, tax authorities have to develop certain measures and standard operating procedures to mitigate the risks associated with tax administration for more efficient and accountable revenue mobilisation.

Objective of risk management

No tax administration operates in a risk-free environment, and tax authorities must take deliberate action to manage risk and enhance business processes in tax administration, with a view to achieving the best outcomes and keeping non-compliance to a minimum. The objective of risk management is to provide and preserve value for the administration's stakeholders. Management decisions about the day-to-day operation of the tax administration are key to achieving this, which means that management must consider both the internal and external environments to determine the amount of financial and human resources that need to be deployed in order to achieve organisational goals. Therefore, risk management enables the tax authorities to operate in a more efficient and effective manner in environments filled with risks.

In the late 1990s, the OECD and the European Union (EU) produced guidelines on compliance risk management for efficient tax administration by the managers of tax institutions. These guidelines were comprehensively explained and detailed in the series of reports published by the OECD (e.g. Compliance Risk Management: Managing and Improving Tax Compliance, 2004, 73 pp.; Compliance Risk Management: Use of Random Audit Programs, 2004, 51 pp.) and the EU (Risk Management Guide for Tax Administrations, 2006, 98 pp.; Compliance Risk Management Guide for Tax Administrations, 2010, 110 pp.). There are five major steps in the compliance risk management process, namely risk identification, risk analysis, risk prioritisation, risk treatment and evaluation.

Risk identification

The first stage in the risk management process is the identification of risks. In this stage, all the possible risks that may impact on the objectives of the organisation are documented. Risk identification is crucial because if risks are not identified at this stage, they are unlikely to be detected and proactive measures will not be put in place to mitigate them. Furthermore, the timing of risk identification is critical for decision-making because the sooner a risk is identified, the sooner the impact of the risk can be controlled. The point at which the risk is identified is very important for the formulation of mitigating measures. If risks are identified in a timely manner, urgent mitigation measures can be put in place to reduce or eliminate their impact on the organisation's objectives. Mitigation measures can curtail the collection risk of non-payment, limit its impact and reduce the gap between contravention of the law and punishment.

It is therefore imperative for tax officers to be trained on how to conduct risk analysis to identify high risk taxpayers and focus more attention on them in tax investigations in order to reduce their negative impact on revenue generation and collection. Some key risk elements the tax authority needs to consider when developing comprehensive risk profiles for taxpayers are outlined below.

a. Registration risk

This risk has the potential to reduce or increase tax revenue as there are individuals and businesses that are not eligible for tax registration but who register or remain registered, which means that incorrect information is kept in the registration system. There are also individuals and businesses that are required to register but fail or refuse to do so. Registration risk concerns four categories of taxpayers or potential taxpayers:

i. Those that are on the register when they are not required to be in the first place and those who remain in the registration system when they should no longer be registered, sometimes for fraudulent purposes

ii. Those operating in the informal economy and those who use avoidance mechanisms to remain unregistered

iii. Those recorded in the tax registration system due to incorrect information and data quality issues, which can potentially lead to loss of revenue

iv. Those who are no longer in business, are bankrupt or deceased or have liquidated or sold their business

b. Filing risk

This risk is widespread in tax administration, especially in emerging and developing economies. If taxpayers file their returns late or not at all, it will impact on revenue collection in a given period and prevent the tax authority from achieving the expected targets. The proactive way to handle this risk is to focus on taxpayers who are most likely not to file their tax returns as they are required to do by law.

c. Payment risk

This risk is critical because non-payment of tax due will affect achievement of revenue targets. Payment risk is related to filing risk but should be treated separately because certain payments are based on returns and there are always tax payments that should be made on a monthly and quarterly basis before the end of the year of assessment.

d. Declaration risk

This risk can affect the total amount of tax collected at the end of the year due to deliberate attempts by taxpayers to conceal income or to incorrect information inadvertently provided by taxpayers about their income on tax returns. Over the years, most tax authorities have focused on this risk area to determine how taxpayers should be selected for auditing. As a result of continued evaluation of tax performance, most tax administrations have developed different measures for examining declarations and returns submitted by taxpayers and take the necessary steps to classify taxpayers under the relevant risk level for action.

Therefore, risk management techniques are critical to effective implementation of a self-assessment tax regime; under such a system, it will be extremely difficult for the tax authority to carry out audits and tax investigations for all registered taxpayers within the stipulated timeframe, as prescribed by tax laws and regulations.

4.4. Digitalisation of the tax administration system

The use of information technology has always been integral to the effective functioning of modern tax administrations. While, historically, its use has been limited to automating the functions of taxpayer registration, returns filing and processing, and managing taxpayer accounts, it has now been expanded to almost all tax administration functions. Tax administration information management systems have also evolved from the former 'core tax system', which consisted primarily of the taxpayer registry, the returns database and taxpayer ledgers, to a modern information system which provides a holistic view of the taxpayer across all aspects of tax administration.

The legacy systems that are currently being used in the GCT have limited functionalities and have not evolved to meet the changing needs of tax administrations. In addition, there are various reforms and initiatives under way, aimed at promoting voluntary compliance, enhancing the effectiveness of taxpayer services and improving the business environment. These initiatives require the strengthening of information technology systems and the development of the corresponding functionalities in order to effectively leverage the benefits.

The introduction of the Integrated Tax Administration System (ITAS) will allow individuals and businesses to use mainly electronic channels to comply with tax laws. There will be easily accessible e-service channels for transacting business with the tax administration, including registering as a taxpayer, filing returns and making payments remotely. Additionally, the ITAS will support the process of receiving and processing data and the creation of correspondence, notices, forms and reports for the tax administration with a built-in configuration. In view of this, the implementation of the self-assessment tax regime must be supported by modernisation measures and the deployment of a robust electronic system that will address the current requirements of the tax authority and also address the most critical issues and limitations of the existing systems to remove (or reduce) deficiencies. The proposed digital transformation should aim to improve the operational efficiency of tax administration functions and increase revenue collection by strengthening compliance monitoring and improving taxpayer services.

Electronic document system

The tax authority's ability to introduce an electronic document system is key to successful implementation of the self-assessment tax regime**.** Such a system, which should be an integral part of the digital transformation of the tax system, will support the self-assessment tax regime in the following areas:

a. Electronic filing of documents

b. Electronic document service

c. Electronic payments

d. Issuance of tax clearance certificates by electronic means

Rules are required on the following:

a. Types of documents that may be transmitted through the electronic document system, permitted formats and manner of transmission

b. Secrecy requirements applicable to those using the electronic document system whether on their own behalf or on the behalf of others

c. access by taxpayers to electronic tax clearance certificates

The electronic document system must also be included in the legislative reform with supporting implementing regulations that clearly spell out when and how electronic filing should be carried out.

5. Potential challenges to the introduction of a self-assessment tax regime

5.1. Dual legal Regime

Effective tax administration is a crucial aspect of any government's fiscal policy. It ensures that the tax system is fair, transparent, and consistent with the law. Parliament has responsibility to formulate good tax laws to enhance revenue administration. Building awareness about the importance of a unified tax regime for the equitable application of existing tax law is key to promoting tax compliance. Iraq faces singular tax administration challenges across the country. The Kurdistan region has tax laws, instructions and regulations on generating revenue in the region which differ from those applicable in Baghdad. The combined effect of these circumstances will make it difficult to implement the self-assessment tax regime across the country, with its dual legal regime for revenue administration.

5.2. Insecurity

The continued insecurity in some part of the country is affecting the government's ability to effectively reform the non-oil revenue ecotax system. The need for money to achieve sustainable security and fight wars has been identified as one of the important driving forces behind the evolution of public finances. The persistent conflict and civil unrest have undermined the government's ability to effectively carry out any fiscal reform, which has negatively affected the structure of the fiscal system and budgetary allocation for service delivery. O'Brien (1988) studies the role of war finance in the size and composition of revenue structure in Britain over a century and a half; Dincecco et al. (2011) study the relationships between warfare, political institutions and revenue structure in pre-unification Italy; Scheve and Stasavage (2010) generally connect wartime with periods of progressive taxation of personal incomes and with high taxation of inherited wealth (Scheve and Stasavage 2012); and Slantchev (2012), attempts to explain in the same theoretical model both the occurrence of war and its deficit financing.

The issues of tax reform are normally politically contentious in most postconflict environment because of the negative perceptions and mistrust between the political actors. The failures of parliaments in postconflict environment to harmonise tax legislation has further exacerbated the perception that (i) there is going to be unfair treatment of some groups if the new tax system is deployed, and other groups of individuals will benefit, (ii) if central government controls certain economic sectors, uniform taxation could have a greater impact on some groups of people than on others, (iii) politically motivated excessive tax exemptions and incentives can be used to the advantages of businesses closed to the government in power. (v) public sector employees whose incomes are currently not taxable may be required to pay tax on what they earn.

5.3. Overdependence on oil revenue

The Iraqi Government's main revenue source is oil, and little attention is paid to investment in developing the non-oil sector. Iraq is one of the most oil-dependent countries in the world. Over recent years, revenues from the oil sector have accounted for about 99% of exports,

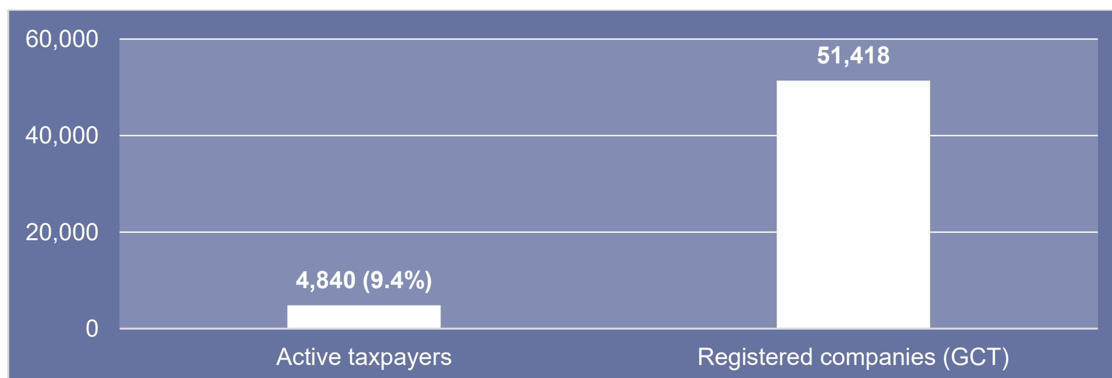
85% of the government's budget and 42% of gross domestic product (GDP). This excessive dependence on oil revenue exposes the country to macroeconomic volatility, while budget rigidities restrict fiscal space and any opportunity for countercyclical policy. While Iraq's economic conditions are gradually improving as international oil markets recover, this recovery is fraught with major risks posed by structural bottlenecks. The country's non-oil revenue system is still very weak and beset by problems including largely untrained staff, excessive tax avoidance and low tax compliance.

5.4. Lack of information exchange

Sharing information within the tax jurisdiction and across borders is key to improving non-oil revenue mobilisation in a transparent and accountable manner. Investing in information technology with a view to transforming revenue administration to meet the current challenges posed by globalisation should be a high priority for developing countries, especially post-conflict and fragile states. There is a complete lack of information sharing between the GCT and the Companies Registration Authority of the Ministry of Trade (CRA-MoT). This is due to a lack of integrated information management systems in the institutions concerned. This situation exacerbates the problem of excessive tax evasion which is a component of illicit financial flows.

In July 2014, the OECD endorsed a proposal for a new single global standard for the automatic exchange of information to fight tax evasion and illicit financial flows. The Government of Iraq could also take advantage of OECD tools to enhance non-oil revenue generation in a fair and efficient manner by deploying a suitable integrated tax administration system.

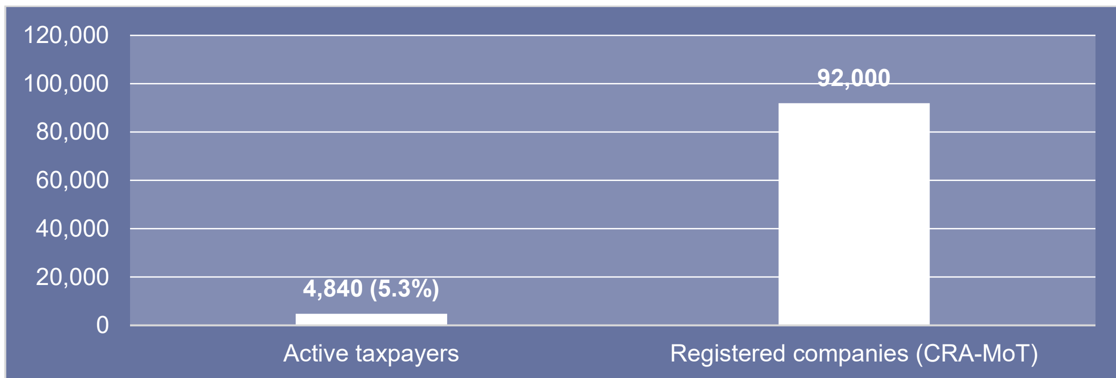
Figure 1: Share of active taxpayers (of companies registered with GCT)



Source: GCT, September 2023

The above diagram shows the extreme discrepancy between the number of registered companies and the number of active taxpayers. According to the GCT database, as at 31 December 2022, out of the 51,418 registered companies, only 4,840 were active taxpayers, representing 9.4% of the total. These figures are very alarming; the fact that 90.6% of registered companies are not paying taxes to the government is an indication of weaknesses in the revenue generation system and reveals a complete lack of effectiveness in tax compliance and enforcement. Therefore, the implementation of a self-assessment tax regime in itself, without any structural reform of the revenue collection system, will not raise the currently low level of tax revenue generation.

Figure 2: Share of active taxpayers (of companies registered with CRA-MoT)

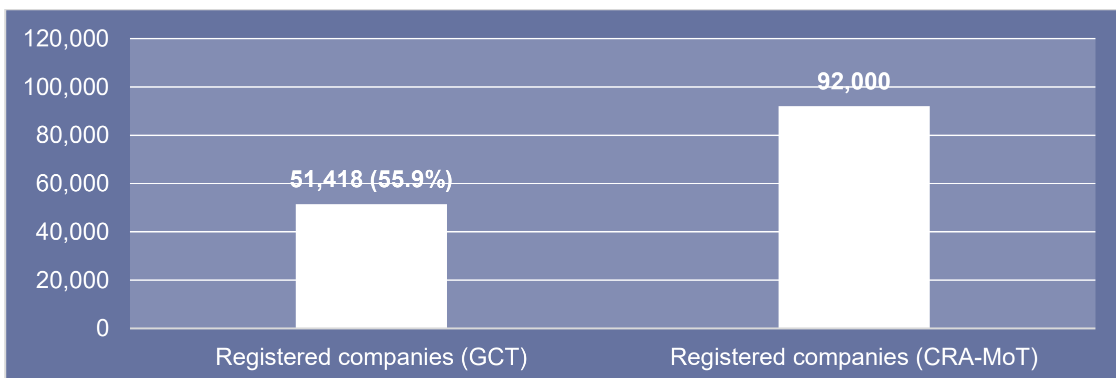


Source: Registered companies: CRA-MoT, Active Taxpayers: GCT, September 2023

The chart above highlights the lack of information sharing between the CRA-MoT and the GCT. Figures provided by the institutions indicated that, as at September 2023, out of the 92,000 companies registered with the CRA-MoT, only 4,840 of them are active taxpayers, according to the GCT database, which is just 5.3% of the total number of registered companies.

As can be seen in the chart below, for the same period, the GCT database contained 51,481 companies, compared to 92,000 registered by the CRA-MoT (55.9%). The complete disconnection and lack of information sharing between the two government institutions not only erodes the government's revenue base, but also provides potential loopholes for tax evasion.

Figure 3: Companies registered with the GCT and the CRA-MoT



Source: GCT and CRA-MoT, September 2023

5.5. Donor coordination in the area of technical assistance

Iraq is one the post-conflict countries that is benefiting from huge donor support in the area of public financial management. While the international community and the country have engaged in very extensive discussions on donor coordination in terms of support for fiscal reforms in public financial management, donor coordination on the direct delivery of technical assistance for building sustainable tax reforms and tax policy has been neglected. The need to build an efficient tax system to enhance domestic tax revenue is very high on the government's agenda, but not enough attention is given to the issue of how to deliver

technical assistance in the most efficient and coordinated manner. This is because some of the development partners supporting fiscal reform are not physically present in Iraq as a result of the continued insecurity, political disagreements between groups, frequent social unrest and politically motivated demonstrations. This has led to there being many development partners working in the same area, which is counter-productive in a fragile environment such as Iraq.

In the early stages of the post-conflict period in Iraq, the country received an influx of external assistance to support post-conflict reconstruction, but such donor aid is temporary and has now diminished significantly. Diversification of the country's resource base to reduce dependence on oil revenue and increase non-oil revenue is a bid to avoid the syndrome of aid 'crowding out' domestic fiscal capacities.

Donor efforts to support democratic elections will not guarantee the legitimacy of the government; this will depend on its ability to provide services for the population, especially vulnerable women and children who are the groups most affected by the prolonged conflict. Democratic elections are expected to give citizens a voice, and how the government responds to the demands of the people will depend on its ability to mobilise domestic revenue in a transparent and accountable manner and allocate resources for service delivery. It should be emphasised that in spite of the surge in oil revenue, non-oil revenue must be regarded as a crucial sustainable source of funds for stabilising the fiscal space.

6. Summary

While Iraq's economic conditions are gradually improving as international oil markets recover, this recovery is fraught with major risks posed by structural bottlenecks. The country's non-oil revenue system is still very weak and beset by problems including largely untrained staff, excessive tax avoidance and low tax compliance. The situation is exacerbated by fragile political conditions and rampant corruption that continue to trigger unrest across the country.

The government needs to shift its focus on tax reform; building a transparent tax system with adequate tax infrastructure and well-trained tax personnel would boost non-oil tax receipts and enable the government to support development financing, especially in the areas of education, health and economic infrastructure. At present, the country's non-oil revenue is minimal compared to recurrent expenditures. The usual taxes from non-oil sources (corporate tax, capital gains tax, value added tax (VAT), real estate tax, land tax, excise tax on goods and customs duties) are either inefficiently collected or non-operational.

The priority should be to focus on determining how to develop a simple, feasible and practical non-oil tax revenue generation system which would harmonise national and subnational tax systems. The approach adopted in this context should be flexible and make taxes easy to collect. Deliberate policy measures should be taken to build the capacities of largely untrained tax officers at both the national and governorate level to ensure that they understand how to apply tax laws and are able to navigate the complexities of modern tax administration. It is, however, difficult to establish an effective revenue system when the groups spending the largest amounts of money do not pay taxes as this undermines its credibility.

Finally, the introduction of the self-assessment tax regime must be gradual and supported by the development of effective policy and the adoption of an appropriate legislative and regulatory framework to govern its implementation.

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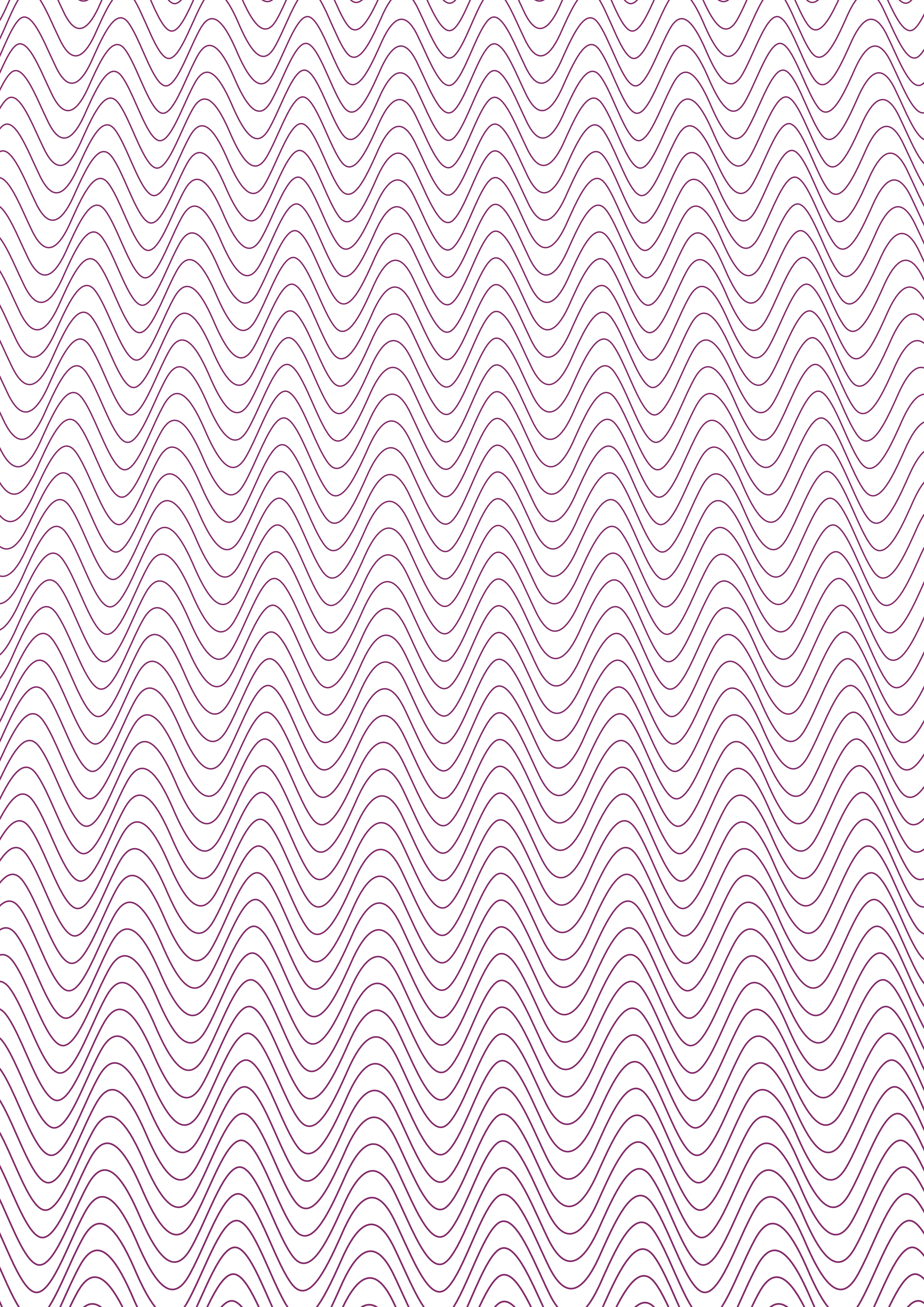

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