

CHALLENGES OF TAX ADMINISTRATION IN DEVELOPING COUNTRIES: INSIGHTS FROM THE 5TH ANNUAL TAX ADMINISTRATION RESEARCH CENTRE WORKSHOP, 2017.

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Abstract

Tax administration is a challenging task, but developing countries' tax administrations face greater challenges than their counterparts in advanced countries. As a result of these challenges, tax revenue generation in developing countries is unusually low. The issue has been at the forefront of academic and international development administration discourse since Nicholas Kaldor raised the red flag in 1963. Kaldor stated that developing countries raise about 8 to 15 percent of their Gross Domestic Product (GDP) as tax revenue, while the ratio for advanced countries is 25 to 30 percent. More than sixty years after this issue came to the fore, and after more than thirty years of tax administration reforms in developing countries, it remains largely unresolved. The 5th Annual Tax Administration Research Centre (TARC) Workshop provided delegates with an opportunity to further discuss the issue. This paper presents insights from that workshop. Our analysis of insights from the workshop provides a fresh perspective on the challenges of tax administration in developing countries. Most importantly, we argue that the challenges of tax administration in developing countries are complex and involve deep-rooted, systemic problems that cannot be tackled by tax administration alone. Some of the problems are linked to acts of omission and commission by political leadership. This may account for the continued low levels of tax collection in developing countries despite the fact that series of tax administration reforms have taken place.

1. INTRODUCTION

Tax revenue generation presents a daunting challenge to governments of developing countries. This problem has been a long-standing one, as it was brought to the forefront of academic discourse as far back as 1963, by Nicholas Kaldor. Kaldor (1963) stated that developing countries generate between 8 to 15 percent of their GDP as tax revenue, in sharp contrast to the advanced countries' tax to GDP ratios of 25 to 30 percent. Kaldor maintained that the developmental aspiration of developing countries will not be realized unless they generate 15 percent and above of their GDP as tax revenue. The tax to GDP ratio is considered a simple metric for assessing adequacy of tax revenue generation (Mascagni, Moore & McCluskey, 2014). It has been adopted by the International Monetary Fund (IMF) as a determinant of tax revenue adequacy, in line with Kaldor (1963). The IMF considers a 15 percent tax to GDP ratio to be the threshold of tax revenue adequacy and considers countries with ratios below this threshold to be high risk (IMF, 2011). For its own part, the United Nations (UN) set the minimum tax to GDP threshold for developing countries to attain the 2015 Millennium Development Goals (MDGs) at 20 percent.

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Realizing the strategic role of tax revenue adequacy in the developmental aspirations of developing countries, the UN, IMF, Organisation for Economic Co-operation and Development (OECD), Department for International Development (DFID), and other international organizations have been at the forefront of driving tax policy and administration reforms in these countries. Initially, the emphasis was on tax structure and policy. Developing countries were dependent on taxes on imports and exports (trade taxes), and the IMF introduced a major policy instrument, Value Added Tax (VAT) (International Monetary Fund, 2011). Despite policy reforms, the challenges of tax revenue generation persisted and this led to the realization that much more than policy reforms would be needed to improve tax revenue generation in developing countries. As noted by Casanegra de Jantscher and Bird (1992), policy reforms need to be accompanied by tax administration reforms. Furthermore, Richard Bird, a staunch advocate of tax administration reforms, stated that “policy change without administrative change is nothing” (1991, p. 39). Bird’s position was in line with the thinking of fiscal experts at the IMF. For instance, Milka Casanegra de Jantscher, who was a deputy director of the IMF’s Fiscal Affairs Department in the 1980s and 1990s, stated: “tax administration is tax policy” (1990, p.179).

As a result of the advocacy of fiscal experts and the IMF, tax administration reforms were initiated in many developing countries. The highlights of these reforms included the construction of robust taxpayer databases, in which all taxpayers were identified with a unique taxpayer identification number (Thirsk, 1997). Other elements of the reforms involved simplifying tax laws, harmonizing tax rates, granting autonomy to tax revenue authorities, computerization, and implementing staff training (Di John, 2006; Silvani & Baer, 1997). As expected, the implementation of tax administration reforms in developing countries resulted in considerable successes. Silvani and Radano (1992), who reviewed tax administration reforms in Bolivia and Uruguay, stated that tax revenue appreciated phenomenally, from 1 percent of GDP in 1985 to 7.4 percent in 1990. Similarly, Bahl and Martinez-Vazques (1992) credited tax administration reforms with improving tax revenue generation in Jamaica and Guatemala, although the improvements were not as drastic as those seen in Bolivia and Uruguay. McLure and Pardo (1992) credited tax administration reforms for increased income tax receipts in Colombia, while Due and Greany (1992) stated that tax administration reforms led to enhanced VAT generation in Trinidad and Tobago.

The success of tax administration reforms was acknowledged in Asian countries, as well as in the above-mentioned Latin American countries. For example, Gillis (1989) stated that Indonesia was one of the typical developing countries relying on natural resource exports, but the reform of its tax administration increased its tax to GDP ratio to about 50 percent, a phenomenal improvement. Similarly, Sewel and Thirsk (1997), and Bulutoglu and Thirsk (1997) credited tax administration reforms for the improvement of tax revenue in Morocco and Turkey respectively. More recently, the International Tax Compact (ITC) and OECD reviewed tax administration reforms in seven countries across four continents: Bangladesh, Vietnam, Afghanistan, Bosnia-Herzegovina, Georgia, Paraguay, and Rwanda (ITC & OECD, 2015). The study credited tax administration reforms for an improvement in tax revenue generation in these countries. Surprisingly, fragile and post-conflict states, such as Afghanistan and Rwanda, also saw improvements in their tax revenue as a result of tax reforms.

Despite these successes, however, tax revenue generation in developing countries remains far from adequate. Although there have been more than thirty years of tax administration reforms in developing countries, these nations' tax to GDP ratios remain far below the IMF and UN threshold, and this has continued to attract scholarly attention (Burgess & Stern, 1993; Moore,

2013; Mascagni, Moore, & McCluskey, 2014; Besley & Persson, 2014). Recently, the OECD (2014) classified 51 developing countries as "fragile" – i.e. states prone to failure. The OECD stated that these countries' fragility arises from their inability to generate adequate tax revenue in the face of falling prices of natural commodities exports and dwindling receipts from aids. This shows that tax administrations in developing countries are still unable to generate adequate tax revenues, despite having undergone reforms. The IMF and other multilateral organizations have continued to work on the challenges of tax revenue generation in these countries. Recently, Richard Bird, arguably one of the most prolific experts on tax administrations in developing countries, has acknowledged the persistence of the problem of tax revenue generation despite years of reforms (Bird, 2015).

The underlying question in this discussion is: what are the challenges facing tax administrations in developing countries, which have resulted in huge gaps in revenue generation? While this question has been explored by scholars and practitioners alike, the 5th Annual Tax Administration Research Center (TARC) Workshop provided researchers with a unique opportunity to further explore this question. This workshop was unique in the sense that it brought together scholars and practitioners working in developing countries, thus providing a rich blend of theory and practice. Scholars from universities in Malaysia, South Africa and Nigeria were present, as well as practitioners from the revenue authorities of Nigeria, Kenya and Indonesia. Moreover, there was a presentation by a member of staff of the Fiscal Affairs Department of the IMF, who is a Tax Administration Diagnostic Assessment Tool (TADAT) expert, with wide-ranging field experience in developing countries. TADAT is an assessment tool developed by the IMF to evaluate and improve tax administration especially in developing countries.

As to be expected from such a diverse group, discussions at the workshop were enriched by papers from multidisciplinary backgrounds and practitioners' field experiences. This discussion paper provides an analytical synthesis of the various papers presented at the workshop, thus providing useful insights and takeaways from the workshop. While the workshop presenters discussed a wide range of factors that constitute challenges to tax revenue generation in developing countries, our analysis shows that these factors fall into two broad categories: factors within the control of tax administration and factors outside the control of tax administration. The discussion proceeds as follows: section two discusses the challenges facing tax administrations as described by presenters at the workshop. Section three discusses findings from the workshop papers relating to analytical insights about factors within the control of tax administrations and those outside of their control. It also discusses how the contribution of the workshop advances knowledge of the challenges of tax administrations in developing countries. Section four concludes the discussion.

2. INSIGHTS FROM THE 5TH ANNUAL TARC WORKSHOP (2017)

As stated in the introduction, the 5th Annual TARC Workshop brought together a mix of scholars from multidisciplinary backgrounds, and practitioners from national and international agencies. Scholars from universities across five continents participated. Interestingly, practitioners were also from diverse jurisdictions across the continents and included an IMF expert on tax administration evaluation who has field experience across many developing countries. In response to the workshop's theme, which placed emphasis on tax administrations in developing countries, there were many presentations made by scholars and practitioners from these countries. The presentations were enriched by their multidisciplinary flavor, and the

mix of theoretical and practitioners' perspectives. This section of the discussion presents the preliminary findings from papers presented at the workshop. Additionally, in presenting the findings, we analyze them in relation to previous studies. Our findings are categorized into five themes: inadequate and ineffective databases; complexity of the tax system; audit effectiveness; trust in authorities, perceived corruption and the supply of public goods; and strained power, and the fiscal relationship between central and subnational governments.

2.1. Inadequate and ineffective databases

Papers at the workshop found the existence of inadequate and ineffective taxpayer databases to be a key challenge for tax administrations in developing countries. The paper presented by Adegboye (2017), who carried out fieldwork in Southern Nigeria, found that, in the absence of a reliable database to support tax administration, tax agencies resort to presumptive taxes and contracting out tax collection to consultants. Similar field work in northern Nigeria, conducted by Ndajiwo (2017), found that tax administrators were working with a poor database, which hampered their revenue generation efforts. In response to the presentations, practitioners with extensive field experience, especially in Africa, agreed that the existence of inadequate taxpayer databases poses a huge challenge in that part of the world, due to entrenched informality. As noted in the TADAT Program Document (2013, p.5):

without complete and accurate information about the taxpayers registered with the tax administration, and an understanding the profile of those who chose to remain outside, it is not possible to provide effective and efficient service to support voluntary compliance and to take action against noncompliance.

It is glaringly obvious from this statement that there are different issues which need to be considered when tackling the challenges of maintaining an effective taxpayer database. Firstly, the information held about the registered taxpayers needs to be accurate. If it is not, the tax authority would be operating on erroneous assumptions, and this could negatively affect tax revenue generation. Secondly, it is important to hold useful information about those who are outside of the tax net, as such information is needed in order to bring them into the tax system or to introduce policies that could help to do this. Tax administrations in developing countries currently face challenges in both areas identified above. While tax administration reforms have been carried out in most developing countries in the past thirty years, and have usually involved updating taxpayer databases, these reforms largely appear to have been about computerization (Di John, 2006). While computerization is desirable in order to speed up information processing, enhance efficiency, and increase the capacity to store huge volumes of information, building an effective database of taxpayers goes beyond this. As noted by Casanegra de Jantscher and Bird (1992), the computerization of taxpayer databases in the 21st century is too important to be left to computer specialists alone. Administrators and researchers must be involved in the development of the tax management information system. The tax management information system must include details of the uses to which tax administration resources are put and outputs generated from such uses, as well as information on actual and potential tax bases.

The findings presented at the 5th Annual TARC Workshop suggest that tax administrations in developing countries are still struggling to catch up with this trend in 21st century tax management information system development. Computerization for its own sake would not be enough.

2.2. Complexity of the tax system

Tax system complexity has been an issue of concern for stakeholders in developing and advanced countries over the years, and it was a recurring theme in the findings of papers presented at the 5th Annual TARC Workshop (Adegboye, 2017; Ndajiwo, 2017). The authors found that taxpayers face a mix of taxes that are not only confusing, but also challenging in terms of their compliance costs. In addition to maintaining effective taxpayer databases, as discussed earlier, simplifying the tax system has been a goal of tax administration reforms in developing countries. There was a consensus among researchers at the workshop that enlightenment campaigns and awareness are being intensified across developing countries. According to PricewaterhouseCoopers (PwC) and the World Bank (2017), average tax compliance times are decreasing in developing countries, although much still needs to be done. They attributed the improvement to the growing adoption of e-filing.

It is puzzling, however, that despite the increasing simplification of tax compliance procedures and creation of intensified awareness across developing countries, tax compliance has yet to improve commensurately. According to Maimbo Nyanga, the IMF's TADAT expert at the 5th Annual TARC Workshop, there are country cases in which knowledge was passed to taxpayers and awareness was created, but taxpayers failed to be impressed. Insights from the workshop indicate that simplifying tax systems and continuing to improve awareness may increase tax collection in developing countries, but these methods appear to be inadequate when tackling the issue of non-compliance to a large extent. Perhaps, as suggested by a participant, what is needed is taxpayer engagement. Taxpayer engagement goes beyond simplifying the tax system and creating awareness. Engagement involves taxpayer participation at the agenda-setting, policymaking and implementation stages (Umar, 2017).

2.3. Audit effectiveness

One of the key insights gained at the 2017 TARC Workshop was from the presentation on audit effectiveness by Umar (2017). While previous research on the relationship between audit enforcement and tax compliance has traditionally focused on the effects of audit probability, detection probability and sanctions, Umar argued that the dynamics of audits in developing countries do not necessarily follow the assumptions made in advanced countries. He argued that, despite the new wave of socio-psychological variables in the aftermath of Allingham and Sandmo (1972), audit could still play a key role in tackling the large-scale tax non-compliance in developing countries. However, there is a huge gap in our understanding of the concept of audit. Existing research findings about the topic are fragmented in terms of audit probability, detection probability, fines, and sanction severity. Many studies treat these concepts in isolation and the few that combine them neither combine them all nor treat them as dimensions of the same construct. Umar stated that segregating these concepts leads to a problem of construct validity. Instead, he advocates a construct of 'audit effectiveness', which subsumes audit probability, detection probability, and sanction effectiveness.

This argument is underpinned by system theory, which postulates that phenomena should be understood in the context of the systems in which they operate. For instance, the probability of audit determines whether or not a taxpayer will be audited. However, in developing countries, unlike in advanced countries, the audit rate or probability does not translate to automatic detection, because detection is influenced by other variables, such as the experience and integrity of the auditors. Even if non-compliance is detected, in a developing country, there is

no automatic guarantee that the taxpayer will be fined or prosecuted, because the tax administration could be frustrated by other agencies involved in the system. Even if audit probability and detection probability both work, a failed sanction will render them useless. For audit to perform its role as a deterrent, it must be taken as a holistic system in which all parts support one another. Umar's study presented an audit effectiveness model and explained its components, their individual roles, and how they interlink to constitute a holistic and systemic construct of audit effectiveness. While the theory should hold in every context, it is particularly useful in developing countries where the system is ineffective and vulnerable to leakages in all areas. The study concludes that understanding audit effectiveness as a composite construct comprising of audit probability, detection probability, and sanction effectiveness holds the key to understanding the challenges of tax administration in developing countries.

2.4. Trust in authorities, perceived corruption, and the supply of public goods

Trust in authorities has been a recurring issue in the efforts made by researchers to investigate the determinants of tax compliance (Kirchler, 2007). While trust in authorities is an issue in both advanced and developing countries, it constitutes a greater problem in developing countries, where governance is predatory and corruption is rife (Moore, 2004; 2013). In the midst of the unhealthy relationship between authorities and citizens in developing countries, tax compliance rates are very low (Fjeldstad & Rakner, 2003), thus affecting the capacity of these states to generate revenue in order to provide essential services. To worsen matters, the leaders of some of the developing countries prefer to source revenue from exports of natural resources and foreign aid. By prioritizing these revenue sources, they become less reliant on taxes and, consequently, less accountable to the taxpayers (Brautigam, 2008). However, this situation results in a vicious cycle of low revenues, non-accountability, non-provision of public goods, and mistrust of authorities which ultimately leads back to low revenue.

Corruption and trust in authorities came up in the discussions at the 5th Annual TARC Workshop. Palil and Faizal (2017), who conducted an extensive survey of taxpayers in Malaysia, found that trust in authorities plays a key role in the relationship between authorities and taxpayers. For their own part, Rosid, Evans, and Tran-Nam (2017) investigated the effects of perceived corruption on tax compliance in Indonesia. They found that the phenomenon is perceived to be widespread in the country, and that it significantly affects taxpayers' trust in authorities and, consequently, their willingness to comply. Interestingly, perceived corruption and distrust in authorities are, in both studies, like Siamese twins. Where taxpayers perceive corruption to be prevalent, they distrust authorities. Both factors work to affect tax compliance negatively. The links between perceived corruption, distrust of authorities, and supply of public goods are also evident in previous literature. Kraay, Kaufmann, and Matstruzzi (2010) define corruption as the conversion of public resources to private use. Consequently, fewer public goods are available for the welfare of citizens and this goes on to cause tax non-compliance.

2.5. Strained power, and the fiscal relationship between central and subnational governments

The idea of fiscal federalism is gaining momentum worldwide. As Oates (1999, p.1120) puts it, "fiscal federalism is in vogue". It is being embraced in both advanced and developing countries. The philosophy behind fiscal federalism is that local or subnational governments are closer to the citizens and, hence, are better able to identify and meet those citizens' needs.

However, such responsibilities should co-exist with the power to impose certain taxes within the jurisdictions of subnational governments. Bahl and Bird (2008) identified personal income tax surcharges, taxes on the use of motor vehicles, payroll taxes, and property taxes as some of the taxes usually imposed by subnational governments. The authors stated that proponents of fiscal decentralization argue that it is capable of resolving most of the challenges of economic development in developing countries by improving revenue mobilization and ensuring the accountability of elected officials through grassroots participation in governance. While the ideals of fiscal decentralization are lofty, Bahl and Bird (2008) also noted that they cannot be attained unless a democratic mechanism exists, through which the citizens (taxpayers) can exercise control. Information by which to evaluate the local government's performance must also be available. These essentials are missing in most developing countries.

As noted by Bird and Vaillancourt (1999), fiscal federalism could be a double-edged sword in developing countries. It could improve revenue generation, as argued earlier, but could also constitute a stumbling block to tax revenue generation. Prud'homme (1995) argued that it could increase costs, reduce efficiency in service delivery, and lead to macroeconomic instability. Findings presented by Chilenga and Guimares (2017) at the 5th Annual TARC Workshop appear to confirm the positions of Bird and Vaillancourt (1998) and Prud'homme (1995). Chilenga and Guimares (2017) interviewed stakeholders of subnational taxation across South Africa and Nigeria, and found that political or constitutional federalism does not effectively translate to fiscal federalism in practice. While the federal authorities are quick to offload responsibilities onto local governments, they are slow in ceding taxation powers to them, thereby stalling the performance of the local authorities. In many cases, power tussles ensued between the tiers of government and, in some instances, citizens face double taxation, as both tiers of governments flex their muscles. Taxpayers are always at the receiving end when such power tussles complicate tax systems. As could be expected in such circumstances, tax evasion and non-compliance become rife.

3. POLICY IMPLICATIONS OF FINDINGS FROM THE TARC WORKSHOP 2017

The findings from the 5th Annual TARC Workshop, as discussed in the preceding section, are presented in Table 1, along with a policy recommendation for each theme.

These insights are very interesting and have the potential to open new areas of discussion on the salient issue of low tax revenue generation in developing countries. The findings and discussions at the workshop provided fresh perspectives on the role played by tax administration in generating tax revenue in developing countries.

Activities and policies aimed at increasing tax revenue in developing countries have traditionally revolved around improving tax administration. As stated in the introduction to this paper, tax administration reforms have been taking place in developing countries for decades, with remarkable support from multilateral organizations and individual donor countries. Yet, despite some improvements, low tax revenue is a topical issue in developing countries today, just as it was more than sixty years ago, when Nicholas Kaldor (1963) drew scholarly attention to the issue.

Table 1: Thematic areas of findings presented at 5th Annual TARC Workshop and policy recommendations

Theme	Policy recommendation
Ineffective and incomplete databases of taxpayers and their financial activities.	Implementing more effective databases.
Tax system complexity, knowledge and awareness.	Simplifying the tax system, going beyond awareness to engage taxpayers in policy formulation and implementation.
Audit ineffectiveness.	Ensuring a more effective audit system encompassing audit, detection and sanctions.
Corruption, distrust in authorities, and inadequate supply of public goods.	Build trust in political leadership, reduce corruption, and improve supply of public goods.
Strained power, and the fiscal relationship between central and sub-national governments.	Resolve areas of conflict in the fiscal relationships between central governments, subnational governments and taxpayers.

At this point, it is necessary to ask whether or not tax administrations are capable of tackling all the challenges of tax revenue generation in developing countries. It is doubtful they can resolve all of the challenges. Based on insights from findings and discussions at the 5th Annual TARC Workshop, we argue that the problem of low tax revenue generation in developing countries has persisted because some of the challenges faced in these countries are beyond the control of tax administrations. While tax administrations can increase their effectiveness in order to tackle some of the challenges, they have little control over others. We continue our study by re-examining the five issues raised in Table 1, and discussing those that tax administrations can control and those that they cannot. The model in Figure 1 depicts the classification.

In other words, can tax administrations in developing countries implement all of the policy recommendations in Table 1? Figure 1 reveals an interesting paradox. Tax administrations are usually burdened with the responsibility of tackling the challenges of tax collection and keeping tax monies flowing into government coffers. In view of their enormous responsibilities, governments in developing countries and their international supporters have focused on reforming them. However, as shown in Figure 1, out of the five policy recommendations derived from the findings of papers at the TARC Workshop, two can be fully implemented by tax administrations (policy recommendations 1 and 2) while two cannot (policy recommendations 4 and 5). Policy recommendation 3 (audit effectiveness, comprising of audit and sanction) presents a peculiar problem. It can only partially be implemented by tax administrations, as will be discussed below. We now provide a brief outline of policy recommendations 1 to 5, and argue why tax administrations are able to implement recommendations 1 and 2, cannot implement recommendations 4 and 5, and can only partially implement recommendation 3.

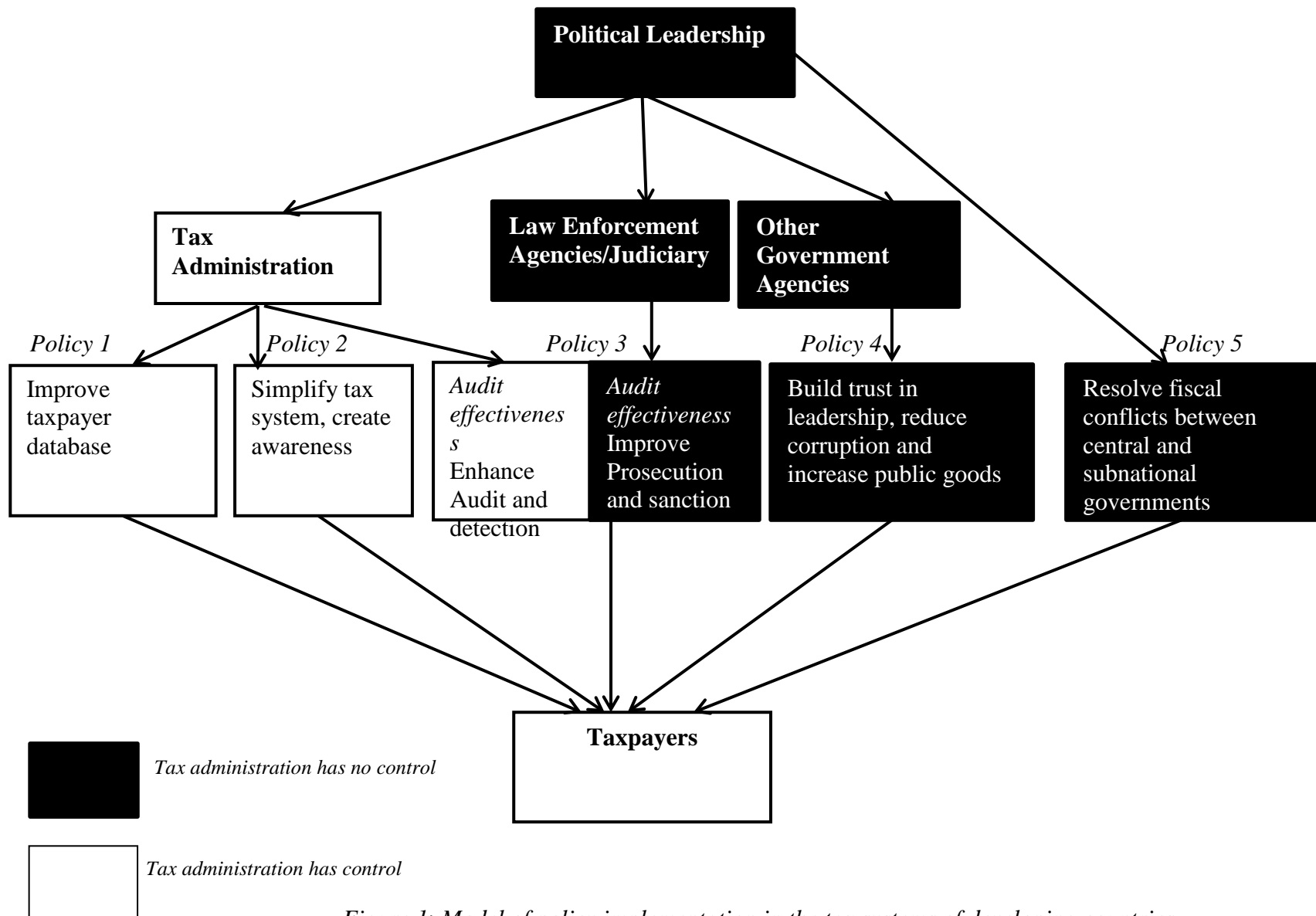


Figure 1: Model of policy implementation in the tax systems of developing countries

3.1. Policy recommendation 1: Implementing a more effective taxpayers' database

The findings from papers presented at the 5th Annual TARC Workshop on the inadequacy of taxpayer databases show that this issue can be remedied by improving existing databases, and incorporating information systems and data that were previously unavailable. As the IMF (2015, p.82) noted, "successful revenue administration depends on managing information effectively." The IMF further advised that an effective information system in a tax administration goes beyond costly investment in technology or excessive focus on the tools. Instead, the goal should be to ensure that relevant information is available at the right time. The issues involved in improving taxpayer databases and the management of information systems are well within the grasp of tax administrations in developing countries. The good news, according to IMF (2015), is that developing countries could leapfrog their way to technological advancement, as tax administrations in advanced countries are now battling with outdated systems. Tax administrations in developing countries are capable of taking advantage of modern information technologies. They could deploy more resources and management commitment to implementing modern information systems. As stated earlier, tax administrations in developing countries are fortunate to have willing and enthusiastic supporters in multilateral organizations and donor countries. Moreover, the Semi-Autonomous Revenue Authority Model is currently in vogue in most developing countries. Using this model makes tax administrations fairly independent of mainstream government bureaucracy. This means that they are able to set and manage their own priorities. They can choose to invest more in information technology.

3.2. Policy recommendation 2: Simplifying the tax system, creating adequate awareness and engaging taxpayers

Complexity of the tax system and the knowledge/information gap were some of the challenges identified from the findings shared at the 5th Annual TARC Workshop. The appropriate policy response should be a continuous simplification of the tax system. While ongoing efforts are being made to this effect, the ultimate goal should be to create taxpayer-friendly tax systems in which taxpayers can pay tax with ease and are happy to discharge their fiscal duties. Anything short of this is unacceptable and could lead to reluctance to comply. Developing countries' tax authorities urgently need to imbibe the spirit of the New Public Management, which means taxpayers should be seen as business customers worthy of being treated as kings. Current efforts aimed at creating knowledge/awareness appear to hinge on information campaigns. As noted by Maimbo Nyanga, the IMF's TADAT expert at the 5th Annual TARC Workshop, field experience shows that such campaigns do not work in all cases. The mere sharing of information about tax issues may not be adequate. As suggested by Umar (2017), what could work is a two-way interaction between tax authorities and the taxpayers, so that information does not just flow in one direction (from tax authorities to taxpayers). Input should be sought from the taxpayers, and there should be painstaking negotiation and consensus between tax authorities and taxpayers before policies are implemented. If taxpayers are involved in policy formulation, implementation becomes easy and this further saves tax authorities the cost of having to mount expensive information campaigns that may not get favorable responses from taxpayers. As with policy recommendation 1, the issues of tax system simplification and taxpayer engagement are well within the control of tax administrations. Again, the current semi-autonomous status of most tax administrations in developing countries affords them discretion as to how much to simplify the tax system and how far to engage with taxpayers.

3.3. Policy recommendation 3: Ensuring effective audits in terms of audit, detection and sanctions for evaders

Looking at Figure 1, the policy recommendation of ensuring effective audit appears to be caught in the middle of the two extremes. It is different in the sense that the implementation of this policy cannot be effected by tax administrations alone. While the tax administration controls some areas of the audit effectiveness policy (audit and detection), the other areas (prosecution and sanction), can only be effected with cooperation from other government agencies and the judiciary. According to Umar's (2017) presentation at the 5th Annual TARC Workshop, developing countries are peculiar and their peculiarity must be noted when tackling the issues involved in audit. He explained that audit, detection and sanction comprise a flow of activities working together in a sequence, and operate within a system to attain the objectives of deterrence and tax compliance. Hence, audit, detection and sanction conform to the system theory, which postulates that all parts work together to produce results. As such, neglecting any part of the system could result in disastrous consequences for the overall goal.

As noted earlier, the context of developing countries constitutes a systemic challenge for tax administrations. Even when they improve their audit processes and are able to detect evasion, evaders may escape via complicit law enforcement agents. Worse still, cases of evasion end up in courts where they drag on endlessly. For instance, Everest-Phillips (2010) found that tax evaders in Yemen are happy to go to court, as they are aware their cases will not be resolved for about seven years, during which time they are not liable to pay the amount in contention. As in the Yemen case, interviewees in Umar's (2017) study challenged the interviewers to mention any case of successful prosecution of tax evasion in Nigeria, but the interviewers could not do so. This shows that sanctions are not effective when dealing with tax evaders in many developing countries.

Unfortunately, as noted by Kirchler (2007), if tax evaders go unpunished, the entire tax system will, in time, be overwhelmed by evasion, as even hitherto compliant taxpayers may feel cheated and join the ranks of the evaders. Looking at the gap in prosecution/sanction in developing countries, it is clear that tax authorities' hands are tied. Looking at Figure 1, while tax administrations can implement policy recommendations 1 and 2 on their own, they cannot do so with policy recommendation 3. Tax administrations can only audit and detect evasion. The implementation of prosecution and sanctions depends on the effectiveness of a country's legal system. Therefore, efforts need to be made to tackle the challenge in all aspects of the system. A possible policy option could be creating special courts or tribunals for tax offences, and training special prosecutors and judges for tax-related cases. This will ensure that cases involving tax evasions are not bogged down in the bureaucratic bottlenecks and corruption currently associated with the conventional justice system. While this is desirable in the short-term, it would be better in the long run for political leadership in developing countries to ensure a systemic cleansing, as it would be difficult to maintain an island of effective tax administration amidst a sea of inefficiency and corruption.

3.4 Policy recommendation 4: Create trust in political leadership, reduce corruption, and improve the supply of public goods

Among the numerous factors that influence tax compliance, the interlinked effects of corruption, distrust for political leadership and inadequate supply of public goods appear to have the most influence. Findings from taxpayer surveys across advanced and developing countries are largely consistent on this issue, and results from surveys and experimental studies

have largely been consistent on the positive relationship between the availability of public goods and tax compliance (Alm, Jackson & McKee, 1992; Aiko & Logan, 2014; Bodea & LeBas, 2014). From the model in Figure 1, it is glaringly obvious that the tax administration does not play an active role in the supply of public goods and services. The job of a tax administration is to act as a mediator in the fiscal social contract between the citizens and the government by collecting taxes from the former and transferring those funds to the political leadership. How well the political leadership manages taxpayers' monies and how many public goods they choose to provide is not within the domain of tax administrations anywhere in the world. It should be noted that the tax administration itself is an agency of political leadership, and is only one of a number of agencies that act as interfaces between taxpayers and the political leadership.

While the supply of public goods, reducing corruption and building trust are the most important policy initiatives that could improve tax compliance, it is obvious that these matters are well beyond the scope of the tax administration's role. The tax monies collected by a tax administration are channeled to the government treasury, from where they are dispensed to various government agencies. The job of the tax administration stops at the point at which the funds get transmitted to government's coffers. Anything that happens beyond that point does not involve the tax administration. Developing countries are known for widespread corruption, which breeds distrust and tax non-compliance (Moore, 2004; 2013). As we have argued in this section, policy recommendations for building trust between taxpayers and the political leadership, fighting corruption, and improving public services must look beyond the tax administration. The political leadership and the myriad of government agencies that provide public services to the taxpayers should be the focus of policies aimed at building trust and fighting corruption.

3.5 Policy recommendation 5: Resolve the conflicting fiscal relationship between the federal and sub-national governments and the taxpayers

The 5th Annual TARC Workshop included discussions about the thorny issue of fiscal federalism in developing countries and its negative influence on tax compliance was brought to the fore. Taxpayers are enmeshed in a conflicting fiscal interrelationship with, on one hand, the sub-national government and, on the other hand, the central government. More often than not, taxes are duplicated and made more complex, thus leaving the taxpayers frustrated; in such circumstances, they are easily swayed towards non-compliance. The policy implication is to resolve areas of conflict between the central and sub-national governments. The taxpayers should not face ambiguity about their fiscal obligations to either tier of government. In each case, the fiscal responsibility of the taxpayer to pay tax must be matched by the corresponding service obligation of the tier of government that collects the tax. Again, as with policy recommendation 4, resolving the needlessly complicated relationships between the tiers of government and the taxpayers is not within the domain of the tax administration. Tax administrators are technocrats using their professional expertise to implement fiscal policies/directives from the political leadership. They are not politicians and cannot meddle in the fiscal turf war between politicians in the central and sub-national governments.

4. Conclusion

The issue of low tax revenue generation in developing countries has attracted global attention as far back as 1963, when Nicholas Kaldor brought it to the fore in his seminal paper. More than 60 years later, the issue remains unresolved, despite more than 30 years of tax

administration reforms supported by multilateral organizations and donor countries. In this paper, we discussed insights from the 5th Annual TARC Workshop (2017), which featured a special theme; the challenges of tax administration in developing countries. We discussed findings from the workshop, adding some useful analytical insights.

Findings and discussions at the workshop were incisive, given the rare blend of academic researchers from multidisciplinary background and field practitioners who attended the event. The findings and discussions were along five thematic areas, as follows:

- Inadequate and ineffective taxpayer databases.
- Complexity of the tax system and taxpayer apathy towards current knowledge/awareness creation.
- Ineffectiveness of the audit process.
- Systemic corruption and distrust of political leadership.
- Conflicting fiscal relationships between the central and sub-national governments and the taxpayers.

While these discussions have some precedence in the growing literature on taxation in developing countries, there is no doubt that fresh perspectives have emerged from the 5th Annual TARC Workshop. Our own analytical contribution in this discussion paper should open a new line of debate about the critical issue of low tax revenue generation in developing countries. For instance, there appears to be an excessive focus on tax administrations in developing countries in the quest to improve tax revenue generation. Consequently, extensive tax administration reforms have been carried out during the past thirty years and are ongoing. However, the analytical insights presented in this paper show that the challenges of raising tax revenue in developing countries cannot be tackled by tax administrations alone. While tax administrations can tackle some of the problems, they may not be in the position to deal with others. The policy implication is such that, while tax administration reform is commendable and should be sustained, the issues which cannot be resolved by tax administrations should simultaneously receive more attention.

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