CONFIDENTIAL

0411

COMMITTEE ON ADMINISTRATIVE POLICES

Meeting 92/6

3:00 p.m., December 8, 1992

R. D. Erb, Acting Chairman

Executive Directors	Alternate Executive Directors
	B. R. Fuleihan, Temporary
	J. M. Abbott, Temporary
I. Fridriksson	
	N. Tabata
	G. Y. Glazkov
	G. Torres
	O. Kabbaj
	J. M. Jones, Temporary
	J. Dorrington
	F. A. Sorokos

A. Leipold, Secretary
S. W. Tenney, Assistant

Also Present

B. Esdar
J. Prader

Administration Department: G. F. Rea, Director; D. A. Anderson, D. S. Cutler, R. V. Kennedy, C. Nelson, C. M. Ragland. Legal Department: J. S. Powers. Secretary's Department: B. R. Hughes. Advisors to Executive Directors: P. Bonzom, N. Mancebo, A. Thornqvist. Assistants to Executive Directors: G. A. Heinen, K. J. Langdon, G. Lindsay-Nanton, S. Ogliati, R. K. Powell.

1. TAX ALLOWANCE SYSTEM - REVIEW

The members of the Committee continued from CAP/92/5 (11/10/92) their consideration of a staff paper on a review of the tax allowance system (EB/CAP/92/11, 10/15/92; and Sup. 1, 12/4/92).

The staff representative from the Administration Department stated, with respect to the concerns that had been raised at the previous discussion about whether an extension of the so-called safeguard to all U.S. nationals

could establish a precedent with respect to other benefits, that the provision of the original By-Laws gave employees whose incomes were subject to income taxation a right to reimbursement equivalent to the actual taxes due on the incomes derived from Fund employment. Under the current By-Laws, U.S. nationals employed prior to January 1, 1980 continued to have that right. However, the U.S. nationals who had begun their appointments after January 1980, when Section 14(b) of the By-Laws was amended, had only a right to receive a reimbursement that in the opinion of the Executive Board was reasonably related to the actual tax paid.

As the proposed extension of the safeguard mechanism was not intended to represent an extension of the rights conveyed by the original By-Laws to the group of employees who had joined the Fund since 1980, any decision to modify the calculation of tax allowances should clearly state that, in agreeing to extend the safeguard mechanism, the Board would retain the authority to review and revise the tax allowance system for all post-1979 staff.

Mr. Abbott commented that the supplement to EB/CAP/92/11 had clarified several of the issues that had been raised at the previous meeting, particularly with respect to the main objective of the Kafka Committee, namely, to ensure internal equity among U.S. staff and external comparability between U.S. nationals and expatriate staff. In particular, it helped to address the concerns that had been raised about disturbing the apparent symmetry of the current system of staff benefits. As the last column of Table 1(c) clearly showed, under the current system of benefits, U.S. nationals were treated substantially different from expatriates, whose incomes from the Fund were tax exempt. Indeed, tax allowances would need to be increased by about 20 percent to place U.S. nationals on a level of compensation that would be equivalent to tax-exempt status. In the light of that consideration, it should be borne in mind that the current system was not centered around a harmonious distribution of benefits across all classes of Fund employees. On the contrary, the whole system was skewed by the undercompensation of U.S. nationals.

It was also important to note that the staff paper for the current discussion did not attempt to redress all of the problems related to the current tax allowance system, Mr. Abbott considered. It merely attempted to describe how tax allowances under the current system were derived and proposed small modifications to correct the problem that existed for employees at the lower end of the distribution of compensation.

Mr. Dorrington remarked that the staff's comments on the possible implications of extending the safeguard mechanism to staff who had joined the Fund since January 1980 was helpful. Nevertheless, the position of his chair had not changed since the previous discussion. Indeed, he was even more convinced that it would be impossible to achieve complete equivalence between compensation to U.S. nationals and expatriates on a narrow tax basis, which did not take into account differences in the circumstances of the two groups of staff.

It was important to note that expatriate staff faced two unique disadvantages, Mr. Dorrington considered. First, their working spouses were treated by the U.S. tax authorities as if they were single, and thus taxed at a higher rate. Second, the expatriate staff who came to the Fund on short-term appointments could not be expected to sell property in their home countries while they had to pay rent in the Washington area. In addition, the rental income they received in their home countries was not exempt from taxation.

As the staff noted, any notional apportionment of deductions and tax inevitably would be arbitrary, Mr. Dorrington stated. While both of the alternative methods of determining tax allowances currently under consideration would appear to reduce or eliminate both underpayments and overpayments, the apparent symmetry was achieved only as a result of redefining the meaning of overpayments or underpayments. Thus, any decision to modify the current system of tax allowances would also be arbitrary.

In the light of those considerations, he was prepared to support the current system of tax allowances, as it seemed to represent a reasonable compromise. If for any reason, a move to an alternative form of tax allowance became necessary, it would be best to extend the mandatory safeguard, which entailed some increase in administrative costs, but even larger savings in the actual allowances paid to staff.

If large numbers of U.S. staff felt significantly disadvantaged by the current tax allowance system, that may reflect the way in which the terms and conditions of their employment were explained when they began their appointments, rather than any inherent bias in the system, Mr. Dorrington considered.

Mr. Fridriksson recalled that he had not supported the staff proposal at the previous discussion. Nevertheless, after carefully considering the information contained in the supplement to EB/CAP/92/11 and consulting with representatives of the Staff Association Committee and staff from the Administration Department, he was reluctantly willing to accept the staff proposal.

As he had indicated on previous occasions, the optimal solution would be for the United States to recognize the tax-exempt status of Fund salaries. Barring that, a system like the one used by the United Nations would seem to have advantages over the present one. However, neither of the alternatives presented in EB/CAP/92/11 was better than the staff proposal.

He agreed with the staff that a clarification of the existing By-Laws should be incorporated into any decision to modify the current system of tax allowances in order to avoid setting a precedent that could be used to extend grandfathering clauses in other areas, Mr. Fridriksson concluded.

Mr. Kabbaj stated that he could support the staff proposal with a clarification of the existing By-Laws.

Mr. Fuleihan commented that his chair had approached the review of the current tax allowance system with an open mind. However, the supplement to EB/CAP/92/11 had not presented a convincing case for changing the current system of tax allowances. As a result, it had served to solidify the views expressed by his chair at the previous discussion. The most important claim made by the staff in EB/CAP/92/11 was that lower-paid staff suffered most from underpayments under the current tax allowance system. However, Annex I of the supplement to EB/CAP/92/11 showed that overpayments would be reduced by 13-24 percent under the mandatory safeguard and that the largest reductions would occur at the lower salary levels. While undercompensation could occur at any salary level, emphasis should remain on the lower-paid staff. Based on that consideration, he did not support the staff proposal.

Mr. Sorokos said that the main objective was to find a tax allowance system that would provide adequate compensation to employees within the framework of the Fund's ability to manage such a system without incurring undue administrative costs. The staff proposal would go farthest toward meeting that objective without creating divisiveness within the staff. While both of the alternative systems presented in the staff paper--the mandatory safeguard and the pro-rated tax system--would effect greater reductions in the amount of overpayments and underpayments, the administrative costs associated with those alternatives was forbidding. Therefore, he could support the staff proposal.

Mr. Jones stated that he could support the staff proposal.

The Acting Chairman noted that most Committee members had indicated that they could support in principle the draft decision appearing on page 26 of EB/CAP/92/11. He wondered whether the text of the decision should be revised to reflect the provision of the By-Laws with respect to staff hired after January 1, 1980.

The staff representative from the Administration Department suggested that the first part of the draft decision could be amended to read:

> The procedures used in calculating tax allowances under the Safeguard shall be extended to all staff receiving tax allowances, beginning with the allowances paid with respect to 1992 income, on the understanding that the Executive Board shall retain the authority to review and revise or replace the Average Deduction System of calculating tax allowances, provided that as to staff hired before January 1, 1980, the tax allowance shall continue to be determined in accordance with the principle set forth in the Fund's By-Laws as worded at the time of their appointment.

Ms. Powers said that she could support the text recommended by the staff either in the text of the proposed decision or in the Committee's report to the Executive Board.

The Acting Chairman noted that the preference of the Committee was to incorporate the language recommended by the staff in the decision itself.

Mr. Esdar commented that, as he agreed with the concerns expressed by Mr. Dorrington, he wondered whether it would be appropriate for the Committee to recommend the staff proposal as an interim solution on the understanding that the Committee should review the system of tax allowances again in two years with a view to finding a more balanced approach that would focus on overpayments as well as underpayments.

The staff representative from the Administration Department noted that the review of the tax allowance system currently under consideration had been conducted over the past two years and had entailed a great deal of staff resources on the part of both the Fund and the World Bank. While the Committee could agree to undertake a further review of the tax allowance system in the future, such a review would likely need to be based on another survey of the staff.

Mr. Bonzom stated that, as he agreed with the concerns that had been expressed by previous speakers, in particular Mr. Dorrington and Mr. Fuleihan, he supported Mr. Esdar's proposal for a future review of the tax allowance system.

Mr. Prader commented that he supported Mr. Esdar's suggestion to review the tax allowance system in two years. The Executive Director for his constituency in the World Bank had proposed the adoption of the pro-rated tax system, because it was less costly to implement than the alternative systems proposed. Nevertheless, as the pro-rated tax system was too strong in addressing the problem of overpayments and too weak in addressing the problem of underpayments, he could accept the staff proposal.

Several issues related to the situation of expatriate staff had arisen during the previous discussion, Mr. Prader recalled. He continued to hope that the Fund would undertake a comprehensive review of those issues in the near future. As his chair had demonstrated on many previous occasions, it was willing to support the Fund staff on all administrative and personnel issues. However, it was crucial to ensure that such issues were examined with a view to ensuring equality among all groups of staff.

Mr. Fuleihan remarked, with respect to Mr. Esdar's proposal, that any further review of the tax allowance system should be undertaken in a more general context. The staff proposal currently under consideration would not significantly affect the balance in the treatment of U.S. nationals and expatriate staff; it focused only on reducing the extent of overpayments and underpayments within the current system of tax allowances. Issues related to staff benefits for expatriates should be taken up separately, as they were not related to the tax allowance system for U.S. nationals.

Mr. Tabata noted that it was clear from the previous discussion that there was little hope the U.S. authorities would agree to make the income of

U.S. nationals employed by the Fund tax exempt. Nevertheless, he could support the staff proposal only on the understanding that the Fund staff and management would continue negotiations with the U.S. authorities.

Mr. Dorrington commented that it was important to ensure that the amount of resources devoted to the review of the tax allowance system would not exceed the cost of the system. In that connection, it should be noted that a wide-ranging review of all staff benefits could be extremely costly. As it was not likely that a future review of the tax allowance system would achieve different conclusions, he could not support Mr. Esdar's proposal.

Ms. Lindsay-Nanton and Mr. Torres stated that they agreed with Mr. Dorrington.

The staff representative from the Administration Department noted that the Executive Board was expected to review staff benefits in the coming year. While that review was essentially to simplify staff benefits and to compare the overall package of staff benefits offered by the Fund with comparator markets, the issues related to expatriate benefits could be considered at that time.

After some further brief discussion, Committee members agreed to submit the proposed decision, as amended, to the Executive Board for approval on a lapse of time basis.

The meeting was adjourned at 3:45 p.m.

APPROVED: May 28, 1993