

Improving Tax Administration in Developing Countries

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Improving tax administration has long been a matter of concern to those concerned with developing countries. Since all countries need revenues, all countries have revenue administrations.² For developing countries to benefit from the opportunities afforded by globalisation - or to rebound from the blows it may deal out - they must be able to mobilise adequate fiscal revenues. Money alone is not enough; but it is necessary for any state to function, and the most reliable way to get it is with an effective tax administration. How countries tax affects the allocation and distribution of resources and the rate of economic growth. In addition, however, the tax system constitutes one of the major interfaces between citizens and state in any country so how taxes are administered may affect not only the political future of the government of the day but also, more fundamentally, public trust in government. Tax administration may thus play a critical role not only in shaping economic development but in developing an effective state.

The standard economic approach to taxation usually ignores such key administrative issues as evasion and avoidance, administrative and compliance costs, and how the way in which taxpayers and tax officials conceptualize and carry out the process of assessing, collecting, and enforcing taxes may profoundly alter the effects of the tax system. However, "...optimal policy requires simultaneous consideration of the design of the tax code and of the administrative structure created to enforce it (McLaren 2003, v). Good tax administration focuses on the collection of information in a world in which "...information is observable with error, to varying degrees, and its quality depends greatly on the type of administration and enforcement in place" (Slemrod & Gillitzer 2013, 186). Since such problems are especially critical in developing countries around the world, it is not surprising that good tax administration is seldom found in practice.³ Until recently, little good information was available on tax administration and even less scholarly attention was paid to the mundane but important reality of how tax systems actually worked in developing countries.⁴ Now, however, the pioneering effort of the OECD to collect comparative information about tax administrations in OECD member countries (OECD, 2013) has been extended to a wider set of

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² In many if not most countries, substantial revenues – including tax revenues – are collected by agencies other than the central tax administration: in Latin America, for example, on average over the 2006-2010 period, only 62.5% of tax revenues were collected by “the” tax administration (<http://www.ciat.org/index.php/en/blog/item/68-importancia-fiscal-administraciones-tributarias-america-latina.html> accessed 23/02/2015). Tax revenues are also collected by sub-national governments, social security agencies, and, in some countries, separate customs agencies; moreover, a variety of non-tax revenues are collected by still other agencies. Since in addition the authority, autonomy and internal organization of central tax agencies are also often very different from country to country, international comparisons must obviously be made with care. However, none of these issues can be discussed further in the present paper.

³ See, for example, the recent extensive review of tax administration in India by the Tax Administration Reform Commission, available at http://finmin.nic.in/the_ministry/dept_revenue/tarc_report.asp, and reviewed in this journal see page 132

⁴ Of course, a few excellent country studies existed, with Radian (1980) being a particularly noteworthy example.

countries,⁵ and several recent empirical studies have already appeared drawing on this new data base.⁶

The absence of good comparative data did not slow the flow of advice over the years from many sources to many developing countries about how they might improve their tax administrations. Although this activity generated a huge volume of material, little was published and even less was systematically evaluated either by the providers themselves or by outside scholars.⁷ Nonetheless, recently international agencies, building on their considerable experience in the field, have laid increasing emphasis on ‘benchmarking’ tax administration performance in developing countries.⁸ Moreover, a few such countries have begun not only to analyse the massive amount of administrative data generated by their increasing modernized tax administrations but even to allow outside scholars to have access to such data under certain conditions.⁹ For all these reasons, it may perhaps be timely to discuss briefly a few aspects of tax administration in developing countries that need to be considered by those who wish to improve this important (and unduly neglected) aspect of the state-building and development process and to move a bit further down the long road between analysing an optimal tax structure for developing countries¹⁰ and understanding how a more effective tax system may perhaps become reality in such countries.

THE POLITICAL ECONOMY OF TAX ADMINISTRATION

The economic approach to tax administration is simple: apply additional resources to the task up to the point at which the gains from doing so cease to be worth the cost.¹¹ The political economy of tax administration is more difficult. Curiously, however, the aspect of tax administration in developing countries that has been most examined by scholars in recent years has perhaps been the political dimension.¹² As would-be tax reformers in all countries usually learn all too soon, short-run political considerations often hamper not only policy changes but also attempts to improve revenue administration (which are inevitably long-term in

⁵ The most recent OECD (2013) study covers 52 countries; additional information is provided in IDB (2013) for 13 additional Latin American countries, in ADB (2014) for another 6 Asian countries and in ITD (2010) for some African countries.

⁶ See Robinson and Slemrod (2012) and Alm and Duncan (2014). These studies are suggestive although (in part for reasons mentioned in note 1) cross-country administrative comparisons must be handled with care.

⁷ One of the few outside analyses of foreign technical assistance in tax is that by Stewart and Jøgarjan (2004); for my own views, see Bird (2014). In many ways the most interesting, and probably most studied, foreign study of taxation in a non-western country was perhaps that by Carl Shoup in Japan under the American post-war occupation (Shoup 1949), as discussed by Gillis (1991) and especially Brownlee, Ide and Fukagai (2013). However, although Shoup paid an unusual amount of attention to administrative issues in his missions (including those to Venezuela (1959) and Liberia (1970)), the principal focus of these studies, like the contemporary and later studies by such other distinguished tax advisers as Kaldor (1980) in India, Sri Lanka (then Ceylon) and elsewhere and Musgrave in Colombia (1971) and Bolivia (1981), was on tax policy. Apart from an early IMF-based review of tax administration reform efforts (Bird and Casanegra 1992) and a few internal or at least little-circulated internal reports by the IMF, USAID, and other agencies, to my knowledge no systematic examination of the extensive foreign assistance to tax administrations in developing countries during the last six decades exists.

⁸ See, as only one example, the TADAT approach of the IMF (available at <http://www.tadat.org>). My own (somewhat skeptical) view on these efforts is set out in Vazquez-Caro and Bird (2011).

⁹ For examples of such studies in Latin America, see Pomeranz (forthcoming) and de Paula and Scheinkman (2010).

¹⁰ For pioneering examples of the optimal approach, see Newberry and Stern (1987) and Ahmad and Stern (1991); for a more recent example, see Gordon (2010).

¹¹ As Slemrod and Yitzhaki (2002) make clear, the economically optimal level of administrative effort is always less than the level that will yield the greatest revenue.

¹² See, in particular, Moore (2007), Brautigam, Fjeldstad, and Moore (2008), and a series of interesting country studies emerging in recent years from the International Centre for Tax and Development such as Prichard (2009).

nature).¹³ The connection between revenue systems and political development has attracted attention from scholars such as Levi (1988), Steinmo (1993), and Lieberman (1988), to mention only a few. Until recently, however, the focus of most such studies was on the (perceived) distributional impact of state policy, with changes often being interpreted as reflecting the rise and fall of different social and economic groups. For example, the extent to which a nation's finance relies on income taxation was seen as a "mirror of democracy" in the sense that the income tax symbolised the strength of egalitarianism and commitment to social justice.¹⁴ The characterization of 'direct' taxes as progressive and indirect taxes as 'regressive' continues to play an important role in tax politics. Many of the 'VAT wars' that have occurred in recent decades in countries as varied as Canada, Japan, South Africa, Guatemala, and Ghana, for example, have been driven in part by the perception that a 'regressive' consumption tax like VAT is inherently less desirable than a 'progressive' income tax.¹⁵ How governments raise revenue not only affects policy outcomes but also reflects political forces and induces political reactions.

The same can be said about how taxes are collected. Consider, for example, the simple question of whether taxpayers should file income tax returns. Some have argued that doing so is an unnecessarily costly and troublesome exercise for most taxpayers so that countries should move away from requiring most taxpayers to file annual returns (Graetz, 1997). On the other hand, others suggest that, not only (in the well-known words of U.S. Supreme Court Justice Holmes) are taxes "what we pay for civilized society," but that society is more likely to be civilized if people are aware of the costs they incur when they think governments act on their behalf (Shoup, 1969). People may differ about such deep issues: but it is clear that the way in which people pay taxes may affect how they feel about both taxes and government.¹⁶

The administrative and compliance costs associated with collecting taxes are also relevant in this context. Often, 10 percent or less of tax returns produce 90 percent of the revenue. But the remaining 90 percent of returns may account for perhaps 80 percent of the associated administrative and compliance costs. Whether for cost or political reasons, or both, many countries in recent years have reduced the role of self-assessment in the income tax by using 'pre-populated' returns (OECD 2006) with much—even all—of the information being filled in administratively, and the taxpayer's main role being simply to sign and submit. Singapore has taken this approach to the extreme by not only enabling most taxpayers to avoid filing anything but even debiting their bank accounts for the taxes the government calculates are due (Oldman & Bird 2000). On the other hand, a recent study (Coleman 2007) concluded that Australians would rather file returns that generated refunds rather than have less tax withheld in the first place.

¹³ Studies of successful administrative reform in countries like Singapore (Sia and Boon 1997) and Chile suggest that it is likely to take 8-10 years to modernize an administration, even with a good starting point.

¹⁴ The quoted phrase comes from Webber and Wildavsky (1986), p 526. For an example of this approach in action, see Kato (2003).

¹⁵ The first two countries are discussed in Ecclestone (2007), and the last three, more briefly, in Bird and Gendron (2007). How progressive either VAT or income tax is in practice in any country depends on such features as the structure of the tax, the nature of the economy, the effectiveness of the administration, as discussed in e.g. Bird and Zolt (2005) and Bird and Gendron (2007).

¹⁶ This linkage has recently been explored in some of the literature on 'salience' beginning with Chetty, Looney and Kroft (2007) as well as in the 'Wicksellian' literature epitomized by Breton (2006). My own take on each of these approaches may be found in Bird (2010) and Bird and Slack (2014).

In Canada, where many transfer programs are administered through the income tax, many people file even when they have had no tax withheld.

Such issues are even more important in less economically developed countries. For example, Smith (2003) suggests that, although the South African Revenue Service (SARS) in post-Apartheid South Africa did a good job in raising revenue, the way it did so actually reduced fiscal redistribution while its failure to tap the large informal sector substantially reduced its state-building role. This comment raises the important question of the interaction between tax administration and such nebulous but potentially important concepts as ‘tax culture’ (Nerré, 2008) and ‘tax morale’ (Torgler, 2007).¹⁷ Among the many factors that shape the nature and impact of tax administration are the nature of the legal system, the extent of corruption, and how people feel about government. On the other hand, how taxes are collected may itself weaken or strengthen public trust (social capital) in a number of ways. Early attempts to explore this interdependence suggest that influence does indeed run both ways, with higher levels of trust – a more responsive and legitimate state – being associated with more tax effort and the level of trust being associated with better ‘governance quality’ in terms of the performance and perception of key state institutions like tax administration.¹⁸

How and how well a tax administration works depends to a considerable extent on the environment within which it works (Gill, 2000). The nature of the tax structure and the underlying legal system is one factor, as is the extent to which taxation is used to achieve objectives other than simply collecting revenue. Another obvious factor is the structure and nature of the economy. For example, financial development, particularly the use of banking channels for payment, makes transactions easier to observe and hence broadens the potential scope of taxation and makes tax administration easier (Gordon & Li 2009). Because growth is usually accompanied by a rising share of the formal or organised sector, the base for most taxes increases. Unless modern systems of business accounting are adopted widely, however, it is difficult to make effective use of such modern taxes as the income tax, the corporation tax and the VAT. Only when accounting is both common and standardized can countries move from dependence on the burdensome and harassing physical verification of items on which older taxes like stamp taxes and excises are based. When ‘informal’ economic activity remains important all too often about all that can be done is to adopt some variant of presumptive taxation in the hope that over time the problem will disappear (Alm, Martinez-Vazquez & Wallace 2004). On the other hand, as financial systems become more sophisticated and countries more open it becomes easier for funds to cross international borders to escape taxes. The possibility of international income shifting through various forms of transfer pricing and related financial transactions, like the growth of cross-border electronic commerce, limits the scope of feasible administrative actions by national tax authorities. While such matters are neglected by administrations in developing countries at their peril, they are not discussed further here in part because even the most sophisticated tax administrations in the most developed countries are still struggling to work out

¹⁷ The important question of taxing ‘informality’ is not discussed further here: see Alm, Martinez-Vazquez and Wallace (2004) for a useful introduction.

¹⁸ Among the earlier attempts to explore these relationships empirically, see Bird, Martinez-Vazquez and Torgler (2008); a good review of more recent work may be found in Alm, Martinez-Vazquez and Torgler (2010).

how to deal with what is now generally called ‘base erosion and profit shifting’ (BEPS).¹⁹

THE REVENUE PRODUCTION PROCESS²⁰

One way to think of revenue administration is as a multiple-input, multiple-output process. Outputs include not only revenue but also such important intangible products as equity and perhaps even a certain degree of state-building. The principal inputs are people, materials and information. These inputs are combined in a series of systems within an organisational framework and then transformed in the context of the specific environment and the process of management into outputs. Although this production process may be further broken down into a number of separable components, only a few key aspects are noted here. For example, the resources required include properly skilled staff, adequate infrastructural and equipment support, and managerial input through an organisational hierarchy and an intra-organisation communication and information sharing system.

Importantly, as emphasized earlier, the critical information needed to ascertain the existing and potential tax base includes a number of subsystems to cover specific areas, such as: (1) assessing the potential tax base for the aggregate economy;²¹ (2) identifying potential taxable entities and – at least in principle – being able to estimate the amount of the tax base for each if it proves necessary to do so; (3) establishing a ‘risk management’ function to classify potential taxpayers into relatively homogenous groups from the point of view of differences in the resources needed and the strategy that the administration must employ to collect taxes from them;²² and (4) monitoring and providing feedback on the effectiveness of strategies employed by the administration in collecting taxes from different groups of potential taxpayers. Perhaps the most important of these subsystems with respect to revenues is the second, which includes the collection of information from potential taxpayers themselves, from third parties (including other public agencies), and from within the tax administration itself.

In addition to developing risk management strategies, rules governing activities to counter each type of non-compliance by different groups of taxpayers need to be established. Such activities may include, for instance: requiring new or non-filing potential taxpayers to file, preventing or punishing tax avoidance, preventing or punishing incorrect tax base reporting by filers, recovering taxes due but not paid voluntarily by taxpayers, and imposing penalties when required. The design of implementation of penalties for non-complying taxpayers—and perhaps also of rewards for complying taxpayers – is an unduly neglected question, requiring close attention not only to exactly what constitutes sufficient proof of non-compliance to warrant sanction but also, more importantly, the appropriate

¹⁹ See OECD (2013a) for an introduction, and <http://www.oecd.org/ctp/beps.htm> for current developments in the on-going struggle. My own views on this issue may be found in the latter part of a recent paper (Bird 2015).

²⁰ Portions of the next few sections draw on earlier work on this subject, particularly Bird (2004).

²¹ The extent to which the potential base is reached by the existing tax system is the focus of many recent discussions of the ‘tax gap’ (Gemmell & Hesseldine 2012) as well as such empirical studies as HMRC (2010) and European Commission (2013).

²² See, for example, European Commission (2010) and Kkwaja, Asawati and Loepick (2014)

nature and structure of penalties.²³ For example, given the critical importance of information to good tax administration, it is surprising how few countries seem to impose adequate penalties for not providing required information or to monitor adequately the completeness and accuracy of third-party information returns. Finally, since no tax administration is perfect, careful and explicit provision should also be made to deal with mistakes. At least two sub-systems are required for this purpose—one to redress taxpayer grievances (review, appeals, administrative remedies, ombudsmen), and one to identify and correct (or prevent) errors by officials (internal reviews, inspection and anti-corruption units).

To operate this complex production process efficiently and effectively in a complex environment is not simple. Three key ingredients seem essential for effective tax administration in any country: the political will to implement the tax system effectively; a clear strategy as to how to achieve this goal; and adequate resources for the task at hand (Casanegra de Jantscher & Bird 1992). It helps, of course, if the tax system is well designed, appropriate for the country in question, and relatively simple, but even the best-designed tax system is likely to be properly implemented only if these three conditions are satisfied. Much attention is frequently and correctly paid to the resource problem—the need to have sufficient trained officials, adequate information technology and so on. In the absence of a sound implementation strategy, however, even adequate resources will not do the job. And in the absence of sufficient political support, even the best strategy cannot be effectively implemented. Indeed, abundant experience around the world has made it clear that the single most important ingredient for effective tax administration is clear recognition at the highest levels of politics of the importance of the task and the willingness to support good administrative practices, even if political friends are hurt.²⁴

Unfortunately, relatively few developing countries—and by no means all developed countries—have been able to leap this initial hurdle. Often, urged by international agencies (such as the ‘troika’ in Greece) or simply desperate to get more revenues, countries have launched frantic efforts to corral defaulters or to rope in new victims without hurting politically powerful interests and without providing the time, resources and consistent long-term political support needed to do a good job. No doubt it would be nice if this could be done, but it cannot. The widespread reluctance to collect taxes efficiently and effectively without fear or favour may be understandable in countries, like many developing countries, that are somewhat fragile politically, but without major changes in this respect, no viable long-term tax system can possibly be put into place.

If the political will is there, the techniques needed for effective revenue administration are not a secret. The lessons taught by experience “...on the whole were not exciting – more like ‘how to be a good public accountant’ than ‘how to be a star in the movie or in the opera or on the football field’” (Harberger, 1989, p.27). The tax administration must be given an appropriate institutional form. It must be adequately staffed with trained officials. It should be properly organised. Computerisation and appropriate use of modern information technology can help

²³ An old but still useful discussion of some of the issues involved may be found in Oldman (1965).

²⁴ See, for instance, the fascinating comparison of tax administration in Argentina and Chile in Bergman (2009).

a lot, but technology alone cannot do the job.²⁵ Further, the technology must be carefully integrated into the tax administration if it is to increase output and not just costs. Many countries have found it difficult to work out the right mix and sequencing for upgrading both IT and human resources (Bird & Zolt 2008). In the end, well-trained people, with adequate political support, are needed to administer taxes effectively. Provision must be made for training and retraining staff as needed. The information needed for effective administration must be collected from taxpayers, relevant third parties, and other government agencies, stored in an accessible and useful fashion, and used to ensure that those who should be on the tax rolls, are, that those who should file returns, do, that those who should pay on time, do, and that those who do not comply are uncovered, pursued, and sanctioned, as necessary. All this may seem obvious and trite but none of it is easy and little of it is simple. But it is not rocket science. It can be done and it has been done, in countries ranging from rich to relatively poor.

BENCHMARKING TAX ADMINISTRATION

One approach to improving tax administration is to begin with a model of what a good revenue administration should look like, then to examine the actual tax system in a country to determine how it diverges from the model. The usual next step is to propose changes that will transform ‘what is’—the imperfect reality of the current situation—into ‘what ought to be’—the perfect model of a modern revenue administration. Variants of this approach dominate both the literature and in many respects in practice. It is, for example, essentially the approach followed in both OECD ‘principles’ of good administration (OECD 1999) and in the World Bank’s diagnostic framework (Gill 2000). Although extending the ‘standard model’ of tax reform to include more aspects of tax administration (Slemrod & Gillitzer 2014; also this issue, page 6) is obviously desirable, it too has important limitations as a guide to reforming tax administration because, like the less formal approaches just mentioned, it does not pay sufficient attention to the critical question of why ‘what is’ exists, that is, why certain administrative styles and practices exist and persist in a particular environment. ‘Model’ approaches are unlikely to point the way to perfection in any real situation because they unduly downplay the importance of ‘path dependency’ and ‘context specificity’—academic language for history and the current environment – in shaping outcomes. Would-be reformers who attempt to implement a pure ‘model’-based reform are likely to encounter many unforeseen obstacles, traps, and dead-ends along the way and to end up some distance from the postulated ideal.

An alternative approach to assessing – and, hopefully, improving – the performance of a particular tax administration is to compare it to the experience of other countries.²⁶ To some extent, this approach is simply a variant of the theoretical model approach—with the model now being based on some international ‘best practice’ standard—and hence subject to the same pitfalls. Nonetheless, it is always illuminating to look at institutions in comparative perspective. If other countries face similar problems, one can learn from examining how they have dealt with them. One may also learn from observing the

²⁵ It can certainly help a great deal, however: for an interesting recent example from China, see Winn and Zhang (2013).

²⁶ For earlier reviews of this approach, see e.g. Das-Gupta (2002), Gallagher (2005), and Crandall (2010).

outcomes of alternative solutions tried elsewhere. Most importantly, perhaps, one can learn a lot about any particular system by thinking about the similarities and differences between it and that in other countries. If nothing else, comparative analysis frees one to some extent from parochialism—the tendency to generalise local problems to universal dilemmas and local solutions to universal truths – and perhaps also helps to overcome the common belief that there must be a simple solution to our local problems that can simply be borrowed from somewhere else.

Of course, one has to be as careful in making use of comparative information as in employing theoretical models. Each approach may be helpful in skilled hands. Equally, however, each may be dangerous if misused. On the comparative side, for example, it is all too easy to fall into the approach of picking this good feature from that country, and that one from another country, and then proposing to introduce both into a third country without taking adequately into account that from an institutional perspective every country is both unique and to some extent an organic unity. As Hirschman (1967) once noted, there are no such things as ‘side effects’ when it comes to policy analysis: there are only effects. When considering any change, one needs to take into account not only the desired consequences—for example, more revenue and less evasion or lower administrative costs—but all the relevant consequences that change might produce, such as higher compliance costs and increased taxpayer discontent. Benchmarking tax administration performance along the lines set out in the IMF’s TADAT approach, for instance, may be helpful in indicating respects in which a country’s administration deviates from what seems to be best practice. But knowing there may be a problem is a very different matter from knowing how best to deal with that problem in that country. What most benchmarking exercises do is essentially to consider (some) inputs --for example, money, people and the extent and nature of IT (information technology) -- and (some) outputs -- for example, revenue collection, arrears and evasion detected – with respect to a particular set of activities packaged within a particular organizational structure. In addition, benchmarking exercises may sometimes also consider a few aspects of the rather dark box within which policy design (architecture), implementation systems (engineering), and operations (management) combine to turn inputs into outputs. But not even the most extensive benchmarking study can either tell the whole story or permit direct inferences about causality.²⁷

²⁷ For a more extended discussion of benchmarking and a proposed variant of the conventional ‘by the numbers’ approach, see Vazquez-Caro and Bird (2011).

HOW TO IMPROVE TAX ADMINISTRATION PERFORMANCE

There is thus no single set of prescriptions—no secret recipe—that, once introduced, will ensure improved tax administration in any country. However, experience suggests that there are a number of simple general rules that are more likely to lead to successful reform.

Know the context

Countries exhibit a wide variety of tax compliance levels, reflecting not only the effectiveness of their tax administrations but also taxpayer attitudes toward taxation and toward government in general. Attitudes affect intentions and intentions affect behaviour. Attitudes are formed by such factors as: the perceived level of evasion, the perceived fairness of the tax structure, the complexity and stability of the tax system, how the tax system is administered, how much people value the services financed by taxes, and the legitimacy of government. Government policies affecting any of these factors may influence taxpayer attitudes and hence the observed level of taxpayer compliance. For instance, measures sometimes recommended for countries with very low compliance levels—such as massive application of administrative penalties, for example - may be quite inappropriate for countries with higher compliance levels, where selective application of stricter penalties may be effective in enhancing more ‘voluntary’ compliance and may indeed even lead to increased evasion by offending people’s sense of fairness and hence damaging that nebulous but real state of mind often called “tax morale” (Frey & Torgler 2007).

Keep it simple

To assess how well a tax administration is functioning, let alone suggest how to improve it, one must take into account the environment in which it has to function, the laws it is supposed to administer and the institutional infrastructure with which it has been equipped. It is not possible to appraise the efficiency or effectiveness of tax administration without taking into account both the degree of complexity of the tax structure and the extent to which that structure remains stable over time. As a UK report said almost 80 years ago, a certain degree of complexity may be inevitable.²⁸ Nonetheless, complexity still remains a concern in the UK, as elsewhere (Ulph, 2014). An essential precondition for the reform of tax administration is to simplify the tax system in order to ensure that it can be applied effectively in the generally low-compliance contexts of developing and transitional countries. Even the most sophisticated tax administration can easily be overloaded with impossible tasks such as ascertaining the legitimacy of credits claimed by businesses for “scientific research” or verifying deductions for dependents resident abroad. The life of administrators is also complicated by the propensity of many governments to alter tax legislation annually or even more frequently.

²⁸...To expect from us a codification of the law of income tax which the layman could easily read and understand was a vain hope, which only the uninstructed could cherish. ... Income tax legislation must, by its very nature, be abstract and technical, and can never be easy reading” (Income Tax Codification Committee, 1936, pp. 18-19).

Some countries have acted very drastically along these lines. Much of the initial success achieved in reforming the tax administration in Bolivia in the 1980s, for example, was clearly attributable to the extensive simplifications made in the tax system (Silvani & Radano 1992). It seldom makes sense to reform tax administration without simultaneously reforming tax structure to be both sensible and administrable. Often, even small simplifications in tax policy may permit considerable improvements to be made in administration. Even in more developed countries, measures such as reducing the number of income tax deductions may permit the elimination of filing requirements for most wage earners, thus greatly reducing the administrative burden because withholding alone will then suffice to enable most income taxpayers to fulfil their obligations. Of course, some countries have taken the opposite path and complicated the life of administrators greatly by introducing such complexities as joint filing under the income tax, special reduced VAT (GST) rates, and multitudinous tax incentives.

Tax law often must be complex to cope with such issues as cross-border transactions. Nonetheless, it is important to simplify procedures for taxpayers by such measures as eliminating demands for superfluous information in tax returns and, when possible, consolidating return and payment invoices. As mentioned earlier, restricting the number of policy objectives and hence the number of tax expenditures, as well as being willing to accept only 'rough justice' in taxation, will also make the tax task a lot easier (Slemrod, 2010). If too many objectives of social and economic policy are incorporated into tax law, the result may be a system too complex for both taxpayers and tax administration. Voluntary compliance may not work well when taxpayers find it hard to figure out their obligations correctly and withholding (and its verification) becomes difficult when the tax base is ill-defined or when there are many exemptions and deductions.

Have a reform strategy

Even if one takes the external environment facing the revenue administration as given, it is useful to think of the strategic problem facing the administration at three levels - architecture, engineering, and management (Shoup, 1991). The architecture is the design of the general legal framework—not only the substance of the laws to be administered but also a wide range of important procedural features including the degree to which tax administration is centralised and the size of the administrative budget. Once the general architectural design has been determined, the 'engineer' takes over and sets up the specific organisational structure and operating rules for the tax administration, including the basic strategy to be followed. In many ways, doing this, and evaluating how well it is being done are the primary tasks of top management. Finally, once the critical institutional infrastructure has been erected, the tax managers charged with actually administering the tax system can do their jobs - determining how to apply the technology and human resources available to them.

Different taxes and tasks may require different implementation methods: for example, a property tax is an essentially presumptive levy, in which the tax base is determined administratively whereas a value-added tax is (in practice) an essentially accounts-based tax. Different skill sets and technologies are required. A property tax needs input from numerous agencies outside the revenue

administration such as land registers, information on sales, and the like as well as expert valuers. A VAT, like an income tax, requires not only some expert accountants but also people who are knowledgeable about how different industries operate. The appropriate strategies for facilitating compliance and dealing with non-compliance are unlikely to be the same with respect to these two very different taxes.

The main ways in which an administration can be improved are, essentially, either by altering the tasks with which it is charged or by strengthening the tools with which it is equipped. Simple exhortations to ‘do better,’ while cheap and always popular, are of little use to resource-strapped administrators faced with impossible tasks. Gimmicks or quick-fixes such as tax amnesties²⁹ or lotteries in which tax invoices constitute lottery numbers are usually of little use in resolving the basic problems of good revenue administration.³⁰

A somewhat more useful device may be to introduce widespread withholding, covering not only traditional items such as wages, interest and dividends but also extending to professional fees, rents, and indeed in some countries to practically all business transactions.³¹ In fact, occasionally countries have even introduced what may be called ‘reverse withholding’ in which purchasers (government agencies or large enterprises) ‘withhold’ tax from sellers (small enterprises). However, even such widespread withholding is no panacea. The administration must be able to control withholders to make sure they hand over to the Treasury the amounts withheld, and it must also be able to check whether the amounts taxpayers credit against their liabilities have in fact been withheld. The mere expansion of withholding is unlikely to lead to a sustainable increase in compliance unless the administration is able to control both withholders and taxpayers subject to withholding.

The taxpayer as client

The most important player in the tax game is the (potential) taxpayer. The most important change in thinking about tax administration in recent years has been the increasing recognition of the central role of the private sector—taxpayers and third-party agents like banks and employers—in the taxing process.³² It is critically important to treat them not as potential evaders but as clients -- unwilling clients as a rule, but clients nonetheless. Facilitating compliance involves such elements as improving services to taxpayers (and third-party agents) by providing clear instructions, understandable forms, and assistance and information as necessary. Monitoring compliance requires the establishment and maintenance of taxpayer current accounts and management information systems covering both ultimate taxpayers and third-party agents (such as banks) involved

²⁹ Governments desperate for quick funds sometimes turn to amnesties as one way out. Sometimes the immediate revenue results are impressive, although the real present value of any net revenue increment is seldom clear as people pay deferred taxes and “launder” illegal money. Perhaps the most effective amnesty is one that is given to, so to speak, “wipe the slate clean” of old offenses in order to launch a new era of tough tax enforcement. Unfortunately, all too many countries have given periodic amnesties, and hence lost all credibility. If amnesties are given too often (e.g. India granted 7 over a 35- year period, while Argentina had 21 in the same period) they soon come to be anticipated. Even an amnesty with initial positive revenue effects may prove of little use if future compliance is eroded.

³⁰ Wan (2010) reports a favorable ‘lottery’ experiment in China, but experience elsewhere with this approach has been much less positive (Berhan & Jenkins 2005).

³¹ For an older but still useful introduction to many of the issues, see Soos (1990).

³² See, for instance, Aberbach and Christensen (2002) and Braithwaite (2003).

in the tax system as well as appropriate and prompt procedures to detect and follow up on non-filers and delayed payments. Improving compliance requires a judicious mix of both these measures as well as additional measures to deter non-compliance such as establishing a reasonable risk of detection and the effective application of penalties. Ideally, such measures should be combined so as to maximise their effect on compliance. For example, when introducing a VAT or other new tax, emphasis should first be given to assisting taxpayers to comply with the new tax, then to detecting noncompliance, and finally to applying penalties. Successful reform strategies require an appropriate mix of all these approaches.

Improving tax compliance is not the same as discouraging noncompliance. This perhaps paradoxical conclusion emerges from the numerous sociological and psychological studies of taxation that have been carried out in recent years, based on both experimental and survey evidence (Kirchler, 2007). This literature suggests that to a considerable extent tax administrations get the taxpayers they deserve in the sense that how taxpayers behave reflects how tax authorities treat them.

Tax compliance in most countries most of the time can perhaps best be characterised as ‘quasi-voluntary compliance’, because taxpayers have little choice as to whether their income sources have tax withheld or not. Nonetheless, in many ways it can be useful to think of there being three distinct groups of taxpayers in any country at any time: those who always comply, those who do not—almost irrespective of whether they can get away with it or not -- and those who may or may not comply, depending on how they perceive the costs and benefits of doing so. Each group needs to be dealt with differently. Some always pay; some always cheat; and some cheat when they think they can get away with it. An important task facing any tax administration is to prevent the mix from tipping in the direction of pervasive non-compliance.

Some taxpayers always comply. They may do so not simply because they do not have much opportunity to evade or because they are exceedingly risk-averse, but because they think it is the right thing to do—and, importantly, they think other right-thinking people are also complying. By definition, there are more such people in high-compliance countries than in low-compliance countries. Even in the latter, however, it is a gross oversimplification to pretend, as the standard economic model of tax evasion (as set out in e.g. Cowell (1990) generally does, that every taxpayer views the decision as to whether to pay his or her taxes as a gamble to be decided independently of his or her membership in, and loyalty to, the community. Care must be exercised in extrapolating results from one context to another. While non-compliers may be similar in some respects everywhere, both the size and the nature of the factors inducing compliers to comply may be quite different in different countries. Aspects that may differ from country to country include: the value attached to ‘fairness’ (and its meaning), the degree of deference to authority (and the legitimacy attached to that authority), and the extent to which contributing to the finance of government activities is seen to be socially (as opposed to privately) desirable. Increased enforcement actions -- like amnesties, whether viewed separately or jointly from increased enforcement -- may have quite different results with respect to compliers than non-compliers.

Public education about taxpayer rights and obligations and increased efforts by tax authorities to provide improved service to taxpayers may also help. However, there is as yet little quantitative evidence supporting this view and, although such policies may change attitudes, not all changes for all groups will necessarily be in the desired direction.

No tax administration can play the policeman for every potential taxpayer, if only because resources are always limited. Partly for this reason tax systems all over the world have tended over the years to move toward a regime in which taxpayers themselves determine and report - in other words, 'self-assess' - their tax liability and pay the amounts due without any special prodding from tax authorities. In most cases, such compliance is at most quasi-voluntary in the sense that through withholding the default position for most taxpayers is to let the authorities keep the money, but even so self-assessment is likely to result in high levels of compliance only if accompanied by actions that lend credibility to the sanctions prescribed in the law against non-compliance. More recently, some countries have, as mentioned earlier, taken steps to make compliance even easier by practices such as pre-populating tax returns.

Whatever the approach taken, effective tax administration requires establishing an environment in which citizens are induced - for whatever reason (whether the credible threat of punishment for non-compliance or a social norm of compliance) - to comply with tax laws. Efficient tax administration requires that this task be performed at minimum cost to the community. Neither task is simple.

Compliance costs matter

Compliance costs are costs incurred by taxpayers in complying with revenue law (Evans 2008). Studies of private compliance costs generally find that these costs are larger than budgetary administrative costs, that they are largely substituted for administrative costs, and that their incidence can be quite different from those of the taxes themselves (Sandford, 1995). In particular, the complexity and cumbersome administrative methods commonly found with respect to such taxes as stamp taxes and minor excises in some jurisdictions may result in very high compliance costs. Low compliance may to some extent be a function of high compliance costs, as well as of such more basic problems as lack of state legitimacy, inadequate connection between taxes and benefits, and perceptions of tax fairness. Because of their partly 'fixed cost' nature compliance costs have generally been found to be regressive and hence relatively much more important for small than for large traders (Sandford 1995). Such costs are often significant in developing countries and constitute yet another barrier to the 'formalization' of economic activity (Coolidge & Ilic 2009).

Manage IT properly

Tax administration is not so much about money as information. A good tax administration has to gather and utilise information in such a way as to collect the revenues set out in the law in the fairest and most efficient way possible. It is not surprising that recent attempts to improve tax administration in developing countries have centred to a considerable extent on the adoption of new

information technology' (IT). Indeed, it is difficult to conceive of a modern tax administration that can perform its tasks efficiently without making considerable use of IT. All too often, however, the expectation of greater effectiveness from adopting new technology has either not materialised or has proven to be a much more time-consuming and costly process than originally envisaged (Bird & Zolt 2008). Successful reform requires not simply 'computerising' existing forms and procedures but rather rethinking, redesigning and streamlining systems and procedures—for example, to eliminate unnecessary and unused information required from taxpayers. The successful introduction and use of IT thus requires fundamental reorganisation in both systems and procedures. And since process change inevitably changes what people do, technological improvement usually requires major (and often difficult) negotiations with present staff as well as changes in recruitment, training, and evaluation procedures. Even the best IT system will not produce useful results unless there are real incentives for officials to utilise it properly.

Keep your eye on the ball

Simplifying the procedures involved in being taxed is always a popular cause. Taxpayers are frequently irritated by the complexity of tax forms and the varied requirements for record-keeping and documentary support. Of course, forms and procedures reflect the underlying legislation and that legislation is often not simple. The world is complex, and so must the tax system be to a considerable extent. However, not everyone needs to be confronted with its full complexity. While there is obviously need for information essential to determine tax liability, tax forms in many countries are often cluttered with items which are not relevant for most taxpayers. Careful review of existing forms can help identify such items, eliminate them in the interest of simplicity, or at least confine them to separate schedules for those few for whom they are relevant. In many countries, tax forms require so much information that it is hard to imagine what conceivable gain can justify imposing such complexity and compliance costs on taxpayers. Often, such information, even if supplied by taxpayers, is put to no good use. In some countries, taxpayers do not even bother to fill out forms because they know that in the end their tax liabilities will be negotiated in any case. Nonetheless, tax forms (often web-based these days) are the critical interface between the tax system and the public. Good initial design, as well as obtaining and utilising feedback for improvement, is an important element in a good revenue system.

In some countries, the tax system is sometimes used as an instrument for detailed policy intervention. In part for this reason, tax laws change often, and provisions favouring narrow industry interest groups to achieve some very specific policy goal are not uncommon. Substantial and frequent changes in tax rules cause many problems. Ideally, the tax structure should, so far as possible, be a fixed parameter that entrepreneurs can factor into their business decisions and discretionary interventionism should be held to a minimum. The development of the tax system and that of the private sector are mutually interdependent processes. The structure of the tax system must not only be adapted to the reality of economic activity but it must as much as possible be stabilised and made transparent if its full benefits are to be realised. Both tax officials and taxpayers must be able to know with a high degree of certainty what the law is and how it will be applied.

From an administrative point of view, most revenue comes from a relatively few tax collecting agents, customs administration (VAT and excises on imports, import surcharges, and tariffs), social security agencies (social security contributions and personal income tax (PIT) on transfers), government itself (PIT withholding on wages), state enterprises (PIT withholding, VAT, excises, and corporate or enterprise income taxes (CIT), larger private enterprises, especially those in the financial sector (as for state enterprises, plus taxes on dividends and interest). Accurate tracking of these fiscal flows, which probably account for 80 per cent or more of current collections in many countries, and keeping these payments current is critical to successful tax administration.

Reliable Tax Identification Numbers (TINs) are essential if the reach of the tax system is to be extended in developing countries from the existing central core of large taxpayers into the remainder of the potential tax base. Before devoting much effort to this difficult task, however, it is critical to ensure that tight control is maintained over the payments and liabilities of large taxpayers, for example, by setting up a large taxpayer unit (LTU) and monitoring closely the non-filing, stop-filing, and compliance behaviour of such taxpayers (Baer, Benon & Toro 2002). Once this is done, attention can be turned to the TIN problem. Even then, however, there is no need for everybody and everything to be numbered. Bringing in potential new taxpayers is, of course, easier when all tax data is accessible in computerised form, and a unique TIN is required on various documents. But it can be a serious mistake to wait for that day to come before beginning to develop effective auditing practices on the basis of what already exists.³³

Dealing with non-compliance

The basic tasks of tax administration consist of three distinct (though connected) activities—identification, assessment, and collection. Tax administrations must also ensure that third parties required by law to report transactions or withhold taxes do not default in their obligations. The primary function of tax administration is to monitor compliance and to apply the sanctions prescribed in the statute against offenders. Even with the best of organisation and effort, no tax agency can detect all offenders. Hence, a major plank in the strategy of tax enforcement is to devise methods to prevent (or at least minimise) non-compliance at all of these stages. Among such methods are two proven strategies mentioned earlier - utilizing IT and other tools to develop effective risk management strategies and utilizing withholding as much as possible - combined with two older standbys - auditing (sharpened and made more effective by good IT utilization) and effective and well-designed sanctions.

CONCLUSION

The prevalent attitude in the tax administration in many developing countries appears to be that all taxpayers are potential criminals and that subjecting them to taxation is fundamentally a matter of identifying and controlling them and catching those who cheat. No modern tax system can function on fear alone.

³³ There is a huge literature on auditing; a useful brief starting point is Biber (2010, 2010a).

Problems of tax enforcement cannot be solved simply by calling in the ‘tax police.’ On the contrary, there is often much to be gained from viewing taxpayers more as clients than as would-be criminals. A taxpayer service perspective would emphasise on reducing taxpayer uncertainty by clarifying some of the present legal ambiguities (for example, with respect to the treatment of cross-border services), communicating clearly what the law is, and sticking to it instead of changing it every year (or every month) and leaving people uncertain as to just what the law is, and taking compliance costs more clearly into account in designing legal and administrative procedures. Services to taxpayers that facilitate reporting, filing and paying taxes may sometimes be a more cost-effective method of securing compliance than measures designed to counter non-compliance, although little research seems yet to have been done on such matters.

The job of establishing an environment in which citizens are induced to comply with tax laws is obviously difficult in countries with large informal sectors, poor salary structures for public servants, ineffective and uncertain legal systems, and an entrenched distrust of government - often somewhat paradoxically combined with a habit of excessive dependence on that same government. The key to success lies in evolving a strategy that best utilises the available resources to minimise the scope for non-compliance and to maximise the likelihood of detection and punishment of non-compliance, while simultaneously providing facilities and incentives for compliance at each stage of the compliance process. But no single formula can apply everywhere: each country must evolve its own strategy, depending on its own circumstances and background.

The new availability of detailed information on tax administration in a number of countries and of (at least roughly) comparative information across an increasing range of countries offers researchers new opportunities and policy-advisers a better chance than they previously had to design reform strategies based on solid evidence rather than anecdote and inevitably limited personal experience. Those who have worked in this field in the past may perhaps have some wise advice to pass on - “the owl of Minerva spreads its wings only at dusk” as Hegel put it - when they consider the rich new data bases becoming available to researchers today they can only agree with Wordsworth that “bliss was it at that dawn to be alive, but to be young was very heaven!”

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