JOTA
Journal of Tax Administration

Volume 5, Issue 2   **August 2019**

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ABOUT THE JOURNAL

The Journal of Tax Administration (JOTA) is a peer-reviewed, open access journal concerned with all aspects of tax administration. Initiated in 2014, it is a joint venture between the University of Exeter and the Chartered Institute of Taxation (CIOT).

JOTA provides an interdisciplinary forum for research on all aspects of tax administration. Research in this area is currently widely dispersed across a range of outlets, making it difficult to keep abreast of. Tax administration can also be approached from a variety of perspectives including, but not limited to, accounting, economics, psychology, sociology and law. JOTA seeks to bring together these disparate perspectives within a single source to engender more nuanced debate about this significant aspect of socio-economic relations. Submissions are welcome from both researchers and practitioners on tax compliance, tax authority organisation and functioning, comparative tax administration and global developments.

The editorial team welcomes a wide variety of methodological approaches, including analytical modelling, archival, experimental, survey, qualitative and descriptive approaches. Submitted papers are subjected to a rigorous blind peer review process.

SUBMISSION OF PAPERS

In preparing papers for submission to the journal, authors are requested to bear in mind the diverse readership, which includes academics from a wide range of disciplinary backgrounds, tax policymakers and administrators, and tax practitioners. Technical and methodological discussion should be tailored accordingly and lengthy mathematical derivations, if any, should be located in appendices.

MESSAGE FROM THE CHARTERED INSITUTE OF TAXATION

The Chartered Institute of Taxation is an education charity with a remit to advance public education in, and the promotion of, the study of the administration and practice of taxation. Although we are best known for the professional examinations for our members, we have also supported the academic study of taxation for many years and are pleased to widen that support with our involvement with this journal.

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The Journal of Tax Administration website can be found here: www.jota.website

SOCIAL MEDIA

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EDITORIAL NOTE

We are pleased to present the second issue of the Journal of Tax Administration for 2019. As with previous issues, this contains a geographically dispersed and diverse set of papers. We are grateful to all contributors to this issue, both authors and reviewers.

In this issue, we present four research articles. The first, by Jelte Verberne and Rex Arendsen, provides us with a more nuanced understanding of the informal sector in Uganda, with particular reference to tax morale, and using socio-legal, qualitative, research techniques. The research entails studying small businesses in their daily practices, without undue concern with formal definitions, such as formal/informal or registered/unregistered, and paying close attention to the context. In the second article, Daisy Ogembo takes us to Kenya, where she describes her research into a specific group of hard-to-tax professionals. The author studies dentists and lawyers in Kenya using qualitative interviews and considers the potential for the application of presumptive taxation to this group, given that professional income is usually excluded from presumptive tax regimes. The findings suggest that professionals fail to comply as a result of peer influence, low financial and tax literacy, and damaged political legitimacy of the tax authority. The author recommends that policymakers focus on increasing simplicity and reducing compliance costs, rather than trying to achieve maximum levels of equity.

The third research article in this issue is by Darius Fatemi and John Hasseldine, and deals with framing effects and whether the framing of individual aspects of a tax system influences overall sentiment towards that system. In particular, the authors study taxpayers' preferences in respect of the income tax system, and how these affect voting intentions in relation to a political candidate wanting to maintain the status quo. The findings have relevance to research on behavioural nudges and the research opens the way for additional studies of taxpayers' perceptions of the income tax system, which has been shown to be related to tax compliance. The final research article in this issue is by Abera Aynekulu Abate and reports on a survey conducted among small business taxpayers in Ethiopia's Bahir Dah city district in respect of presumptive tax. This paper adds to the growing number of survey-based papers published by African researchers, who draw on prior studies in both developing and developed countries to try to understand the determinants of, and attitudes towards, tax compliance. Ethiopia uses presumptive taxation as a mechanism for micro-businesses to transition to the standard regime, but dissatisfaction with the administration has led to businesses closing in protest.

The 'Commentaries' section in this issue contains three contributions, each of which provides a rich account of developments in a different jurisdiction. The first, by Iqtiaruddin Md. Mamun, looks at VAT in Bangladesh, particularly long-awaited changes designed to reduce the presumptive elements within the tax system, the legislation for which was passed in 2012, but was not implemented until 2019. The author argues that these changes reduce the opportunities for, and incidence of, tax evasion in respect of VAT, and bring the Bangladeshi system closer to its modern counterparts. The second, by Khaled Senator, reminds us of the possible ways in which tax authority operations can be organised, and reflects on recent developments in the structure of the tax administration in Algeria, evaluating them against recognised best practice. The shift from the old way of organising responsibilities between different parts of the administration to new, more modern, practices threw up several problems, the most serious of which was the dilution of the previously clear separation between the functions of assessment and collection. The third comment paper, by Abdinasir Abdullahi Mohamud and Najibullah Nor Isak, describes recent efforts to build revenue-raising capacity in Somalia. The authors

describe the background challenges faced by the Federal Government of Somalia and the measures taken to improve tax collection.

The issue of presumptive taxation looms large in four of these contributions, and it is refreshing to see systems in practice being probed to assess their efficacy and suggestions for policy reform being made.

In addition, this issue of the journal includes a review of some recently published academic literature, which has been compiled by members of the Tax Administration Research Centre (TARC) at the University of Exeter, as well as John D'Attoma's review of 'Tax and Trust: Institutions, Interactions and Instruments', a book edited by Sjoerd Goslinga, Lisette van der Hel-van Dijk, Peter Mascini and Albert van Steenbergen.

We hope you find the contributions interesting and inspiring.

Lynne Oats & Nigar Hashimzade (Managing Editors)

TAXATION AND THE INFORMAL BUSINESS SECTOR IN UGANDA: AN EXPLORATORY SOCIO-LEGAL STUDY

Jelte Verberne[1], Rex Arendsen[2],[3]

Abstract

Sustainable taxation could build the capacity of governments in the Global South, contributing to the realization of the 2030 Sustainable Development Goals. A major challenge for countries in Sub-Saharan Africa today is the growing informal sector. Taxing the informal sector could support domestic revenue mobilization and build a wide tax base. However, because of the nature, size, and location of informal businesses, this sector is known to be hard-to-tax. This study intends to gather a bottom-up understanding of taxation in the informal sector, and tax morale among small and medium-sized enterprises (SMEs) in Kampala, Uganda. It shows how socio-legal research can contribute to the study of tax and development. We use data from a two-month qualitative fieldwork study to examine the social fabric within which these businesses operate. The results show that there is very low tax morale among SMEs in Kampala. Tax compliance attitudes are influenced by issues relating to their trust, knowledge of the tax regime, perspectives on public goods and service delivery, and ideas about fairness, as well as the power of the authorities to enforce compliance. The presumptive tax system in place is not capable of being aligned with the structure of the informal sector. We argue that it is important that the development of the informal economy and taxation go hand in hand, thereby building the capacity of society to pay taxes, rather than the capacity of the state to enforce taxation.

Keywords: Taxation, Socio-Legal Research, Informal Sector, SMEs, Uganda.

1. INTRODUCTION

The 2030 Sustainable Development Goals (SDGs) seek to "end poverty, protect the planet and ensure prosperity for all". Sustainable taxation could contribute to the achievement of these goals. SDG 17 aims to revitalize global partnerships for sustainable development and encourages the international community to "strengthen domestic resource mobilization, including through international support to developing countries, to improve domestic capacity for tax and other revenue collection" (United Nations, 2015). International organizations such as the International Monetary Fund (IMF) and the World Bank, and national tax authorities, collaborate with governments and tax authorities in the Global South to strengthen national and local tax systems, with the aim of increasing the total tax revenue generated (Platform for Collaboration on Tax, 2018). This often involves taking a top-down, macroeconomic approach.

The Base Erosion and Profit Shifting (BEPS) initiative is an example of such an approach (Valderrama, 2018).

Countries in Sub-Saharan Africa generally have large and growing informal sectors. This is also the case in Uganda, where the informal sector covers more than 50 percent of the GDP. A substantial part of this sector consists of small and medium-sized enterprises (SMEs), which are inherently hard to tax because of their size and location, and the nature of their business. Efficient taxation of this sector could help to build the capacity of the state. But how do you target a hard-to-tax segment of the economy, such as SMEs in the informal sector? How can you effectively formalize these businesses? Indirect taxes have become important sources of revenue in many Sub-Saharan African countries, including Uganda. However, these SMEs operate below the VAT threshold. Direct taxes are also problematic because of high administrative costs on the side of the authorities and high compliance costs for the taxpayers. In order to target SMEs, the Uganda Revenue Authority (URA), like authorities in other countries in Sub-Saharan Africa, has a presumptive tax regime in place. In theory, this small business tax enables the URA to tax SMEs, and keep the costs for both the administration and the taxpayers as low as possible. However, returns have been low ever since the initiation of the tax.

Taxation plays a major role in building the capacity of the state and is an important factor determining state-society relations (Tilly, 2009). However, there is no agreement as to whether taxation contributes to state-building in the Global South (I. W. Martin & Prasad, 2014). To understand how the informal sector in this specific context can be effectively taxed, it is important to understand which factors influence tax morale among SMEs. These are found in the fabric of the society within which most informal businesses operate, under the radar of government authorities. Socio-legal research helps us to gain a better understanding of these businesses and the *social fabric* within which they operate.

This study aims to gather a *bottom-up understanding* of taxation in the informal sector and tax morale among small and medium-sized enterprises in Kampala, Uganda. It shows that it is important for the development of the informal economy and taxation to go hand in hand, thereby building the capacity of society to pay taxes, rather than the capacity of the state to enforce taxation, as well as improving long-term compliance and tax morale. The main question posed in this study is: *What is the role of taxation in the development of the informal sector, specifically among SMEs in Kampala, Uganda?* To answer this question, we take a look at the daily practices of SMEs with respect to taxation in Kampala. In addition, we explore the factors that influence their willingness and ability to pay taxes. This will allow us to elaborate on the implications that this has for the effectiveness of the governmental strategy to tax the informal sector in Kampala.

This paper proceeds as follows. In the next section, we develop the theoretical foundation of this study, starting by taking a closer look at the informal sector, and providing an explanation of what small and medium-sized enterprises are within the context of this research. We conclude the theoretical part of this study with a section on the role played by tax morale in the Global South. Section 3 considers the methodology of the research. What is the socio-legal method? How does it fit within the context of taxation and development? How did we use these methods in this study? In the fourth section, we present the results of the research. How is the small business tax implemented in Uganda? How is doing business in Kampala influenced by taxation? In Section 5, we discuss the implications of our findings and formulate an alternative

development strategy toward taxation of the informal sector. We conclude the paper by answering the research question and formulating new questions to be answered.

2. THEORY

To understand how taxation influences the development of small and medium-sized enterprises in the informal sector, it is important to explore a couple of concepts and theories surrounding the following issues: the informal sector, small and medium-sized enterprises, and tax morale in the Global South.

2.1 The Informal Sector

The informal economy or sector is a contested concept. When first used, it referred to employment outside of the formal labor market (Hart, 1973). These days, the concept most often refers to the legal status of a business, indicating whether a business is registered with government institutions and complies with government legislation (Gërxhani, 2004; Kenyon, 2007; Joshi, Prichard, & Heady, 2014). Following this institutional perspective, a small or medium-sized business is defined as formal or informal depending on whether or not it is on the radar of the state. The formal/informal duality is instrumental for government authorities. It classifies which businesses are paying taxes and which are not. Subsequently, policies are created and implemented to target those who are not paying taxes and these, if successful, increase tax compliance and tax revenue. This can be described as taking a top-down approach to the taxation of the informal sector. However, in practice, the difference between formal and informal is more complex.

Joshi et al. (2014) provide a comprehensive explanation of what it means when a business is part of the informal sector. They state that enterprises are in the informal sector because "they contravene – or are not subject to – some of a variety of rules and regulations, including labor laws, environmental laws, registration, and taxation". They emphasize that, in practice, the duality of formal and informal businesses does not exist. It is more like a continuum ranging from an informal subsistence economy to completely formal enterprises (see Appendix A). According to Joshi et al. (2014), an enterprise might, for example, escape national taxation, but will then often be burdened by several types of fee, charge, or licensing cost imposed on it by local government authorities. In addition, informal and formal businesses are often linked in their economic activities. Even within a state, the distinction between formal and informal is problematic, because the determinants of informality differ amongst government institutions. For example, the tax authority might define informality based on whether or not an SME is paying (the right) taxes. For a municipality, however, the definition might depend on whether or not this same business has a (or the correct) trading license.

The result of this is that, in practice, it is difficult to establish whether or not an SME is (more) formal or informal. Therefore, instead of categorizing SMEs as either formal or informal, we adopt a description of these businesses formulated by Joshi et al. (2014). They explain that these businesses "generate enough income to warrant taxation but find it easy to escape the attention of the tax administration or to conceal a substantial part of their tax liability, because of their location, size, and/or nature of their businesses." This perspective on SMEs in Sub-Saharan African countries, such as Uganda, is useful because it is not subject to institutional dualities, such as formal/informal or registered/non-registered, and is therefore more closely related to the daily practices of these businesses. In the following part of this section, we elaborate on the characteristics of the small and medium-sized enterprises.

2.2 Small and Medium-Sized Enterprises

How can we define small and medium-sized enterprises in the context of the informal sector? What are the main characteristics of these businesses? There is not one universal definition of a small or medium-sized enterprise; it really depends on the economic structure of a country.[4] For this study, we use the characteristics of small businesses and SMEs mentioned in the informal economy continuum (Appendix A, columns B & C), to illustrate the main features of the businesses examined in this study.

The people owning small and medium-sized enterprises are often non-poor, well-educated and skilled. They are mainly manufacturers or service providers, and the markets they work within are often highly competitive. The main challenges they face include gaining access to capital and insurance (personal and business). SMEs are liable to pay taxes, but they underreport earnings, use loopholes, and often escape formal tax assessments. If they have employees, these are commonly unregistered. Cash transactions are common among all small and medium-sized enterprises and they are often difficult to assess because of poor or non-existent recordkeeping (Appendix A; Joshi et al., 2014). In several countries in Sub-Saharan Africa, including Uganda, these businesses' earnings are typically below the VAT threshold and the companies fall within a presumptive/small business tax regime aimed at further formalization. Smaller businesses that are also part of the presumptive tax regime generally have owners who are poorer but still reasonably well-educated and skilled. For these businesses, gaining access to capital is an even bigger challenge.

2.3 Studying Compliance and Tax Morale in the Global South

The literature on tax morale and tax compliance in the Global South is growing but still relatively small. Many of the studies on tax behavior in the Global South build on Kirchler's (2007) work, "The Economic Psychology of Tax Behaviour". Kirchler, Hoelzl, and Wahl (2008) argue that power and trust are important determinants of tax compliance. According to them, tax compliance can be improved by increasing power and/or trust. Increasing the former will result in enforced compliance and the latter in voluntary compliance. Kirchler et al. (2008) demonstrate that tax authorities in the Global South often show little trust in taxpayers and seem to believe that deterrent actions can solve all problems related to tax compliance. Therefore, tax environments in the Global South often feature so-called "cops and robbers" relationships between taxpayers and the tax authority. Gobena and Van Dijke (2015) also look at power and trust in their analysis of tax compliance among Ethiopian business owners. Regarding tax morale, Asaminew (2010) argues that, in Sub-Saharan African countries, paying taxes is not seen as contributing to public goods. He states that is seen instead as a burden imposed by government.

Abdul-Razak and Adafula (2013) look at taxpayers' attitudes and their influence on tax compliance decisions among SMEs in Tamale, Ghana. They found that "the burden of taxes

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[4] The Ugandan Investment Authority (UIA) uses the following categories. A "*micro enterprise*" is an enterprise employing up to four people, with an annual sales/revenue turnover or total assets not exceeding 10,000,000 Ugandan Shillings. "*Small enterprises*" employ between 5 and 49 people, and have total assets of between 10,000,000 and 100,000,000 Ugandan Shillings; A "*medium enterprise*" employs between 50 and 100 people, and has total assets of more than 100,000,000 but not exceeding 360,000,000 Ugandan Shillings. Information derived from the UIA's website: http://www.ugandainvest.go.ug/sme/. We do not use these categories because they come from an institutional perspective rather than an analytical perspective. Therefore, we use the characteristics described in the informal economy continuum (Joshi et al., 2014).

paid affects the attitudes of individuals and this informs how they evaluate the tax system and consequently their compliance decisions". Interestingly, in this study, factors such as accountability and transparency did not significantly impact taxpayers' attitudes. This trust in government could be explained by the high perceived level of benefits derived from the provision of public goods and services. Still, individuals did not clearly understand the tax laws and the researchers found a positive relationship between levels of understanding and tax compliance decisions. Other interesting examples of research into compliance or tax morale include Vadde and Gundarapu's (2012) study, which investigated factors influencing compliance amongst rental income taxpayers in Mekelle City, Ethiopia. Smulders and Naidoo (2013) address the burdens of tax compliance for small businesses in South Africa and conclude that the revenue authority plays a key role in educating small business owners about the tax system.

In order to enhance tax compliance in the Global South, it is important to understand the determinants of tax morale. In previous decades, the authors of several studies have used large-scale, cross-country, quantitative research methods to discover which factors might explain low or high levels of tax morale (Torgler, 2005; Ali, Fjeldstad, & Sjursen, 2013). International surveys, such as the World Values Survey, Latinobarometer or Afrobarometer, are combined with other data in order to find the determinants of tax morale. The results show that a wide range of concepts influence tax morale in the Global South, including trust in government, accountability, public goods and services, efficient and transparent legal structures, support for democratic governance, gender, age, education, and religion. Experience with paying taxes is also an important determinant of tax morale (L. Martin, 2014).

Tax morale concerns an intrinsic motivation and is therefore also linked to local context and cultural values. Cross-societal experiments and data on corruption, tax evasion and fraudulent politics show that weak institutions and cultural legacies, which generate rule violations, might impair individual intrinsic honesty (Gächter & Schluz, 2016). However, it is important to understand that this could be related to the fact that different cultural values and meanings shape different ideas about intrinsic honesty. Different cultural values and meanings might also explain different shapes and levels of tax morale.

3. METHODOLOGY

In order to understand how the informal sector relates to taxation, it is important to study the social fabric of the society from which these businesses emerge. A relatively new movement in the study of tax law takes an interesting approach toward the relationships between taxation, inequality and development. We refer to New Fiscal Sociology, which developed over the past two decades, and which builds upon the work of economist Joseph Schumpeter (1883-1950), who argued that public finance was the key to understanding the development of modern societies (I. W. Martin, Mehrotra, & Prasad, 2009; I. W. Martin & Prasad, 2014). This movement is built on the study of tax law with insights from political sciences and sociology (Mann, 1943). It provides interesting insights into the development of taxation and state-building in the Global South. Kiser and Sacks (2009) state that centralized bureaucracies are not expected to work well within the context of contemporary African states, mainly due to their limited monitoring capability. Based on their historical comparative study, they recommend decentralizing and privatizing the tax administrations in African states further.

Socio-legal research is closely related to the New Fiscal Sociology's research perspective and approach; both focus on "law in action" rather than "law in the books". In this section, we

elaborate on the methods used in this study. First, we explain what socio-legal research with respect to taxation and development entails. In the second part, the focus is on the socio-legal methods used in this research.

3.1 Socio-Legal Research into Taxation and Development

Studying taxation and development in the Global South requires a multi-level and interdisciplinary approach. Taxation is connected to both local, national and global issues, and involves challenges that raise governance, legal, and social-scientific questions. The increased international interest in taxation as a solution for domestic resource mobilization and development requires us to take a closer look at the social functioning of legal systems that are created and changed in order to increase tax revenue. We need to study taxpayers and tax authorities, and behavior and governance, both analyzing current situations and looking for possible sustainable alternatives.

The roots of the socio-legal approach are found in legal anthropology. In his landmark fieldwork study, one of its pioneers, Bronislaw Malinowski (1926/2002), concluded that all societies have some form of law or other mechanism by which to maintain social order. In today's society, tax law is a tool for maintaining order through fiscal efforts, ensuring stability in revenue collection for the state, something which is crucial for its functioning. Taxation becomes an instrument of governance rather than a natural part of society (Mann, 1943); a fiscal instrument that is used to increase the control of the state. In the context of this research, tax law in Uganda attempts to formalize SMEs and thereby bring order to this sector.

The socio-legal approach can be used to study the social functioning of legal systems because it looks beyond the institutional perspective. Instead of revealing what *should be* or *could be* happening, the socio-legal approach helps us to understand what is actually *going on* in practice. It is analytical rather than instrumental. It looks at law in action rather than law in the books – or, in the case of this study, tax law in action. In this way, it differs from the top-down legal comparative studies mentioned in the theoretical part of this paper. Using qualitative research methods helps us to gain in-depth understanding rather than enabling us to produce a quantitative analysis. Taking a socio-legal approach can help us to understand the dynamics of the relationships between state and society, and the fabric of society, from the bottom up.

3.2 Methods

The main research population of this study consists of people working at or owning SMEs in Kampala Central Division, an economic hotspot in the city. In Section 2.2, we illustrated the main characteristics of these businesses. Besides SMEs in Kampala, the Uganda Revenue Authority and Kampala Capital City Authority (KCCA) also play important roles in this research.

The data for this study was collected in May and June 2017, during fieldwork carried out in Kampala using qualitative research methods. The main method used was the qualitative, unstructured interview. This study is based on 20 in-depth interviews, of which 15 were with SMEs and 5 with URA, KCCA, and non-governmental organization (NGO) staff working on taxation, as well as dozens of informal conversations. Other important methods used included "Being There" and participatory observation. "Being There" helps researchers to establish contact with the research population and builds a relationship of trust. It is a way of collecting data outside of formal meetings with respondents. Participatory observation is described by

DeWalt and DeWalt (2011) as taking "part in the daily activities, rituals, interactions, and events of a group of people as one of the means of learning the explicit and tacit aspects of their life routines and their culture". This is an excellent socio-legal method as it helps us to understand the differences between the official story and how things work out in practice, i.e. reveals the differences between what should be and how things actually are.

The internal validity of this research is threatened mainly by the fact that people are generally reluctant to talk about their unwanted behaviors or non-compliance. That is why this study examines attitudes rather than actual (non-)compliance. Looking at perceptions and attitudes instead of actual non-compliance helps us to understand behavior related to tax compliance. Research from social psychology states that attitudes have a strong influence on behavior (Ajzen & Fishbein, 1977). We aimed to use a diverse sample in terms of gender, location, and trade. The use of a local research assistant to find respondents significantly lowered the threshold for participation in this research.

4. RESULTS

In this section, we present the results of the research. The first part looks at the tax regime. We then explore the daily practice of business and taxation in Kampala. In the concluding part of this section, we summarize some of the main characteristics of SMEs and taxation in Kampala.

4.1 The Tax Regime in Kampala

SMEs in Kampala are affected by several types of fee and tax. Direct taxes include the national income tax and trading licenses. Indirect taxes, such as import and excise duties, and the Value Added Tax (VAT), also impact these SMEs. Payments for services such as the collection of garbage and the supply of water or electricity are often perceived as taxation but are, by definition, a retribution. In the following paragraphs, we discuss these taxes and the authorities responsible for collecting this revenue.

Taxes Related to SMEs in Kampala

We start with the *trading license*. It is obligatory for anyone in Uganda who wants to run a business to have one. In Kampala, this policy is implemented by the Kampala Capital City Authority (KCCA) under the mandate of the Ministry of Trade and Industry. The KCCA is responsible for implementing the local tax regime within its administrative boundaries. Some of the KCCA's main revenue responsibilities include issuing trading licenses, and collecting property tax, the local service tax, hotel tax, and market fees (Government of Uganda [GoU], 2010). The trading license is required for all businesses, including service companies. The license has to be renewed each year, something which can be done at any KCCA division council, or at a so-called "one-stop shop". The KCCA uses a system called COIN (City Operator Identification Number) to identify individual enterprises. The amount that has to be paid to receive the license depends on the location and nature of the business. Locations in the city are divided into four categories and the nature of the business is classified using a list of more than a hundred business types.[5] The size of the business or annual turnover is not relevant.

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[5] The costs or rates for the KCCA trading licence can be found on the KCCA website: https://www.kcca.go.ug/?jsp=trading_licence_rates.

The national income tax Act includes a so-called "small business tax" for SMEs. The small business tax is collected by the URA and consists of two parts. The first part covers businesses with turnovers of between 50 and 150 million Ugandan Shillings. The second part concerns a presumptive tax for businesses with turnovers of between 10 and 50 million Ugandan Shillings a year. The focus of this research is on businesses which fall under this second part of the small business tax. The amount payable in respect of this presumptive tax is determined by the location, nature, and turnover of the business. This makes it much more complicated to assess what a business is liable to pay, compared to the process of issuing trading licenses by the KCCA. In Appendix B, we provided an overview of the schedule determining the rate of this tax. The small business tax has a significant compliance gap. It was initiated about two decades ago and changed several times, but never raised more than about 4 billion Ugandan Shillings (about €900,000). This is next to nothing when compared to the total revenue of about 13 trillion Ugandan Shillings (about €2.9 billion) collected in the 2015/16 fiscal year (1/7 until 30/6). In 2015/16, the URA estimated the potential revenue from the small business tax to be about 83 billion Ugandan Shillings, of which 24 billion could be raised in Kampala alone (Nanziri, Atukunda, & Lumal, 2016).

SMEs are not able or obliged to pay Value Added Tax (VAT). The threshold to register is an annual turnover of 150,000,000 Ugandan Shillings. As these SMEs are within the presumptive tax regime, with annual turnovers below 50,000,000 Ugandan Shillings, they do not have to and cannot register for VAT. Most SMEs do not import goods themselves, so they do not directly pay customs or import duties. They buy their goods from (other) wholesalers in town. However, the prices of goods are affected by these duties. Garbage collection and other services are provided by governmental and non-governmental institutions. Some business owners perceive paying for these services as paying taxes. VAT does influence the costs of services. For example, water and electricity are rated at 18%.

The URA, KCCA and Taxpayer Register Expansion Program

As mentioned above, the URA and the KCCA are responsible for revenue collection in Kampala. The URA is the oldest semi-autonomous revenue authority in Sub-Saharan Africa after Ghana's (Kiser & Sacks, 2009). It is partially privatized, legally separated from the state, and can own its own assets, but is financed by parliamentary appropriation. How are the URA and KCCA involved in ensuring compliance in this sector? What measures do the URA and KCCA take to decrease compliance costs? To what extent are the URA and KCCA successful in moving SMEs from the informal sector to the formal sector? We answer these questions by illustrating some recent developments in the policy and practice of these organizations, which aimed to increase tax compliance through the Taxpayer Register Expansion Program (TREP). In this program, the URA and KCCA work together with Uganda Registration Services Bureau (URSB).

The aim of TREP is to increase taxpayer registration, which is the first step toward increasing tax compliance. TREP started about four years ago, and has been evaluated and expanded each year. Several "one-stop shops" were opened across Kampala. A business can handle all of its URA, KCCA, and URSB formalities at a one-stop shop. A business has to go through three stages at a one-stop shop. First, it needs to register for, or verify that it has, a business registration number with the URSB officer. Second, it should apply for, or verify that it has, a Tax Identification Number (TIN) with the URA official. In addition, payment has to be made for any outstanding taxes, such as the presumptive income tax. Finally, with a verified business registration number and TIN, the business owner can apply for a trading license from the

KCCA official. In practice, businesses often go to the KCCA official first, because it is the trading license for which most businesses come to the one-stop shop. This is related to the fact that the KCCA has the greatest capacity to enforce compliance.

Collaboration between the different institutions in TREP increases each year. In theory, this makes it increasingly difficult for SMEs to evade or under declare taxes. Different governmental systems are integrated, enhancing the amount of information that they have about these businesses. It is, however, the disintegration of different governmental systems which allows SMEs to, for example, pay local government fees but escape national taxation. It might be easy for businesses to stay under the radar of the URA. However, it is more difficult to avoid local government enforcement. This is because the KCCA has more capacity for enforcement than the URA; the KCCA physically checks for licenses throughout the city several times a year.

The KCCA, URA and URSB's definitions of an "informal business" differ. For example, for the URA, a business could be informal because it has no TIN, regardless of whether or not it has a trading license or a business registration number. For the KCCA, a business could be informal if it has no trading license, regardless of whether or not it has a TIN or a business registration number. Finally, for the URSB, a business could be informal if it has no registration number, regardless of whether or not it has a TIN or a trading license. This shows how the formal/informal duality facilitates the different goals of government institutions. By means of a program such as TREP, governmental systems become more and more integrated, as does the governmental definition of the "informal sector".

The URA and the KCCA attempt to decrease compliance costs by implementing simplified tax laws that are easier to understand, as well as by making use of technological developments to reduce the amount of money and time that it takes to comply. Initiatives such as mobile payment aim to further decrease compliance costs. The fact that one still has to go to three different officials is one of the challenges TREP faces today; the different officials are not allowed to access the systems of the other institutions. Even though some businesses complain that they have to visit three desks instead of one, use of a one-stop shop does significantly decrease compliance costs in terms of time.

To what extent are the URA and the KCCA successfully moving SMEs from the informal sector to the formal sector? It seems like the "formalization" of these SMEs by the URA and the KCCA is increasing. TREP introduces these businesses to the tax system. However, TREP has not led to an increase in the amount of revenue collected from SMEs by the URA. The total revenue collected through the URA's small business tax has not significantly increased. The URA collected less than 10% of the target set for the 2016/17 fiscal year. Instead, the URA focuses on collecting other taxes, such as VAT and PAYE, which contribute significantly more to the total revenue collected than the small business tax would be expected to raise even if compliance was at one hundred percent. Still, it will be interesting to see if and how the total revenue collected through this presumptive tax changes over the next couple of years, as TREP is supposed to start paying off.

In the previous paragraphs, we examined the roles of the URA and the KCCA when it comes to revenue collection among SMEs in Kampala. On paper, both organizations aim to follow a "service and client" model of interaction with taxpayers. For example, the culture statement of the URA is: "We are a client focused & responsive organisation [...] to deliver a great client experience in an enjoyable environment". Moreover, the URA organizes a "taxpayer

appreciation day".[6] In practice, the relationships between the tax authority and taxpayers are more like those of "cops and robbers". We elaborate on this in the following paragraph.

4.2 Practice of Business and Taxation in Kampala

In Section 2.2, we distinguished the main characteristics of the small and medium-sized enterprises in this study. In this section, we illustrate what day-to-day business life looks like for SMEs in Kampala. What challenges do they face? We describe how taxation affects these businesses. We demonstrate how businesses go about paying these taxes, if they pay them at all. Furthermore, we elaborate on how the people working at or owning SMEs relate to the taxes imposed on them by the authorities. What influences their tax compliance and tax morale? In the following paragraphs, we describe a number of SMEs operating in various sectors in Kampala. These profiles are created to illustrate the day-to-day business life of SMEs in Kampala. The information comes from several informants and the names used are pseudonyms. We use quotes from interviews, anecdotes, and general observations from data collected during fieldwork.

Day-To-Day Business and Taxation in Kampala

Secondhand clothing is a major business sector in Uganda, especially in Kampala's Central Division. Louisa sells secondhand clothing in her shop, which is close to the biggest secondhand clothing market in Uganda, Owino Market. Her shop is on one of the major routes leading to the market and is, therefore, in a prime location. Rent is expensive; people in that area pay from one million up to three million Ugandan Shillings a month. Therefore, Louisa has two sub-renters to ease the burden of the rent. Apart from some basic information, she does not keep records. Louisa pays the URA 250,000 shillings a year and pays about 200 shillings for her KCCA trading license. Compared to the rent, these costs are affordable for her. Louisa does not really understand where the money from the taxes she pays is going. She does believe that the government should be using tax revenue to build decent infrastructure, and provide affordable education and health care. However, she does not know what the government is really doing with the money. Louisa blames the politicians. According to her, they do whatever they want and not what the citizens want. She is obliged to pay these taxes, but she does not feel like she gets anything in return.

> They are not doing anything. [I do] not know exactly where the money is going. The roads are bad. The filth in the city is quite a lot. If you go to KCC hospitals there are no medicine. The money is not doing anything. [...] Let them build good roads. Let them put drugs in the hospital. Let them clean the city so that the city everywhere is clean.
>
> Louisa, May 2017

Lawrence works as a driver of a "matatu" or Public Service Vehicle (P.S.V). Since the 1990s, when the governmental public transportation system collapsed, the matatu has been the main mode of transportation in Kampala, with Boda Boda (motorcycle taxis) and private vehicles being the next most popular options. Typically, a matatu is a Toyota van which has a line of

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[6] Both the culture statement and details of the "taxpayer appreciation day" can be found on the Uganda Revenue Authority's Facebook page, which is remarkably active: https://www.facebook.com/URApage/. The statement can be found here: URA Culture Statement on Facebook.
.

blue squares painted on the side. Two people work on it: the driver and the conductor. The former is responsible for operating the vehicle, while the latter spots potential passengers on the road and collects the fees. There are dozens of routes along the main roads in Kampala, mainly connecting different residential neighborhoods with Kampala's Central Division (or city center). The vans are quite small, which makes them crowded even when the maximum number of 14 passengers is not exceeded. However, using one is the cheapest way of travelling around Kampala. Lawrence, like most matatu drivers, does not own the vehicle himself. Lawrence has to deduct 80,000 Ugandan Shillings from the 220,000 (about 50 euros) that he makes each day in order to pay the vehicle's owner. On top of that, he pays another 80,000 shillings for fuel. This leaves him with about 60,046 Ugandan Shillings (about 15 euros), which he has to share with his conductor and use to pay for the KCCA license, parking fees, and vehicle maintenance costs.

Lawrence has to sustain himself and his family on about 300,000 Ugandan Shillings each month (about 70 euros). Although he does not earn enough to be liable to pay income tax to the URA, he pays the monthly KCCA transport license fee of 120,000 shillings. Lawrence only completed primary school education, and does not know a lot about tax laws and tax authorities. What he does know is that if you do not pay for the license, they will confiscate your vehicle until you pay. The system used by the KCCA is now digitalized and people can pay with mobile money. According to Lawrence, this has made it almost impossible to evade taxation, because you can go on your mobile phone and check whether you have paid or not. There are some ways to avoid paying, but they mainly involve delaying payment and either keeping away from or bribing KCCA officials. Lawrence particularly complains about the tax on fuel. According to him, he would make more money if these taxes were lower. He believes that he is not able to do many trips because he can only put in a limited amount of fuel each time, as the price is high. Therefore, if the government could lower the tax on fuel, he might make a bit more money. Furthermore, Lawrence considers it unfair that the license fee is a fixed rate for a month. What happens if he falls ill and cannot operate the vehicle? He works almost every day from early morning until late in the evening and, at times, he gets tired and has to find somebody to replace him. However, that means he does not earn anything that day; the person operating the vehicle takes home whatever is left.

> The only thing you can do is to delay. To delay paying. But if they get you. If the KCCA people come here and find out you did not pay they will just impound your vehicle. They impound the vehicle [...] and you pay even a higher fee.
>
> Lawrence, May 2017

Fred works in a bookshop close to Kampala Road. The street is crowded with other bookshops. Trades tend to flock together in certain places of Kampala. Fred is not the only individual operating his business in this shop; four others have their collections of books (mainly educational) which they bought from importers who, in turn, got them from Kenya or Tanzania. Together they operate as one enterprise, which is registered at both the KCCA and the URA. They share the costs of rent, the URA's small business tax, the KCCA trading license, and of services such as garbage collection, water, and electricity. It is not easy for the URA to determine which bracket they fit into because each person keeps his or her own records, some of which are very basic. According to Fred, even if he brings the combined books to the URA, they refuse to look at them, and estimate the turnover of the business based on the size and location of the shop.

> Even if you are starting a new business you have to pay income tax in advance. Before getting a license. [...] They tell you go to URA. Pay URA charges or taxes. [...] You haven't progressed. You haven't earned in a year. But you are paying it in advance. They just ask you: "What are your projected turnover a year? What are you investing? How much money are you having for that business?" I have 5 million. "What is your projected turnover for the year?" Could be 10. And then they calculate and put it in the computer. Everything is programmed. And then gets your bracket. Gets your bracket and then you pay. [...] No one is paying less than 200. So we are really puzzled, we are really tortured. You are paying that money when you haven't earned it.

Fred, June 2017

Fred is quite frustrated about taxation. First of all, he considers it unfair that they have to pay taxes in advance, before he has earned a single shilling. Furthermore, Fred mistrusts the authorities and believes they are corrupt. According to him, some of the money does not even reach the government and is kept by officials. Fred believes taxes are too high and that this is also a reason why people do not pay, or try to evade paying, taxes. If taxes were affordable, people would not try to evade them. Finally, he does not believe that he receives any services in return for the taxes he pays. According to Fred, the government does not provide these services because it simply does not care.

Arcades are mainly found in Kampala's Central Division. An arcade functions a bit like a shopping mall, but with hundreds of small shops. The buildings are designed with the aim of fitting as many shops as possible in on each floor. They tend to have some fairly open spaces and openings in the floors, and this makes them feel a little less claustrophobic. However, these features are probably also practical solutions to the fact that power blackouts are not uncommon. As mentioned previously, specific trades crowd together on certain floors. For example, one might find only phone shops on the ground floor, travel bag traders on the first floor, and hair salons on the second floor. According to several shop owners, they crowd together so that customers know where to go. However, competition is vicious.

Susan trades in travel bags on the first floor of an arcade. She employs two people and does not share the shop. She pays a small business tax of about 150,000 and 250,000 Ugandan Shillings for the KCCA trading license. Rent is expensive in these arcades and is no less than 1,000,000 shillings each month. Her other major costs besides her employees are electricity, water, and garbage collection. Susan's shop definitely turns over more than 20,000,000 shillings each year. However, she is still in the lowest bracket (see Appendix B). It is easy for her to under declare because the URA lacks the capacity to thoroughly assess medium-sized businesses like her shop.

> There is a day that they pass through and ask for receipts. If you don't have it they will tell you: 'please carry your things inside' and they close. If they have not paid they are closed [...] and everybody has to go and pay. [At this moment] there are some that have not yet paid. Because this year they have not yet come. They can come any day. Some pay before they come but then there are those one who pay after they have come.

Susan, June 2017

Susan believes that paying for both a trading license and income tax is double taxation on one activity. However, she has to pay because when you do not pay they close your shop and you will have to go and pay anyway. As she pays taxes herself, she believes other people should also pay taxes. Susan is not sure about what happens to the money they pay.

> I don't know even what the government is using that money [for]. I don't know how it is using that money. I don't know whether it reaches the government. [...] I don't know whether that money goes directly to the government. I am not sure. [...] Because I have never, I have never heard any like minister tell me. Explain for us about that money.
>
> Susan, June 2017

Ibrahim and Isaac are two young boys manufacturing mainly welding and popcorn machines in Katwe, an area known for its unlimited manufacturing capabilities. They dropped out of school to work in the business that was started by Ibrahim's brother. They share their shop with a boy who sells secondhand carpets, and a man who cuts and sells glass and mirrors. Sharing the shop lowers the burden of rent. They also pay for the trading license together. These boys struggle to keep their business going. Sometimes it is hard to pay the rent and it is quite a challenge to gather enough money each year for the trading license. Therefore, Ibrahim and Isaac wait until the KCCA comes knocking on doors and closes down businesses without licenses; only then they will pay. If they are not able to gather enough money, they are forced to move their business and start anew. Ibrahim and Isaac do not pay the URA's small business tax, as URA officials visit this part of town less frequently than other parts. If they come and they can pay, they will pay. If they cannot, they have to move their business elsewhere.

> If you don't have a license, they close your shop. For us. You have to pay. [...] If they don't come, no pay. The problem is money. [...] If you get some money we are paying. If we don't have. We leave.
>
> Ibrahim, June 2017

Ibrahim and Isaac understand what the government uses the money collected through taxation for to some extent. Isaac believes the government is using this money to build roads, schools, and hospitals, but he does not believe that it is doing a very good job.

> The government uses these taxes to pay for services such as roads and keeping the city clean. However, the government is doing a 50/50 job at this. Services should be better.
>
> Isaac, June 2017

4.3 Characteristics of Business and Taxation in Kampala

In the previous paragraph, we presented several profiles of SMEs in Kampala and discussed how these SMEs relate to taxation and the authorities. The results show that how, and the extent to which, taxation influences the day-to-day business of SMEs in Kampala varies. For some, taxes are truly a burden, while for others, the costs of taxation are relatively low, but they find it easy to escape the attention of the authorities, or under declare and avoid paying a substantial part of their taxes. The results indicate that a lot of these businesses are partly formal and partly

informal. For example, a shop might be registered, and its taxes and licenses may all be paid for, but several people may be employed there who are not registered. According to the KCCA, the business might be formal, but not all rules and regulations may be being followed. Another example relates to sub-renting. One person might be renting the shop, and paying all taxes and licenses that need to be paid. However, because rents are high, this person may be sub-letting parts of the small shop to other people. In some cases, groups of people rent a shop and pay for the taxes and licenses together under the name of one enterprise. People in Kampala do not like paying taxes, so often ensure that the location, size, and nature of their businesses is flexible enough for them to be able to decrease the burden of these taxes or evade paying them. SMEs try to adapt to the URA and KCCA's increased efforts to formalize them.

Compliance costs seem to be relatively low because of recent changes to payment methods (URA & KCCA) and the simplified tax regime (URA). People can pay by mobile devices, or can go to any bank to pay for the trading license fee and presumptive income tax. The KCCA trading license fee is relatively difficult to evade when compared to the URA's small business tax. The cost of the KCCA license is fixed and does not depend on the turnover of the business, and the KCCA will go around town to check for licenses several times a year. It is quite difficult for the URA to establish the correct presumptive tax because many of these businesses do not keep (proper) records, while some even keep several sets of records. In addition, the URA lacks the capacity to systematically assess these businesses.

People working at or owning SMEs understand that taxation is necessary for the development of Uganda. However, they do not believe that the taxes they pay are being put to good use. Therefore, they also understand why people would under declare their earnings or evade tax. Their tax compliance and tax morale are influenced by issues related to their trust in the authorities, knowledge of the tax regime, perspectives on public goods and service delivery, ideas about fairness, other social norms and values, and the power of the authorities to enforce compliance. These issues correspond directly with some of the explanations for compliance and tax morale provided by Ali et al. (2013) and Kirchler et al. (2008), which are mentioned in the theoretical section of this paper.

The level of knowledge of the tax system among the people working at or owning SMEs is generally low. It depends on their level of education, but most people do not know a lot about tax laws or the authorities responsible for executing these laws. They know that they have to pay the KCCA or the URA, or their business will be closed down or their property confiscated. Many taxes are perceived as double taxation (for example, paying for the trading license and the presumptive income tax, or paying these taxes and for services such as garbage collection). There is a lot of mistrust toward the tax authorities and the government in general. Tax administrators are often perceived to be corrupt, sometimes collecting taxes twice or at higher rates than people believe they are supposed to. In addition, people do not believe that (all) the money they pay even reaches the government and think that it eventually ends up in some individuals' pockets.

People do know what they would like the government to spend tax revenues on. Almost all respondents mentioned infrastructure, health care and education. People working at or owning SMEs would like to see the money they pay put to good use. However, they believe that politicians just use the money to enrich themselves and their families. This also helps to explain the poor tax culture. People believe that the government should support them in return for the taxes they pay. However, the government is perceived as being corrupt and the conditions of the roads, hospitals, and schools are considered to be poor. However, people do not always see

evasion as an option because their businesses might be closed, or their property confiscated. Interestingly, if people pay taxes, they do believe other people should pay taxes too, even though the money is not being spent appropriately. There is very low tax morale within the sector because the government lacks transparency, accountability, and legitimacy (in other words, good governance).

5. DISCUSSION

The current top-down approach toward the taxation of SMEs in Kampala does not seem to be working. A top-down approach could work if it focused on the creation of a more stable political and economic context, and business environment. However, this is not what is happening. Because the current top-down approach mainly imposes taxes on these businesses and enforces them to comply, the relationships between the tax authorities and taxpayers look a lot like the "cops and robbers" scenario described by Kirchler et al. (2008). The authorities show little trust in the taxpayers and often use deterrent actions to enforce compliance. Taxpayers are perceived as robbers. However, enforcing compliance is difficult because the authorities lack the capacity. As mentioned above, taxpayers also distrust the government. They perceive the administrators to be cops.

Bearing the above in mind, it might be better to take a different approach. Considering that the informal economy resembles the continuum presented in Section 2.1 (Appendix A, Joshi et al. 2014), it could be beneficial to focus on the needs of SMEs and assist them in working toward becoming more formal enterprises. The delivery of services and the construction of trust between the state and the sector could increase voluntary tax compliance, creating a tax culture, safeguarding long-term compliance, and decreasing the administrative costs of ensuring compliance. This different approach should consider the local conditions of doing business and the tax system should respond to that. Furthermore, taxation should have some "added value" for these businesses, so that their willingness to register, file and pay taxes will increase. This could be called taking a *bottom-up approach* toward the taxation of the informal sector. It starts by considering the perspectives and needs of the SMEs. What do they need in order to develop and grow? How can the state facilitate this role of taxation as "a tool of collective education" (Mann, 1943)?

Such a bottom-up approach toward the taxation of SMEs in the informal sector does not focus (just) on building the capacity of state institutions. The focus is rather on: examining the capacity of society and taxpayers to conduct business and administration, and (as a result) pay taxes; looking at the fabric of society; and building grassroots tax morale. In order to develop strategies for taxing the informal sector in Uganda (and other countries within the Global South), it is important to reflect on the following question: what is capacity-building and on what kind of capacity should we focus? This study suggests the focus should be on society rather than on the authorities. It shows what grassroots capacity looks like by zooming in on small and medium-sized enterprises in the informal sector. Regarding the execution of a bottom-up approach, the informal continuum could be used as a tool that provides a "path of development". Some interesting suggestions or focus areas relating to moving these businesses into the formal sector can be found both in this research and the informal economy continuum: (1) knowledge about the tax system and expenditures; (2) legal justice and certainty through protection from harassment and unexpected or arbitrary audits; (3) administrative literacy, i.e., learning how to keep simple records that can be used by citizens to run their businesses, and by the authorities to provide support and ensure each business has a proper and fair assessment.

Considering the fact that the potential financial gains of taxing this sector are relatively low when compared to the total amount of revenue collected in Uganda, it might be worth investing some of the revenue directly back into the sector. The three focus areas formulated above provide possible starting points. The state also benefits because these businesses will be more inclined to pay their taxes when they have grown and become part of the regular tax regime.

Before we move on to the conclusion of this article, we briefly reflect on the socio-legal approach to researching taxation and development. In this study, the socio-legal approach helped us to analyze the complex dynamics between state and society and, more specifically, the relationships between SMEs and the tax authorities. The qualitative research methods used were crucial to gaining a deeper understanding of the fabric of society within which these businesses operate. This focus on trying to gain an in-depth understanding rather than on quantitative analysis provides us with a different and useful approach to the field of taxation and development, thus adding new knowledge and insights to fuel the debate about taxation and development, because "scholars have barely begun to investigate the relationship between tax policy and social development" (I. W. Martin & Prasad, 2014).

6. CONCLUSION

What role does taxation play in the development of the informal sector, specifically among SMEs in Kampala, Uganda? Taxation plays an important role in the development of SMEs in Kampala. It directly influences their day-to-day business. The role played by taxation has become even greater in recent years, as the tax authorities attempt to increase their grip on this sector through administrative programs such as TREP. In this way, taxation is used by the authorities to further formalize this sector. However, the current top-down strategy does not seem to be very effective and results in a "cops and robbers" scenario. Small and medium-sized enterprises now prefer to maneuver in the informal sector, mainly because the formal alternative is neither predictable or uncorrupted, nor generally safe or beneficial.

Taking the mainly informal character of the business sector being targeted into account, employing a bottom-up strategy might be more fruitful. Such a strategy aims at strengthening the conditions which enable sound, productive, and profitable business conduct. The enhancement of knowledge, legal certainty, and administrative literacy will stimulate formal business and (as a side effect) the ability and willingness to pay taxes. In such a strategy, taxation might be more of a means to, rather than the ultimate goal, of development.

As mentioned before, the increased international interest in taxation as a solution for domestic resource mobilization and development requires us to take a closer look at the social functioning of legal systems that are created and changed in order to increase tax revenue. This study introduced a socio-legal approach to the field of taxation and development. Future socio-legal research studies could and should take a more multi-level approach. Researchers taking such an approach could, for example, look at the role of international organizations and collaborations in order to find answers for questions such as: How do global discourses in taxation influence local realities in countries in the Global South? How can international organizations contribute to the sustainable development of domestic resource mobilization in these countries? A new and interesting perspective focuses on the tax officer or the street-level bureaucrat. The tax officer is the point of contact between the government and the taxpayer. He or she has to implement and apply national laws and regulations, which are influenced by global discourses, and local contexts and situations. When it comes to the implementation of a

bottom-up strategy of taxation as suggested in this paper, the role played by the tax officer will be crucial to its success.

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APPENDIX A – THE INFORMAL ECONOMY CONTINUUM

Source: 'Table 1: A typology of enterprise informality' (Joshi et al., 2014)

Table 1. A typology of enterprise informality

Features	Informal economy			Formal economy
	A	B	C	D
	Subsistence enterprises	Micro enterprises and small businesses	Small and medium businesses	Small, medium, and large businesses
Degree of informality	Totally informal	High proportion of sales undeclared and workers not registered	Some proportion of sales undeclared and workers unregistered	Labour and firms registered and regulated
Type of activity	Street traders, cottage/micro enterprises, subsistence farmers	Small manufacturers, service providers, distributors, contractors	Small and medium manufacturers, service providers	Range of manufacturing and services
Technology	Labour intensive	Mostly labour intensive	Mixed labour and capital intensive	Knowledge and capital intensive
Owner profile	Poor, low education, low level of skills	Poor and non-poor, likely educated, skilled	Non-poor, well educated, high levels of skills	Non-poor, highly educated, sophisticated level of skills
Markets	Low barriers to entry, highly competitive, high product homogeneity	Low barriers to entry, highly competitive, some product differentiation	Some barriers to entry, established markets	Significant barriers to entry, established market/ product niche
Finance needs	Working capital	Working capital, some investment capital, supplier credit	Investment capital and working capital, letters of credit, supplier credit	Investment capital and working capital, letters of credit, supplier credit
Other needs	Personal insurance, social protection, security	Personal and business insurance and business support services, security	Personal and business insurance, business development services	Personal and business insurance, business development services
Tax status	Earnings can be below minimum tax threshold, no recordkeeping, cash transactions	Liable for tax, difficult to identify and assess, poor or no recordkeeping, cash transactions	Liable for tax, under-report earnings, use loopholes, escape formal tax assessments	Taxed under formal tax assessment
Tax design desired features	No tax liabilities	Low rates to encourage registration, minimal compliance costs, low administration costs	Higher rates to encourage graduation into formal regime	

Notes: Greyscale text comprises features less relevant to taxation.
Source: Adapted from Zinnes' (2009, p. 8) adaptation of Djankov et al. (2002).

APPENDIX B – URA PRESUMPTIVE TAXES URA

Domestic Tax Laws 2016 – Income Tax Act (Part II Inserted by IT (Am) ACT 2015)

1.   The amount of tax payable for purposes of Section 4(5) where the gross turnover is less than fifty million shillings is –

     (i)   Kampala City and Divisions of Kampala

BUSINESS TRADE	With turnover between 35m - 50m	With turnover between 20m - 35m	With turnover between 10m - 20m
General Trade	500,000	400,000	250,000
Carpentry/ Metal	500,000	400,000	250,000
Garages (Motor Vehicle repair)	550,000	450,000	300,000
Hair and Beauty/ Salons	550,000	400,000	300,000
Restaurants or Bars	550,000	450,000	300,000
Clinics	550,000	450,000	300,000
Drug Shops	500,000	350,000	100,000
Others	450,000	300,000	200,000

ARE PRESUMPTIVE TAXES A GOOD OPTION FOR TAXING SELF-EMPLOYED PROFESSIONALS IN LOW & MIDDLE-INCOME COUNTRIES?

Daisy Ogembo[1]

Abstract

The term 'hard-to-tax' (HTT), in tax evasion literature, refers to farmers, small and medium-sized enterprises (SMEs), and professionals. However, research on the hard-to-tax in low and middle-income countries (LMICs) has primarily focussed on farmers and SMEs. Professionals are rarely critically considered, despite the acknowledgement in the literature that, considering their potential earnings, the absolute financial amount involved in evasion among professionals in LMICs is probably higher than among farmers and SMEs. Further, while presumptive tax regimes have been widely used in LMICs to tax SMEs and farmers, professional income is almost always explicitly excluded in the eligibility criteria for these regimes. There is also a gap in the literature on presumptive taxes. Scholarly discourse on these regimes have primarily focussed on their suitability for farmers and SMEs; there is little discourse on their suitability for professional income. The author fills these two gaps by making use of qualitative data on tax evasion by lawyers and dentists in Kenya. The qualitative data suggests that professionals fail to comply because of (i) peer influence, (ii) low levels of financial and tax capability, and (iii) the damaged political legitimacy of the tax authority. This paper makes an original contribution to the literature on the hard-to-tax and presumptive taxation by proposing that although presumptive tax regimes ordinarily explicitly exclude professional income, these regimes can be useful partial solutions for taxing newly qualified, self-employed professionals *if* they are well-thought-out, meticulously designed and implemented, and rigorously monitored.

Keywords: Hard-to-Tax, Presumptive Tax, Tax Evasion, Taxing Professionals, Developing Countries, Taxation in Kenya.

INTRODUCTION

Objective

The objective of this paper is to discuss the suitability of presumptive tax regimes for hard-to-tax (HTT) professionals in LMICs. The literature on tax evasion by the HTT and on the use of presumptive tax regimes in LMICs has generally overlooked professionals. The taxation of SMEs and farmers has dominated the discourse in these two topics.

The qualitative data for this research is drawn from 31 semi-structured interviews, conducted in Kenya with dentists, lawyers, and a diverse group of tax experts. This paper does not purport to generalise the findings from the small sample size to the whole population. Instead, the qualitative data provides rich and nuanced patterns and trends in the professionals' attitudes towards tax compliance. The author then uses the data to inform the discussion on the suitability of presumptive tax regimes for HTT professionals in LMICs. The paper concludes by proposing that although presumptive tax regimes ordinarily explicitly exclude professional income, these regimes can be useful partial solutions for taxing newly qualified, self-employed professionals *if* they are well-thought-out, meticulously designed and implemented, and rigorously monitored.

The Hard-to-Tax

Professionals fall within a category of taxpayers known in the literature as the *hard-to-tax* (HTT), a category which also includes farmers and SMEs (Casanegra de Jantscher & Tanzi, 1987, p. 12; Musgrave, 1990, p. 299; Tadesse & Taube, 1996, p. 3; Alm, Martinez-Vazquez, & Schneider, 2005, p. 13-14). These taxpayers are described as hard-to-tax because they share the following typical characteristics (Alm et al., 2005 pp. 13):

a.   They do not register themselves voluntarily with the revenue authority;
b.   They do not keep proper books of accounts showing their income and expenditure, and, when they do, it is difficult to ascertain the accuracy of these accounts;
c.   They are not prompt in filing tax returns;
d.   There is a significantly higher rate of tax evasion among them.

Hard-to-Tax Professionals

This paper focuses on professionals, rather than farmers and SMEs, because of the dearth of research into professionals, particularly in LMICs. Prior research on the HTT has mainly focussed on farmers and SMEs (for example, Rajaraman, 1995; Terkper, 2003; Rajaraman, 2005; European Commission, 2007; Coolidge & Yilmaz, 2016). However, the scope for high-income earners, like doctors, lawyers, contractors and consultants, to underreport is often considerable, particularly when they deal with cash transactions (Keen, 2012, p. 16; Tadesse & Taube, 1996, p. 4). By focussing on professionals, this paper seeks to make a meaningful contribution to the literature on taxation of the HTT.

Furthermore, the author focusses on self-employed professionals. The self-employed have significantly more opportunities for evasion than employees, whose salaries and wages are subject to employer withholding schemes − this idea is well documented in the literature (Casanegra de Jantscher & Tanzi, 1987; Kleven, Knudsen, Kreiner, Pedersen, & Saez, 2011; Kogler, Muehlbacher, & Kirchler, 2015; Slemrod, 2007; Torgler, 2006; Torgler & Valev, 2010).

Professionals are an important group to study. According to Keen, they can be responsible for some of the most severe instances of revenue loss and damage to the fairness of the tax system, particularly in developing countries (2012, p. 16). However, since they are so highly qualified and tightly regulated, it often appears unnatural to refer to them as 'informal' (Keen, 2012, p.

16).[2] Keen (2012, p. 16) explains that, considering their earnings, the absolute financial amount involved in evasion among professionals is probably higher than in any other group.

Significance

This research is essential now, as LMICs, particularly in Africa, strive to improve tax collection in recognition of rapid changes in development funding and the urgent need to harness domestic resources to meet growing socio-economic needs sustainably. As a result, there is increasing awareness that domestic resource mobilisation is essential and requires more attention (Carnahan, 2015, p. 170).

LMICs record a higher number of HTT taxpayers than high-income countries. According to the table below, the informal sector – which has a high number of HTT taxpayers – is responsible for a significant share of the employment opportunities in urban areas, new jobs, and non-agricultural employment opportunities in developing countries. For example, in Africa, the informal sector provides 93% of the new job opportunities and 61% of the job opportunities in urban areas.

Table 1: Make-up of the Informal Sector in Latin America Caribbean, Africa & Asia (Chen, 2001, p. 72)

Informal Sector as a Percentage Share of:	Latin America-Caribbean	Africa	Asia
Non-agricultural Employment	57	78	45-85
Urban Employment	40	61	40-60
New Jobs	83	93	NA

Woodruff (2013, pp. 2–3) explains that in comparing the informal economy as a percentage of GDP and taxes as a percentage of GDP, the former is higher in developing countries while the latter is higher in many Organisation for Economic Co-operation and Development (OECD) countries. For example, according to the graphs below, taxes in Kenya are approximately 20% of the GDP, while the informal economy is approximately 40% of the GDP. The variances are even higher in countries such as Liberia, Honduras, and Georgia.

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[2] Note that the term 'hard-to-tax' comprises taxpayers from the formal and informal sectors. Keen (2012, p. 16) argues that the term 'informality' is not always useful and has become quite loaded, while the term 'hard-to-tax' is 'much closer to the mark'.

Figure 1: Taxes and Shadow Economy as a % of GDP in OECD Countries (Woodruff, 2013, p. 2)
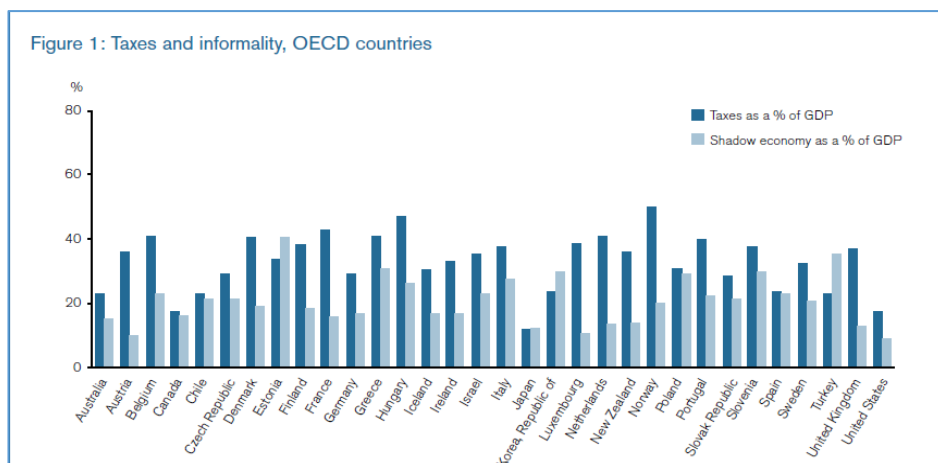
Figure 2: Taxes and Shadow Economy as a % of GDP in Low-income Countries (Woodruff, 2013, p. 3)
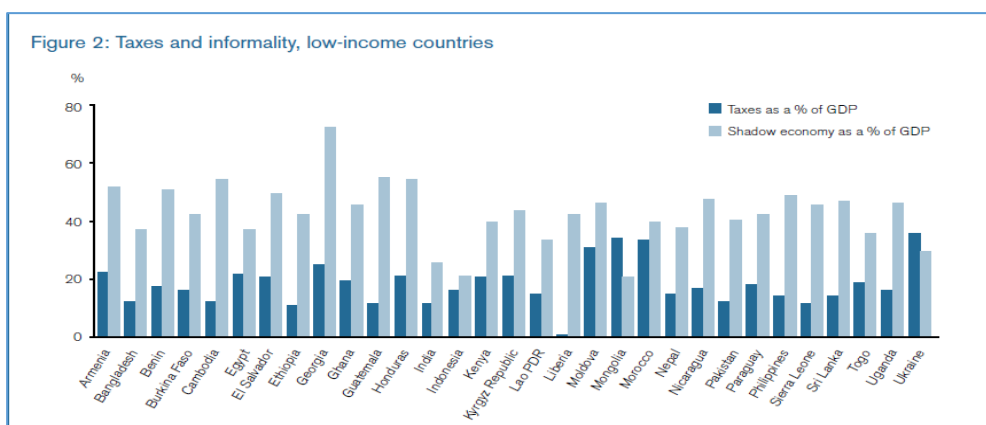
Thus, in LMICs, revenue authorities face dealing with a large number of individual taxpayers and the associated high cost of collection with the risk of minimal returns. In dealing with the HTT or 'informal sector', the default policy reaction seems to be to focus on the agricultural sector and SMEs with relatively low incomes, while ignoring potentially high income earning, self-employed professionals who operate in the informal sector and evade taxes. This professional class is growing in countries such as Kenya and the failure to effectively tax self-employed professionals appears to be unjustifiable. This paper advocates for a tax policy and administration shift, i.e. in policy and administrative efforts aimed at increasing tax collection from the informal sector, the taxation of professionals is a sensible place to start.

The inability or hesitance to effectively administer and enforce taxes on self-employed professionals has several adverse implications for the overall tax system. Admittedly, the revenue potential of these taxpayers is lower than the revenue collected from corporate taxes and PAYE; however, the importance of expending the effort and resources required to effectively tax the HTT stretches beyond revenue collection.

For example, effective taxation of self-employed professionals may promote the equal treatment of similar taxpayers, one of the cornerstones of a good tax system. The significant evasion opportunities that the self-employed enjoy may lead to inequity because, while these professionals can dodge their compliance obligations, their salaried peers, whose taxes are withheld at source, bear the full tax burden. It is inequitable to collect taxes from those who are 'easier' to tax, such as formal employees or larger corporations, while categorising other taxpayers – potentially earning comparable incomes – as hard-to-tax and pursuing the latter group less aggressively or leaving them out of the tax net altogether (Bahl, 2005, p. 343). Such inequity can have severe implications for the overall tax system (Bahl, 2005, p. 343; Bird & Wallace, 2005, p. 130; Musgrave, 1990, p. 299; Terkper, 2003, p. 4).

Second, widespread tax evasion by self-employed professionals can severely damage the tax morale of other compliant taxpayers, who may also begin to look for opportunities to evade. In other words, 'if taxpayers believe tax evasion to be common, tax morale decreases. Alternatively, if they believe others to be honest, tax morale increases' (Frey & Torgler, 2007, pp. 153-156). Thus, in order to promote fairness in the system and tax morale, it would be helpful to make a genuine effort to tax self-employed professionals.

PRESUMPTIVE TAXATION

What are Presumptive Taxes?

Present-day tax systems have evolved from presumptive regimes. For example, in the past, taxes were levied based on the number of windows or doors in one's home, or the number of huts in one's compound, i.e. colonial British government hut tax (for an interesting discussion on the colonial hut tax and further references on the topic, see Gardner, 2010).

In modern tax systems, the goal is to apply the tax rate to 'a well-defined measure of the income earned by taxpayers...in a given period....' (Casanegra de Jantscher & Tanzi, 1987, p. 1). Presumptive taxation 'involves the use of indirect means to ascertain tax liability, which differs from the usual rules based on the taxpayer's accounts' (Thuronyi, 2000, p. 401). In presumptive tax regimes, the ''desired' base for taxation...is not itself measured but is inferred from some simple indicators which are more easily measured than the base itself' (Ahmad & Stern, 1991, as cited in Thuronyi, 2000, p. 401).

The presumption, therefore, replaces 'an entire tax base or at least a large portion of the base' (Avi-Yonah & the International Fiscal Association, 1998, p. 1). In other words, where the revenue authority cannot ascertain a taxpayer's income, or cannot verify the accuracy thereof, presumptive regimes allow them to *presume* the amount of income based on alternative observable indicators, i.e. an alternative base determined by the revenue authority (Bird & Wallace, 2005, p. 124).[3]

Presumptive taxes have been used for a wide range of reasons in several countries. Although they have been used in some high-income countries, like France, Germany, Belgium and Israel, they mostly feature in the tax systems of LMICs. These regimes provide revenue authorities with various opportunities.

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[3] For a detailed discussion on the various legal characteristics of presumptive taxation methods, see Keen (2012, pp. 401–405).

Tax Simplification

HTT taxpayers in LMICs face significant challenges when attempting to meet complex tax and accounting compliance requirements. Many HTT taxpayers run micro, small or medium-sized businesses with modest turnovers; subjecting them to the usual compliance requirements places onerous financial burdens on them, driving many business owners towards evading their compliance obligations altogether.

For example, small business owners are often unable to comply with their accounting and tax obligations without paying for professional help (Terkper, 2003, p. 219). The costs involved in this, both in terms of time and money, are burdensome for businesses of this size (European Commission, 2007, pp. 8-13). As a result, the owners of these businesses will often fail to keep financial records or will keep records which are incomplete, inaccurate, or deliberately misleading (Casanegra de Jantscher & Tanzi, 1987, p. 5). The literature confirms that even self-employed professionals who are highly educated can keep rudimentary, unreliable, and inaccurate books of accounts that are incapable of being effectively utilised for tax auditing purposes (Tadesse & Taube, 1996, p. 4).

One of the primary goals of presumptive regimes is, therefore, to cater to such taxpayers. Policymakers and revenue authorities anticipate that if the compliance burden is low and the rules are kept simple, taxpayers will be motivated to comply voluntarily. The target, in this case, is taxpayers who evade taxes because (i) of lack of knowledge or understanding of their obligations or (ii) the cost (financial or otherwise) of compliance is too high.

Since revenue authorities cannot ascertain the actual tax base in the face of poor record-keeping, presumptive regimes allow these authorities to come as close as possible to ascertaining income using presumptive methods (Casanegra de Jantscher & Tanzi, 1987, p. 4). Presumptive tax regimes are intended to simplify tax administration in LMICs and 'overcome administrative weaknesses that are endemic to many countries in Africa' (Tadesse & Taube, 1996, p. 11).

However, striking the correct balance is easier said than done. In many countries, the simplified tax regimes are still far too complex and burdensome for micro-enterprises; on the other hand, where the regime is too simple with little accountability, the risk of abuse of the system by medium-sized enterprises increases significantly (Coolidge & Yilmaz, 2016).

Enhancing Horizontal Equity

Proponents of presumptive tax regimes are primarily concerned with horizontal equity, i.e. treating similar taxpayers similarly. One of the goals of presumptive regimes is to encourage greater compliance among these HTT taxpayers. The intention is to reduce the 'unfair advantage' that they have, i.e. the opportunity to evade their tax obligations while those who are salaried bear the full burden of their obligations. Horizontal equity demands fairness in the distribution of the tax burden, and this is what presumptive regimes aspire to achieve.

Expanding the Revenue Base

The expansion of the tax base is an urgent need of many LMICs. These countries depend heavily on corporate income tax, value-added tax (VAT) and Pay As You Earn (PAYE) tax from the formal sector. Due to widespread tax evasion, the informal sector contributes very

little to the tax revenue collected in LMICs, despite making up a very significant percentage of the economy. The rationale behind the introduction of presumptive taxes is that with simpler rules and lower compliance costs, previously non-compliant taxpayers will begin to comply voluntarily, thereby expanding the revenue base (Alm et al., 2004, p. 49).

Presumptive regimes have, however, been criticised for resulting in abuse of the law, unfairness, inefficiency, and distorted decision-making. Where the threshold for eligibility is too high, for example, larger taxpayers who are fully capable of keeping proper books of accounts and complying with ordinary tax rules can take advantage of presumptive regimes to pay lower taxes (Bird & Wallace, 2005, p. 6). Presumptive regimes have also been accused of eroding vertical equity. For example, where taxpayers in a specific sector are subject to a lump-sum tax, all the taxpayers in that sector end up paying the same amount of tax regardless of their varying income levels, business expenses, or unexpected losses. Such risks call for the presumptive regime to be carefully researched and designed in order to minimise the chances of distortions and economic instability occurring.

Presumptive Taxes & Professionals

Scholarly discourse on the use of presumptive taxes has mostly considered their suitability for SMEs and farmers (Bird & Wallace, 2005; Rajaraman, 2005; Terkper, 2003; Bird & Zolt, 2004; Erbas, 1993; Jaramillo, 2003; Pashev, 2006; Tadesse & Taube, 1996; Musgrave, 1990). Most of this literature either completely overlooks professionals or briefly mentions that presumptive taxes are not suitable for professionals. One apparent reason for this is that professionals are highly educated, so it is assumed that they are financially literate, tax literate, and sophisticated enough to keep proper financial records and comply with tax legislation.

In addition, tax policymakers and revenue authorities are perhaps hesitant to apply presumptive methods to this group because of the potential high earnings of professionals, and the challenges associated with factoring in the widely divergent incomes among professionals in the same sectors when designing the presumptive tax. There is a risk that high income earning professionals will abuse a poorly designed presumptive tax system in order to pay lower taxes.

However, these assumptions and fears are blind to several realities. First, in LMICs, a significant number of professionals run owner-managed small firms with modest incomes; these professionals run their businesses as informally as other HTT taxpayers (Terkper, 2003, p. 213). The data collected during the case study for this research, which is presented in the next section, suggests that the financial and tax capabilities of professionals within this group are not always as high as the literature often assumes.

Second, the blanket distinction between self-employed professionals and SMEs is problematic. Many self-employed professionals face the same compliance challenges that SMEs face, i.e. the 'compliance costs or what it takes to meet tax obligations are also higher for small entities especially in relation to the amount of taxes they pay' (Terkper, 2003, p. 213). While there are self-employed professionals who run large successful firms with significant turnovers and can afford professional accounting services, there are many self-employed professionals who struggle to cover their compliance costs on their modest incomes. For professionals running small firms, or recent graduates at the beginning of their careers, the typical costs of compliance are incredibly high and prohibitive, forcing many of them to evade taxes and operate in the informal economy. This category of professionals is ignored in the literature.

In practice, almost all countries that have some form of presumptive tax regime apply the regime to SMEs but explicitly make professional income ineligible through the language of the statute. Thus, self-employed professionals are usually unable to take advantage of presumptive tax regimes, even where they meet the other eligibility criteria. There are a few instances where countries have chosen to apply presumptive income taxation to professionals.

India

Before 2016, the income tax law exempted professional income from the presumptive tax regime. However, since the financial year 2016/2017, self-employed professionals in India whose total gross receipts did not exceed Rs. 50 Lakhs in the previous financial year can benefit from the presumptive regime under the new Section 44ADA of the Income Tax Act.[4] The taxpayer's income is presumed to be 50% of their total gross receipts for the year and, since a deemed deduction for all expenses is applied, no further deductions are allowed. The provision further relieves the taxpayer of the obligation to maintain proper audited books of accounts; however, the presumption is a rebuttable one and the taxpayer can produce audited books and receipts showing that their income was less than 50% of gross receipts (Income Tax Department, Government of India, n.d.). This presumptive regime is not mandatory. Taxpayers are free to opt in and out from year to year without restriction. The rate set for the presumptive tax, i.e. 50% of total gross receipts, is high and is likely to affect the uptake of the regime.

Greece

Greece has faced a significant problem with widespread tax evasion, especially among professionals; according to one study, 43-45% of self-employment income goes unreported and untaxed in Greece, and the primary tax evaders are professionals, like lawyers, doctors, and engineers (Artavanis, Morse, & Tsoutsoura, 2016, pp. 743, 763). Early attempts to increase enforcement on professionals in 2010 were unsuccessful, with Parliament voting down a proposed bill to that effect (Artavanis et al., 2016, p. 782). Greece introduced presumptive taxation of professionals as part of the economic and financial policies it adopted in response to the 2010 financial crisis; the regime was expected to raise 'at least EUR 400 million in 2011 and increasing returns in 2012 and 2013' (International Monetary Fund, 2010, p. 50). The presumptive tax regime applies to some categories of professionals but does not apply to liberal professionals, like doctors and lawyers (Ntoukaki, email correspondence, June 7, 2018). The exemption of liberal professionals is an interesting choice when viewed in light of the evidence that these groups are the primary tax evaders.

Costa Rica

In the 1990s, the presumptive regime for professionals applied to doctors, architects, engineers, lawyers, accountants, brokers, notaries, economists, and other technicians and professionals who failed to file their tax returns (Rajaraman, 1995, p. 1110). Costa Rica still faces widespread tax evasion among liberal professionals, including lawyers, architects, doctors, dentists, and accountants (OECD, 2017, p. 71). The receipt of professional fees in cash, for which these professionals do not issue receipts, allows them to underreport their income; they can also 'easily over-report deductible expenses or claim expenses that should not be claimed' (OECD, 2017, p. 72).

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[4] This provision covers professionals in the legal, medical, architecture, accounting, interior design, engineering, and information technology sectors, as well as company secretaries, artists, and technical consultancy professionals.

According to the statistics below, in 2015, tax evasion was highest among professionals in I.T., accounting, and auditing.

Figure 3: Share of Taxpayers Declaring Zero Income Tax in Different Liberal Professions in Costa Rica in 2015 (OECD, 2017, p. 72)[5]
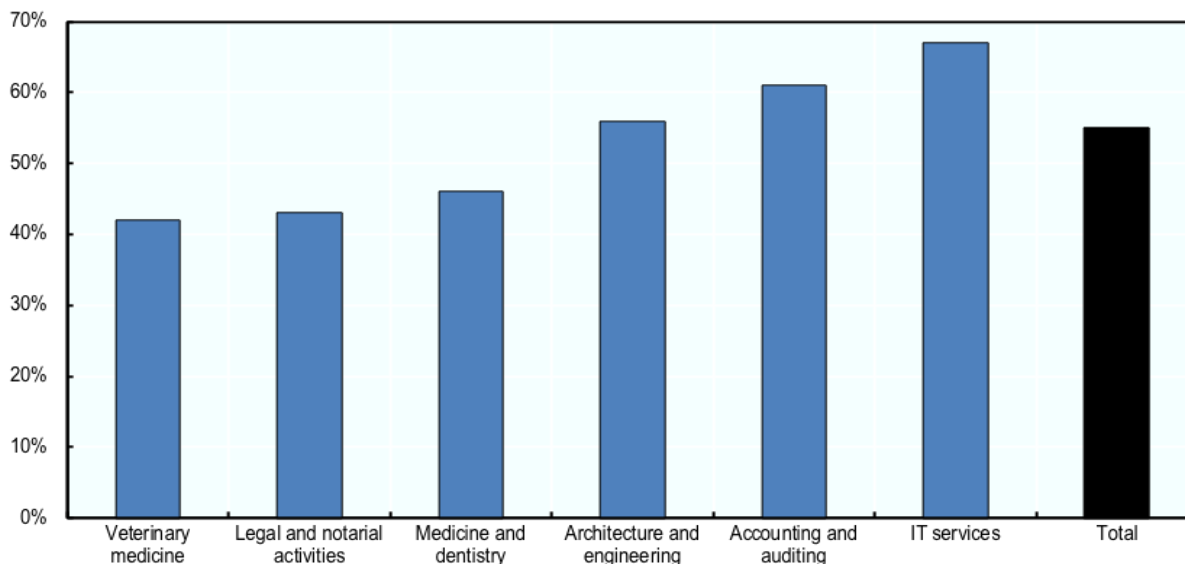
Furthermore, the statistics show that 55% of professionals declared zero income tax and, 'on average, this share remained relatively constant over the 2011-15 period at an average of 56%' (OECD, 2017, p. 71). The assets and gross earnings of most of the taxpayers in this group suggest that they are grossly underpaying taxes. 86% of the taxpayers in this group 'accounted for about 48% of assets and 30% of gross earnings of the total group while accounting for only 9% of total taxes paid' (OECD, 2017, p. 72).

Under the current presumptive regime, professionals who fail to file their tax returns and pay their taxes when due, as well as issue appropriate receipts, are presumed to earn an income that 'is either 250 or 335 times the basis (sic) salary depending on the profession' (OECD, 2017, p. 71). The higher presumption, i.e. 335 base salaries, is equivalent to approximately $242,000 (Quinones, email correspondence, October 28, 2018). This amount is significant in comparison to the GDP per capita based on purchasing power parity of Costa Rica, which is approximately $17,000 (The World Bank, n.d.-b). This disparity suggests that the policy motivation for the presumptive regime is to discourage tax evasion by compelling professionals to file returns and keep accurate records or face heavy tax burdens.

Guatemala

In 1987, Guatemala introduced a presumptive tax on professionals who failed to file tax returns as part of broader reforms on all aspects of individual income tax (Bahl & Martinez-Vazquez, 1992, p. 80). However, 'by 1990, most professionals would find it advantageous to pay taxes according to the fixed presumptive income assigned to their profession in the tax law' (Bahl & Martinez-Vazquez, 1992, p. 80).

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[5] Data based on a 2015 report, Contraloria General de la Republica.

Guatemala still faces a significant problem with tax evasion among the HTT; its low tax to GDP rate (2011-2014) is a partial result of high levels of tax evasion (Kettle, Hernandez, Ruda, & Sanders, 2016, p. 2). 'For the income tax, the estimated average rate of tax evasion for individuals and firms in Guatemala is about 64 per cent…' (Kettle et al., 2016, p. 2).

Under the current presumptive regime, any professional who fails to register as a taxpayer, or who registers but does not file a tax return, is presumed to have earned an income of 30,000Q per month. If the professional graduated fewer than three years ago or is over the age of 60, that presumed income is reduced by 50%.[6] The tax due is then calculated by applying the relevant tax rate to the presumed income. The presumptive regime is a rebuttable one; the taxpayer is permitted to present evidence proving a lower income. However, the taxpayer would still face penalties for failure to file their returns and pay the tax promptly.

The presumed income of 30,000Q per month is the equivalent of $3,800. This figure is about 75% of Guatemala's annual GDP per capita, which is approximately $4,470 (The World Bank, n.d.-a). Once again, this disparity suggests that the policy motive for the regime is to deter would-be evaders and prod them to file their tax returns on the basis of their actual income.

Summary

These country-specific experiences tell us several things. First, presumptive taxation is not a very popular option with tax authorities dealing with the HTT; the uptake of these tax regimes for professionals is limited to very few countries and it is therefore difficult to carry out a comprehensive comparative analysis across countries.

Second, there is scant literature on the policy considerations that inform decisions to adopt presumptive taxes for professionals. In the Greek case, it is obvious that the decision was motivated by extraneous economic circumstances and external political pressure during the economic crisis. In India, the government introduced a presumptive tax regime for professionals in response to the recommendations of a government-mandated committee, which proposed its introduction based on the popularity of the presumptive regime among small traders (Expert Committee on Income Tax Simplification, 2016, pp. 9, 20). Apart from these insights, there is little scholarly discourse on the policy considerations that may underpin decisions to introduce presumptive taxes for professionals; the scepticism over their suitability for professionals seems to be generally accepted without critical consideration of any counterarguments.

Third, one could argue that the high tax rates associated with the presumptive tax regimes in Guatemala, Costa Rica and India suggest that the policy motivation for these regimes is to discourage tax evasion by compelling professionals to file returns and keep accurate records or risk facing unusually heavy tax burdens. In India, for example, the government openly acted in a manner contrary to the committee's recommendation that the presumed income should be 33⅓% of total gross receipts and, instead, introduced a much higher rate of 50% (Expert Committee on Income Tax Simplification, 2016, p. 20). Thus, while presumptive regimes for SMEs and farmers are framed as devices intended to *simplify and facilitate compliance*, governments seem to adopt a much more *punitive* stance with professionals.

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[6] Decree 10-2012, Tax Update Law (Congress of the Republic).

This paper seeks to challenge these assumptions and stances by considering whether, and under what conditions, presumptive taxes may be *useful* rather than *punitive* devices for taxing professionals.

THE RESEARCH QUESTION

This paper seeks to answer the question: are presumptive taxes a good option for taxing self-employed professionals in LMICs?

In answering this question, the rest of the paper is organised as follows:

- Section II explains how the empirical data for this research was collected;
- Section III summarises the significant findings of the research;
- Section IV explores the suitability of presumptive methods for taxing self-employed professionals in LMICs in light of the findings of this research;
- Section V contains the conclusion.

METHOD

The empirical data was collected through semi-structured interviews with taxpayers, tax experts, and senior government officials in Kenya in 2015 and 2016.

Selecting Kenya

Kenya was selected for several reasons. First, it is classified as a lower middle-income country with a GDP per capita PPP of $3,2851.91 (The World Bank, n.d.-b). According to a recent survey, Kenya's tax-to-GDP ratio is 18.1% (2016); this is similar to the average tax-to-GDP ratio for 21 countries in Africa (18.2%) (OECD, the African Tax Administration Forum [ATAF], & the African Union Commission [AUC], 2018, p. 1). Thus, Kenya falls within the category of countries that this study is focussing on.

Second, despite its robust efforts at tax reform, Kenya has not managed to tax the HTT effectively. For example, with effect from January 2007, the government introduced a turnover tax with the intention of bringing the informal sector into the tax net. In Budget Options 2013 (Parliamentary Budget Office, Kenya, 2013) and Budget Options 2014 (Parliamentary Budget Office, Kenya, 2014), the Parliamentary Budget Office acknowledged that, despite legislative reform, the turnover tax had failed to yield significant revenue and its implementation ought to be rethought. Notably for this article, these efforts at taxing the informal sector have focussed on SMEs and farmers and have excluded self-employed professionals.

Third, Kenya possesses a significant number of HTT taxpayers; there is evidence that the underground economy in Kenya is about 20% of its GDP and has a tax potential of 4% (Ouma & Kenya Institute for Public Policy Research and Analysis [KIPPRA], 2007, p. 18). In addition, 61% of Kenyans working in the urban areas are engaged in the non-agricultural informal sector, and the informal sector employs more than 80% of the Kenyan working population (Budlender, 2011; Institute of Economic Affairs, 2016). While statistics on the overall informal sector do not explicitly capture the tax potential of professionals, the growing professional class in Kenya means that it remains a good choice to study.

Selecting Taxpayers

To better understand the tax compliance behaviour of self-employed professionals, it was necessary to focus on taxpayers drawn from one or two professions and to conduct an in-depth study of these sectors. The two professions selected for this project were (i) dentists working in the health sector in Nairobi and (ii) lawyers working in private legal practice in Nairobi. Kenya has more than 15,000 lawyers (The Law Society of Kenya, n.d.) and 1,300 dentists Shiundu, 2018).

Dentists comprise a compelling case because of the highly informal nature of their engagements. The use of the term 'informal sector' in LMICs typically conjures images of small-scale traders, roadside vendors, or public transport operators. This term is rarely associated with professionals such as dentists, yet the reality is that many of them operate very informally and are as challenging to tax as other informal sector entrepreneurs.

Many dentists in Kenya work informally for other dentists or private hospitals and clinics on a *locum* basis; some dentists are in full-time formal employment with the government but have additional part-time informal *locum* engagements. Other dentists are fully self-employed and the level of formality in these enterprises varies widely.

A total of 10 dentists were interviewed for this project. A table in the Annex sets out the profiles of the dentists according to their gender, the nature of their practice, their level of specialisation, and their years of experience.

Lawyers are an excellent group for comparison. First, it is reasonable to assume that lawyers have a much better understanding of tax law and compliance requirements than dentists; it was interesting to find out whether this would have any bearing on voluntary compliance.

Second, legal practice is much more formal than dental practice. The concept of *locum* does not exist in legal practice in Kenya; lawyers in private practice are either self-employed or in full-time formal employment. There are hardly any grey areas.

Third, although the level of formality in law firms run by self-employed lawyers varies just as widely as it does in enterprises run by self-employed dentists, law firms tend to attract more corporate clients as they grow. This transition significantly decreases the likelihood of cash payments and increases the likelihood of formalisation over time. However, many large dental clinics still receive a significant number of cash payments, regardless of their stage of growth or size.

Finally, revenue officials in Kenya and across Africa with whom the author discussed this project were categorical in their view that lawyers evade tax more than any other professionals. Whether this perception is anecdotal or fact-based is not particularly evident, but it was an observation that further buttressed the decision to select the legal profession for comparison.

A total of 12 lawyers were interviewed for this project. A table in the Annex sets out the profiles of the lawyers per the nature of their practice, their years of experience, the age of their business, and their gender.

Snowball Sampling

The respondents were identified and selected using snowball or referral sampling; the interviewees then referred the author to acquaintances within their circles who would be willing to be interviewed. The initial respondent from the legal profession was known to the author through professional networks, and that lawyer introduced the author to other self-employed lawyers and so on. With respect to the dental profession, the author approached a dentist personally known to her, but did not interview that dentist; instead, that dentist was instrumental in referring the author to other self-employed dentists.

This sampling method was beneficial in this context because of the nature of the study. Potential respondents were understandably wary of being interviewed about tax compliance and a good number of them went to the extent of enquiring about the author's relationship with the revenue authority. It was much easier to access the population through referrals by their trusted professional colleagues. Their colleagues assured them that the author was 'safe' and that her questions did not pose a risk to them. By taking this approach, the author was able to gather even more sensitive data than she set out to collect.

Snowball sampling does have its disadvantages; for example, because of sampling bias, it may not be clear whether the sample is sufficiently representative of the population. The initial respondents are likely to have referred the author to respondents who share their characteristics, for example, age, sex, level of education, and size and nature of practice. There is a risk that respondents with different traits were not adequately represented. However, the author took steps to vary the characteristics of the respondents to ensure that they did not fall into the same category; an attempt was made to ensure that their ages, sexes and the nature and size of their practices varied.

Profile of the Government Officials and Tax Experts Interviewed

Public Sector

- A senior commissioner at the Kenya Revenue Authority (hereinafter referred to as SC-KRA)
- A chief manager at the Kenya Revenue Authority – at the time of the interview, she held the title of manager but she has since been promoted from that position (hereinafter referred to as CM-KRA)
- A manager at the Kenya Revenue Authority (hereinafter referred to as M-KRA)
- A director at the National Treasury (hereinafter referred to as D-NT)
- 2 senior managers at the National Treasury (hereinafter referred to as SM-NT)

Private Sector

- A former finance secretary, now working as a private consultant (hereinafter referred to as FFS).
- A senior partner at one of the 'Big Four' audit and accounting firms in Nairobi – has since retired from the firm (hereinafter referred to as SP-B4).
- A manager at one of the 'Big Four' audit and accounting firms in Nairobi – at the time of the interview she was a senior tax consultant, but she has since been promoted from that position (hereinafter referred to as M-B4)

Academia

- Professor Attiya Waris – the leading tax law academic in Kenya.

Data Collection and Analysis

Most of the interviews were conducted face-to-face; four were conducted over the telephone. It is acknowledged that this is a small number of respondents from which it is not possible to generalise conclusions to the whole population. However, the goal of qualitative research is not to achieve sample representativeness in order to generalise findings to the whole population. The worth of the qualitative data obtained from the small sample size lies in the fact that the author was able to conduct truly in-depth interviews, each lasting one hour or more, during which she was able to tease out critical, analytical, and in-depth insights. In line with the theoretical underpinnings of qualitative research, the goal of this research is not to generalise the findings to the whole population, but to build deep, rich, and thick narratives and analysis regarding the perceptions, attitudes, and patterns of thought of these professionals. Besides, towards the end of the interview process with the taxpayers, the responses mirrored each other to such a significant extent that it is possible that further interviewing within the same professions would not have yielded widely varying information. The author analysed the data using a thematic analysis method; this ensured systematic data analysis, and allowed for objectivity and consistency in the identification of recurrent themes. Some major themes that emerged from the data are discussed below.[7]

MAJOR FINDINGS

Peer Perception

It is now generally accepted in compliance literature that social interactions influence taxpayer behaviour. This view is premised partly on *social influence theory*, i.e. an individual's behaviour and attitudes are affected by the behaviour and social norms of that individual's reference group (Ali, Fjeldstad, & Sjursen, 2014, p. 829). Snavely (1990, p.62) argues that this theory applies in the field of taxation in the same way – the willingness to engage in tax evasion is influenced by one's social interactions.

A common sentiment expressed by virtually all the dentists and lawyers was the belief that their professional peers were engaged in tax evasion. In some instances, the respondents had witnessed the tax evasion or directly benefited from it; in other instances, it was premised on 'gut instinct' and insider knowledge about 'the way things are done'.

All the lawyers believed that their peers evade tax and there was a general belief that the level of tax compliance in the profession is low. The lawyers mentioned various forms of non-compliance, including lawyers: underreporting their income; filing nil returns; padding expenses in order to pay little or no tax; keeping two sets of files; demanding cash payments to avoid paper trails; demanding split cash and bank payments to avoid declaring cash payments; and destroying physical evidence of non-compliance. The majority of the lawyers believed that the smaller firms are the worst offenders because they are invisible; however, according to ADV2 and ADV6, the largest firms are engaged in the most evasion.

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[7] The lawyers are abbreviated 'ADV' and assigned numbers; the dentists are abbreviated 'DEN' and are similarly assigned numbers.

Virtually all the lawyers admitted to involvement in some form of tax evasion in the past or present. A few confessed to keeping two sets of files and destroying evidence of income to avoid a paper trail. Three respondents also spoke about a common practice of lawyers: hiding revenue in clients' accounts, which are protected by law from scrutiny due to advocate-client privilege.

The dental practitioners were even more categorical and clear that there is very little compliance in their field. The perception of all the respondents was that medics evade tax through padding their expenses to pay less tax, hospitals evade customs duties on medical equipment and practise other forms of evasion, and that there is widespread underreporting of income among dentists. DEN3 believed that the most common form of evasion was underreporting of income and DEN5 stated that he only knew one dentist who paid tax faithfully.

DEN2 told the author about his previous employer, a senior practising dentist, who is well known within the profession for openly engaging in tax evasion. The senior practitioner was known for treating his employees as 'independent contractors' in order to avoid paying PAYE, even though the nature of their engagement was that of employer-employee. To facilitate his non-compliance, the senior dentist remunerated the 'employees' in cash only, accepted only cash payments for treatments, and paid off revenue officials to avoid audits and prosecution.

Overall, the data from the dentists revealed that the dentists (i) *believed* that the majority of their peers were engaged in tax evasion and (ii) *knew* many peers who were engaged in tax evasion. In both instances, the non-compliance was deemed successful because all the respondents, except DEN8, were unaware of any professional colleagues who had been detected and successfully prosecuted.

This belief that their peers are mostly evading tax has affected the professionals' attitudes towards compliance. DEN2 argued that the law relies on a taxpayer's 'personal morality' for compliance and it is unfair for one to pay tax when others are evading it. The dental practitioners seemed to be emboldened by the fact that 'everyone is doing it, and no one has been caught'. Tax evasion, therefore, seems to have become part and parcel of the ordinary course of business for these professionals. When asked about his perception of the risk of detection, DEN2 answered:

> In my view, the consequences of not paying PAYE on my income are negligible. I was informed by someone who works as a self-employed research consultant that the fines payable if you are caught are so minimal that it is not worth complying. I believe her.

When the author asked him whether he believed that this was an accurate picture of the legal position, he responded that he believed his source and felt no need to cross-check the legal position. This response demonstrates the power of social influences, and the fact that a false narrative within a reference group can easily hold the force of law and influence the behaviour of members of the group. These findings support the theoretical argument that the knowledge that one's peers are evading tax removes the fear of informal sanctions from peers if caught evading (McKerchar & Evans, 2009, p. 178).

The findings also corroborate the existing research that social groups can influence taxpayers' perceptions about the probability of being detected (Fjeldstad, Schulz-Herzenberg, & Sjursen,

2012, p. 16). Lawyers, perhaps because of their training, were more cautious about the risk of detection, but were equally spurred on by the belief that other lawyers are engaged in the evasion game and it is merely the way in which things are done.

Low Levels of Financial and Tax Literacy

The lawyers agreed that financial indiscipline and disorganisation among the profession's self-employed, coupled with the nature of self-employment, had exacerbated the evasion problem. Most respondents confessed that they tended to make haphazard cash withdrawals and did not prioritise tax. They often found themselves without sufficient funds to meet their tax and other financial obligations. ADV5 explained that the discipline of withdrawing money in a structured manner is difficult for sole proprietors. In his case, he would make monthly withdrawals for his upkeep and, occasionally, make large withdrawals when he received unusually large payments. This approach made it difficult to plan for, and pay, his income tax.

In addition, the younger lawyers spoke about their lack of knowledge and expertise in accounting and tax computation, particularly when setting up their law firms; this was a recurrent complaint. These lawyers explained that their transition into self-employment was difficult and dreadful; they were entirely unprepared for the changes in their tax compliance obligations as a result of the transition. ADV6 was of the view that lawyers jump into setting up law firms without the necessary training and knowledge, and with the mindset that the revenue authority is the enemy. ADV4 gave an example of an embarrassing experience with a client who withheld tax on payments according to the law. The respondent was unaware that this was a statutory requirement and therefore queried the action, leading to an embarrassing discussion with the client. Other respondents explained that withholding tax and withholding VAT took them by surprise, and that, overall, their total tax burden was higher than they had expected when going into self-employment.

The accounting and tax illiteracy among lawyers, coupled with the existence of what the respondents described as inaccessible tax information, led to improper billing, inaccurate record-keeping, and inadequate internal structures within their firms. These shortcomings significantly hampered compliance. The tax authority found it difficult to believe that highly educated professionals, particularly lawyers, struggle with financial and tax literacy; in one respondent's view, they should be the most informed group in society.[8] However, as ADV3 put it, 'I was aware of the taxes but did not know how to calculate and remit them; I never learnt how to do that as an employee…I know what the legislation says, but I do not understand the technical aspects.' The revenue authority seems to be blind to this distinction.

The lawyers explained that when they moved into self-employment, they did not appreciate the difference between filing returns as a taxpayer whose only source of income is employment income versus filing returns as a self-employed individual running a business. The respondents explained that they were surprised by how different and challenging it was. Since they could not afford to pay for an expert or professional help, their response to these challenges, they said, was merely to 'cook up' numbers on their returns or file nil returns. While they readily admitted that there was a mix of both deliberate intent and ignorance in tax evasion among lawyers, they maintained that most evasion was inadvertent or a result of ignorance.

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[8] Interview with SC-KRA, Senior Commissioner at Kenya Revenue Authority (Nairobi, Kenya, 10 September 2015).

The emerging trend from the data collected from these lawyers was that many legal practitioners did not consciously develop their internal structures to enable or facilitate compliance. Those who were unable to afford skilled, professional accounting services remained financially disorganised and found it hard to comply. Lawyers who chose, and could afford, to set up proper fully functional in-house accounting departments kept proper financial statements and separate accounts for tax. That level of organisation encouraged and facilitated compliance.

> I wish there was a starter pack for those starting to work in the private sector; for example, classes during the final year of university. We know how to treat patients, but we do not know how to run a business let alone how to pay taxes. [DEN1]

> Generally, medics lack business acumen. We are ignorant; I evaded tax purely out of ignorance. Clinicians should be trained so that they know…Money at hand is simply pocketed, and actually, this causes many clinics to shut down. [DEN5]

As evidenced by the statements above, the dentists mentioned very similar challenges to those mentioned by the lawyers. Most respondents explained that they, and most of their peers, lacked the knowledge and skills required to run a business. According to the respondents, most dental clinics lacked financial accountability and proper internal financial structures, resulting in widespread mismanagement and evasion. Several respondents explained that this financial mismanagement and illiteracy resulted in the collapse of many dental clinics. The medics blamed these failures on the fact that financial and management knowledge was not incorporated into their training programme. The medics also complained that the Medical Board did not concern itself with ensuring, or at least encouraging, proper financial management structures and financial record-keeping among its members' clinics.

Most dentists did not know the correct withholding tax rate due on their payments. As a result, some were overtaxed by unscrupulous clinics. The majority did not receive, or demand, withholding tax certificates as proof that the amounts deducted from their pay had been remitted to the revenue authority and not illegally retained by the clinic. In addition, many respondents were not aware that they were obligated to pay income tax on the remainder of their income; some found out after several years of non-compliance and were either too afraid or not bothered enough to comply. Some respondents only discovered this tax obligation during their interviews for this research.

The dentists were also unaware of the distinction between tax evasion and tax planning. Several dentists spoke about padding their expenses and including expenses that were not related to their work in order to reduce their taxable income. Those respondents referred to these actions as tax planning and believed that this was not criminal behaviour but 'legal tax avoidance'.

It therefore seems that financial and tax illiteracy is a significant contributing factor towards evasion among professionals in Kenya, despite the scepticism expressed by SC-KRA.[9] Not only do these professionals struggle to comply without what they deem expensive professional assistance, they also lack the basic accounting and management knowledge that is a prerequisite for proper record-keeping, business management, and tax compliance.

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[9] Interview with SC-KRA (n 6).

Political Legitimacy: Public Perception of the Revenue Authority

Legitimacy has been described as 'belief or trust in the authorities, institutions and social arrangements to be appropriate, proper, just and work for the common good' (Fjeldstad et al., 2012, p. 7). Per Kirchler, Hoelzl and Wahl, when citizens believe that the revenue authority is legitimate, i.e. trustworthy, just, fair, and benevolent and aims to work for the good of all, they are more inclined to comply (2008, p. 212).

Overall, the respondents' perceptions of the revenue authority were negative. Only one dental practitioner and one lawyer reported positive experiences with the revenue authority; the rest had negative perceptions, shaped either by anecdotal evidence or personal experience. One common complaint across both professions was that the revenue authority does not understand the nature of their work. Consequently, its actions, rules, and decisions concerning taxpayers in the legal and dental professions are deemed to be arbitrary, inconsistent, and unfair.

There was also a general feeling that the authority is blind and aloof to the challenges that the self-employed professionals running small firms face, yet these challenges make compliance difficult and expensive. The professionals spoke about cash flow problems, the high cost of compliance, and the inability to keep proper records and understand their tax compliance obligations. The professionals felt that the revenue authority was more interested in enforcement than supporting SMEs.

The other recurrent theme was that the revenue authority was to be feared, because it is disrespectful, unreasonable, scary, and aggressive, among other adjectives, and has a pre-conceived negative agenda. Most lawyers and dentists felt that the revenue authority deliberately generates this fear and does not want to have a genuine relationship with taxpayers. The tax sensitisation workshops often held by the authority were viewed by lawyers as 'traps'.

Most respondents viewed the revenue authority as an enemy to be feared and avoided. According to DEN6, her fear of the revenue authority was so great that she was unable to go to their offices to process some tax refunds that had been due to her for some years.

The respondents, particularly the lawyers, felt that the revenue authority is more interested in cultivating relationships with multinational enterprises and high net worth individuals (HNWIs) because they help them to realise their targets faster. The dentists also argued that the revenue authority is less interested in smaller boutique clinics and more focussed on larger hospitals. This perception led to fairness concerns because the professionals believed that the revenue authority exists only for the good of large taxpayers. They surmised that the revenue authority is more interested in meeting the needs and addressing the concerns of large taxpayers, and ignores others.

Also common across both groups was the perception that the revenue authority is more interested in collecting bribes than collecting taxes. The respondents generally believed that revenue authority audits are merely intended to intimidate taxpayers and push them into paying bribes. Many respondents, particularly the lawyers, believed that if one is caught evading, one can always escape by paying a bribe. Most of the dentists believed that larger taxpayers pay bribes to the revenue authority in order to get away with evasion. There is evidence that such instances of petty corruption hurt tax morale and trust in the tax authority in sub-Saharan Africa (Jahnke, 2017).

Tax collection is viewed as a tool for harassing citizens and both groups construed the revenue authority's work as 'harassment', 'malicious', 'problematic' or 'interference'. One lawyer told the author that he once encountered what he described as a 'gentle' revenue officer, suggesting that revenue officers are believed to be either gentle or rough.

Finally, the revenue authority is viewed as inefficient; the lawyers, who regularly interact with the revenue authority on behalf of their clients, believed that it was quicker and more efficient to bribe revenue officers than to follow the proper channels. The proper channels were viewed as slow, bureaucratic, inefficient and expensive; corruption was deemed to be quicker and cheaper.

ARE PRESUMPTIVE TAXES A VIABLE SOLUTION?

Musgrave (1990, pp. 307-308) argues that presumptive taxes are unsuitable for professionals because they 'are fully capable of filing adequate returns, and their income levels fall within the middle or even upper ranges of the taxable income scale'. Others argue that the implementation of presumptive tax regimes for professionals would help to ensure horizontal equity (Casanegra de Jantscher & Tanzi, 1987). The tax experts interviewed as part of this research also expressed split opinions. The policymakers believed that it is 'absurd' to impose a 'primitive' presumptive regime on professionals who are highly educated and sophisticated.[10] Other experts expressed support for simplified tax regimes for some professionals.[11]

This paper proposes that *presumptive tax regimes can be a useful partial solution for taxing newly qualified, self-employed professionals if they are well-thought-out, meticulously designed, and rigorously monitored.*

Bird and Wallace (2005, p. 130) argue that, compared to farmers and SMEs, self-employed professionals are easier to track and find. They register with their regulators and associations, and their business premises are clearly marked. For this reason, Bird and Wallace (2005, p. 7) argue against presumptive tax regimes for professionals; instead, they advocate for more stringent enforcement.

Increased enforcement of tax law on hard-to-tax professionals is undoubtedly essential.[12] However, this paper also acknowledges that the reasons behind non-compliance by self-employed professionals in LMICs are varied, complex, and interconnected. The use of several complementary options, rather than solely relying on audits, would address the different barriers to compliance and compensate for any inadequacies in enforcement.

For example, tax authorities in LMICs are significantly resource-constrained, meaning that enforcement levels among individual taxpayers are often low. Ensuring a relatively high probability of audit and detection is a challenge for tax authorities in LMICs; they would

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[10] Interview with D-NT, Director, National Treasury (Nairobi, Kenya, 17 September 2015); Interview with SM, Senior Managers, National Treasury (Nairobi, Kenya, 24 September 2015).

[11] Interview with SC-KRA (n 6); Interview with SP-B4, Senior Partner in a 'Big Four' Firm (Nairobi, Kenya, 13 May 2016); Interview with Attiya Waris, Professor of Fiscal Law, University of Nairobi, School of Law (Telephone Interview, 22 March 2018).

[12] The author has argued in favour of increased enforcement with regard to self-employed professionals in LMICs. Those arguments are available in the author's forthcoming thesis. 'Taxing the Hard-to-Tax in Low and Middle-Income Countries: An Examination and Kenyan Case Study' (2019), and in a forthcoming article, 'Trust or Power: How Should We Improve Tax Compliance by Self-Employed Professionals in Countries Dealing with Severe Government Corruption?' (2019).

require considerable financial resources and a large pool of skilled auditors, both of which are likely to be in short supply. While a country like Israel audits about 50% of the tax returns filed by the self-employed, most tax authorities in LMICs will use the few auditors they do have to audit large corporations, from whom they can collect much more revenue than from the HTT (Bahl, 2005).

While there are no reliable statistics on the exact outlay required for audits in LMICs, audits are expensive. The average estimated cost of audits in the UK is £2,500 per audit (Advani, 2017). This cost is a significant amount for most LMICs; even in the UK, one-third of the taxpayers selected for audit 'end up not being audited, largely due to resource constraints' (Advani, Elming, & Shaw, 2017, p. 9). Terkper explains that, while the cost of auditing a small or medium-sized taxpayer may not be high, the total amount required for auditing a satisfactory number of these taxpayers could be significant (Terkper, 2003, p. 221).

Audits also take up a significant amount of time; in the UK, 'the average time between when a return is filed and when the audit is concluded is 14.3 months but… for 10 per cent it is almost two years or more' (Advani et al., 2017, p. 11). The actual audits take an average of 5.3 months, with about 10% of audits running for 13 months or more (Advani et al., 2017, p. 11).

Audits also require significant human resource; one study estimates that audits take up 30% of a tax authority's professional and administrative staff (McKerchar & Evans, 2009, p. 195). While the threat of audit may successfully deter evasion in the short term, LMICs would have to follow through and carry out audits in order to have an impact on compliance attitudes. 'The existence of a penalty for noncompliance deters tax evasion but only in light of the probability that a penalty will actually be imposed' (Lederman, 2018, p. 15). Many LMICs will not have the sufficient number of skilled auditors required to carry out an adequate number of audits, given the cost, time, and workforce that audits take.

Furthermore, in LMICs with corruption problems, like Kenya, unscrupulous auditors may take the opportunity to extort or collaborate with tax evaders by turning a blind eye to evasion in exchange for a bribe.

In addition, many HTT professionals in LMICs engage in cash transactions. According to Tadesse and Taube (1996, p. 4):

> Small-scale businesses dealing with cash transactions are notoriously difficult to tax, and not just in Africa. Among professionals, including doctors, lawyers, building contractors, and consultants, the scope for underreporting of incomes is often considerable, even though they may be some of the highest income recipients in a country.

The reality of cash transactions among hard-to-tax professionals in countries like Kenya means that enforcement through audits is difficult. Without a defined basis for assessing income, revenue officials struggle to determine the amount of tax due.

Finally, from a policy perspective, it is difficult to justify permitting SMEs access to presumptive regimes but making professional income ineligible even when the professionals meet other eligibility criteria. Many professional firms in LMICs exhibit characteristics that are very similar to other SMEs. Indeed, many respondents often referred to their firms as SMEs during the interviews. The image of a large professional firm with an extensive portfolio of

clients, significant income, and financial access to accounting and tax services is not an accurate representation of all professional firms in LMICs. There are professionals, particularly early career professionals, running small firms with modest turnovers. These professionals face the same compliance challenges that SMEs face, including the high costs of compliance and the inability to navigate complex compliance requirements. From a policy perspective, therefore, it is difficult to justify opting for a blanket ban on presumptive regimes for professionals.

Where presumptive taxes are designed in line with the characteristics of a good tax regime, they can be of benefit to LMICs where professionals evade taxes because of complexity, social influence, and low levels of financial and tax literacy. Presumptive methods can also improve the public perception of, and enhance trust in, the revenue authority if they are preceded by open dialogue and fair negotiation between the revenue authority and taxpayer representatives, and if they succeed in making compliance more manageable and cheaper.

Presumptive taxes are often criticised for being inefficient and inequitable in comparison to ordinary income tax regimes. However, overloading presumptive taxes with equity objectives, or other dissimilar and often competing or contradictory objectives, results in a presumptive regime that does not meet its prime aims. As pointed out in previous research, presumptive tax regimes cannot, and should not, compete with the standard tax regime; the two regimes serve very different purposes, with the former aimed at simplification, lowering compliance costs, facilitating cheaper enforcement, and ensuring that the self-employed also bear the tax burden (Pashev, 2006, p. 417). A presumptive regime is not a standalone or long-term solution; instead it is 'a complementary instrument that can help the tax administration in transition countries in the short and medium-run to handle the challenges of…the large hard-to-tax sector' (Pashev, 2006, p. 417).

This paper advocates for the limited and targeted use of simplified tax regimes for self-employed professionals who are newly qualified and just 'starting out' in self-employment; they face the most significant compliance challenges.

These taxpayers have weaker internal and accounting structures within their firms. They often make haphazard withdrawals of cash from their businesses, resulting in significant cash flow challenges, and have lower disposable income, thus inhibiting their ability to engage professional help for their accounting and tax affairs. The research data did suggest that lawyers naturally outgrow this phase over time, as they attract more corporate clients and begin to streamline their businesses. However, the extent to which this happens is likely to vary significantly, since not all firms will attract the same number and calibre of corporate clients. Dental firms did not exhibit a similar pattern and it is this latter trend that is likely to be replicated in most professions.

The professionals also spoke about the difficulty of dropping the bad compliance behaviour, and the long-lasting effects of the good compliance behaviour, acquired at the start of one's practice. Indeed, previous research has shown that new members of an occupation are 'tax novices' but soon adapt to the taxpaying culture within their occupation – be it one of compliance or one of evasion (Ashby, Webley, & Haslam, 2009, p. 217). Presumptive tax regimes for these newly qualified professionals would ensure that they begin their professional life engaging in good compliance behaviour which they can carry on demonstrating as they grow their firms.

Furthermore, if presumptive methods successfully encourage compliance by those prevented from complying because of complexity, the tax authority may also benefit from the knock-on effect on taxpayers who are influenced by the actions of their peers. Once simplicity encourages higher levels of voluntary compliance within the profession, the social influence of the complying peers may lead to even more compliance. It would, therefore, be a useful tool in professions where evasion is particularly rampant, and the tax authority's goal is to (i) reverse the pervading evasion culture and establish one of compliance and (ii) urgently increase revenue collection in a country dealing with a significant budget deficit. Perhaps this was the idea behind the introduction of presumptive taxes for professionals as part of the fiscal reforms taken by Greece, as discussed above.

To increase the effectiveness of presumptive regimes, the revenue authority, in conjunction with industry representatives, would have to proactively communicate the increased simplicity and levels of compliance within the profession in order to influence the perceptions of those who have previously been non-compliant.

The respondents' current perceptions of the Kenya Revenue Authority are, *inter alia*, that: (i) the authority is blind to the challenges that SMEs face in complying; (ii) the authority is not keen on cultivating relationships with small business owners and is more interested in large taxpayers, like multinational enterprises; and (iii) the authority does not understand the nature of the professionals' work and thus makes arbitrary, inconsistent, and unfair decisions. A presumptive method that simplifies the compliance process for some professionals may play a part in repairing the damaged legitimacy of the revenue authority. Taxpayers may begin to perceive the authority as understanding the costs and complexity that inhibit their compliance, and as taking steps to reduce these burdens.

Furthermore, before introducing a presumptive method that would apply to a profession or several professions, the authority should engage industry representatives in a public participation process; this would provide a platform for dialogue through which the authority can begin to better understand the unique needs and challenges of the professionals, and cultivate relationships with them. If properly managed, this process can demystify the revenue authority and build the trust of taxpayers, i.e. the taxpayers will begin to believe that the authority is benevolent and working for the common good, and increase the likelihood that they will voluntarily comply (Kirchler et al., 2008, p. 212).

How Should a Presumptive Tax for Professionals in LMICs be Designed?[13]

This, perhaps, is the most crucial question. This author does not claim to provide all the answers in this paper, but some useful ideas are suggested below.

Initially, it is necessary to determine which categories of income would be classed as 'professional income' and thus covered by the proposed presumptive tax. The tax should be restricted to professions in which self-employment is a ubiquitous employment option. In the case of Kenya – and most LMICs – this would probably cover lawyers, doctors, dentists, pharmacists, accountants, engineers, surveyors, architects, IT professionals, and consultants.

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[13] I am extremely grateful to Professor Eric Zolt for the comments and suggestions that helped to shape this section.

The next significant action would be to identify the relevant professional association or regulator licensing each profession and make requests for third party data in the form of updated registers of members, including their business addresses, dates of admission to the profession, and personal identification numbers.[14] Keeping a regularly updated register or database of all professionals would be ideal. Without this information, it would be difficult to effectively design and implement a presumptive income tax, monitor its uptake, and prevent its abuse. This data would additionally assist the revenue authority in the monitoring of taxpayers who are subject to the regular tax regime.

It would then be necessary to conduct a study of the eligible professions in order to determine:

i.   the level of financial and tax capability of newly admitted members, and whether and how this knowledge increases during their first seven years in practice[15];
ii.   the revenue potential of newly admitted members during the first seven years;
iii.   the amount of capital required to set up a business in each profession – for example, dentistry is much more capital intensive than accounting, and this determines how long the professional will wait to realise a return on their investment;
iv.   the nature of clients that the various professionals tend to attract in the first seven years of practice (whether individual, corporate, or public sector) and how these trends change over the seven-year period;
v.   the nature of transactions in the professions, i.e. cash or cashless, in the first seven years of practice;
vi.   specific professional rules and regulations, if any, governing financial record-keeping and tax compliance within each profession.

Bearing in mind the resource limitations of the revenue authorities in LMICs, the tax authorities can take a phased approach, tackling one profession at a time.[16]

With this data, revenue administrators and policymakers will have a sound basis for designing a presumptive regime that takes into consideration the subtle differences in each profession. For example, some professions, like law, have professional rules and regulations governing the

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[14] In addition to statutory powers underpinning requests for third party data, the success of such requests will depend on whether registration with the professional association or regulator is mandatory. Registration with regulators, particularly regulators established by statute, is almost always mandatory and this is perhaps the best source of data, since the professionals cannot opt out of registration for fear that the register is used for tax compliance purposes. Some professions self-regulate and membership to an association may be mandatory; such associations would also provide reliable data. Where registration with an association is optional, there is a higher risk that professionals will simply choose to withdraw their registration or membership, particularly if the other benefits of membership do not outweigh the risk of detection by the tax authority.

[15] The seven-year benchmark is not based on any particular scientific analysis; rather, it is intuitive and informed by the benchmarks applied in the legal profession in Kenya. Advocates who have practised for five years or fewer are deemed to be 'young advocates' and are entitled to certain privileges, including reduced practising licence and continuing legal education fees. Such advocates are also prohibited from making applications to serve as notary publics. Furthermore, in order to be eligible for judicial appointments, advocates must have practised for a minimum of 10 years. In the author's view, the benchmark for eligibility for a presumptive tax regime ought to sit somewhere between those two benchmarks, and seven years appears to be a reasonable middle ground.

[16] See, for example, HMRC's approach to auditing professionals in the United Kingdom (www.gov.uk/government/publications/2010-to-2015-government-policy-tax-evasion-and-avoidance/2010-to-2015-government-policy-tax-evasion-and-avoidance).

keeping of accounting and financial records. A presumptive tax regime permitting taxpayers in such professions to keep simple books, or to keep no books at all, would have to be designed in consultation with the relevant regulator. The rules on simpler record-keeping should not result in the breaking of professional rules and standards; these things must coexist.

Eligibility for the presumptive regime should be based on the date on which one qualified to practice in the relevant profession and not when one chooses to become self-employed. This distinction would prevent abuse of the system by those fully capable of complying with the ordinary tax rules. For example, if Professional A was licensed to practice in 2010 but chose to go into self-employment in 2018, they are more likely to be capable of coping with the ordinary compliance requirements than Professional B, who qualified in 2016 but also went into self-employment in 2018.

The regime should contain a sunset clause that limits the number of years for which the taxpayer is eligible for presumptive tax, thus prodding the taxpayers towards self-assessment. The implementation should be accompanied by training and support from the revenue authority, thus preparing the eligible taxpayers for their eventual exit from the presumptive regime. The goal would be to inculcate a taxpaying ethos early in the taxpayer's career and encourage a fairly uniform path of growth towards formalisation for these small businesses, ensuring that none, or at least only a tiny number, are left behind.

The exit from the presumptive regime also needs to be managed appropriately to prevent taxpayers from slipping into evasion and the subsequent erosion of the gains made. Revenue authorities should work closely with regulators and professional bodies in determining how long taxpayers can be deemed to be 'newly qualified' and eligible for the regime. Revenue authorities would also have to determine whether or not there needs to be an 'intermediary' stage between eligibility for the presumptive regime and eligibility for the ordinary income tax regime, and what such an intermediary stage should look like.

Policymakers and tax authorities would also have to decide on the type of presumptive tax that would be suitable for professionals. The often-favoured turnover tax, where the taxable income is 'no less than a specified percentage of the gross receipts of the business', may be simple to administer, but it is likely to be ineffective among self-employed professionals whose gross receipts are easily hidden (Thuronyi, 2000, p. 410). This method has, however, been adopted in India, as explained above.

A presumptive regime, in which the taxpayer pays a lump sum amount, may be an option for sectors in which the turnover method would be unsuitable. Such a tax would operate as a 'maximum' tax, i.e. the taxpayer would have the option of producing books of accounts proving a lower income. This method would relieve the tax authority of the burden of ascertaining a taxpayer's actual income through audits and the taxpayer's compliance costs would be negligible. If the taxpayer chooses to keep proper books of accounts, their compliance costs will be no higher than they already are. This method has been criticised for resulting in vertical inequity, where the incomes within professions diverge widely, and proposed solutions have included the creation of bands within the lump sum in order to make the tax less regressive (Tadesse & Taube, 1996). However, as Pashev points out, overloading presumptive tax regimes with these equity objectives seriously undermines their effectiveness in achieving simplicity (Pashev, 2006). Some level of inequity is a trade-off that must be accepted in order to achieve the other goals of simplification, horizontal equity, and cheaper compliance and audit.

The French *forfait* and the Israeli *tachshivim* are examples of lump-sum taxation methods that may be considered. The *forfait* method is a sort of 'contract' between the tax authority and the taxpayer; they agree on the estimated income that will form the basis for taxation for a fixed period, usually between one and three years. Since this method involves negotiation and agreement between revenue officers and taxpayers, it is susceptible to abuse in countries where revenue officers are dishonest or corruption is a challenge (Casanegra de Jantscher & Tanzi, 1987).

In LMICs where corruption is a challenge, a better option would be to utilise the idea behind the *tachshivim*, which was subsequently replaced by *tadrihim*. Like the *forfait*, the *tachshivim* involves an advance 'agreement between taxpayers and the tax authorities' but, unlike the *forfait*, 'the agreement is on the tachshiv in general (being negotiated with industry representatives), not on its application to particular taxpayers' (Thuronyi, 2000, p. 424).

The in-depth study on average earnings among taxpayers in the different professions mentioned above would be vital in determining a suitable lump sum amount, since this would likely vary from profession to profession. A good starting point would be to determine the revenue earned by professionals with similar years of experience in government service and determine whether the average income of the self-employed professionals would be comparable.

Implementing a presumptive regime may inevitably result in a lower tax burden for these hard-to-tax professionals. One could argue that it amounts to an unjustified government subsidy for the decision to enter into self-employment. However, this is not necessarily an adverse outcome in Kenya's case and this may be true for other LMICs. With one million births a year, Kenya is experiencing a significant bulge in the number of youths in its population (United Nations Development Programme, 2013, p. 5).

However, the country also has high unemployment rates, particularly among the youth; nine in every ten unemployed Kenyans are aged 35 or below (Kenya National Bureau of Statistics, 2018). There are inadequate waged jobs in the formal sector; only two out of five waged jobs are formal and only 6 per cent of youths reaching the working age are securing modern waged jobs (The World Bank, 2012, pp. 29-30).

With the introduction of free primary education and an ever-increasing number of universities, there has been a significant increase in the number of graduates, but many graduates struggle to secure formal employment. One of the main objectives of the current Kenyan government is to increase income-generating opportunities for unemployed youths. A presumptive regime for newly qualified professionals would ease the pathway for graduates who are unable to secure formal employment; they would be able to set up firms, and enjoy the reduced cost and complexity of compliance for a few years to allow their firms to grow.

CONCLUSION

The reasons behind non-compliance by self-employed professionals in LMICs are varied; no single solution will address all the barriers to compliance and, therefore, a mixed methods approach is appropriate. This paper considered the suitability of presumptive tax regimes as a partial solution.

The literature on presumptive taxation has either overlooked professionals or automatically deemed the regimes unsuitable for them. In practice, most countries explicitly exclude

professional income from eligibility for presumptive regimes in the language of the statute. Where presumptive taxes for professionals are introduced, they are used to punish non-compliance, rather than to support taxpayers and positively encourage compliance.

This paper makes two main contributions. It provides interesting qualitative data on the tax compliance attitudes of hard-to-tax professionals in a lower middle-income country, a group of taxpayers that have not been well covered in the literature on tax evasion in LMICs.

Second, the paper contributes to the literature on presumptive taxation. The author proposes that where presumptive taxes are well-thought-out, backed by research, carefully designed and implemented, and rigorously monitored, they can be of benefit to LMICs in which newly qualified professionals evade taxes because of complexity, peer influence, and low levels of financial and tax literacy. Presumptive methods can also improve the public perception of, and enhance trust in, the tax authority if they are preceded by open dialogue and fair negotiation between the authority and taxpayer representatives, and if they succeed in making compliance easier and cheaper.

Careful attention must be paid to thresholds and the period of time for which a taxpayer is eligible for the presumptive regime before they transition into the ordinary tax system. The tax should be designed with time limits, encouraging the taxpayer to move into the ordinary regime, and specific effort made to develop the taxpayer's capacity and financial sophistication during the period of eligibility.

However, policymakers and tax authorities should not be bogged down with the task of achieving maximum equity within a presumptive regime, as this will merely result in complexity; instead, the focus should be on simplicity, and reducing the costs of audit compliance and graduating the taxpayer to the ordinary tax regime within a reasonable timeframe.

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ANNEX

Table 3: Profile of Dentists Interviewed for the Project

Identification	Nature of Practice	Level of Specialisation	Gender	Years of Experience
Dental Practitioner 1	-Self-employed -Runs own practice -Previous locum experience	Specialist	Male	More than 7
Dental Practitioner 2	-Self-employed -Informal employment working for a self-employed practitioner -Previous locum experience	Non-specialist	Male	Fewer than 7
Dental Practitioner 3	-Formal employment (private) -Previous locum experience	Non-specialist	Female	Fewer than 7
Dental Practitioner 4	-Self-employed -Runs own practice -Previous locum experience	Non-specialist	Male	Fewer than 7
Dental Practitioner 5	-Formal employment (government) -Engaged as a locum	Specialist	Female	7
Dental Practitioner 6	-Self-employed -Runs own practice -Engaged as a locum	Specialist	Female	More than 7
Dental Practitioner 7	-Formal employment (government) -Engaged as a locum	Non-specialist	Female	7
Dental Practitioner 8	-Self-employed -Runs own practice -Previous locum experience	Specialist	Male	Fewer than 7
Dental Practitioner 9	-Self-employed -Runs own practice	Specialist	Male	More than 7
Dental Practitioner 10	-Formal employment (government) -Engaged as a locum	Specialist	Female	More than 7

Table 4: Profile of Lawyers Interviewed for the Project

Identification	Nature of Practice	Years of Experience	Age of Business	Gender
Legal Practitioner 1	Sole proprietor	> 10	> 3 years	Male
Legal Practitioner 2	Sole proprietor	< 10	< 3 years	Male
Legal Practitioner 3	Partnership	< 10	< 3 years	Male
Legal Practitioner 4	Partnership	< 10	< 3 years	Female
Legal Practitioner 5	Sole proprietor	< 10	3 years	Female
Legal Practitioner 6	Partnership	< 10	< 3 years	Male
Legal Practitioner 7	Sole proprietor	> 10	> 3 years	Female
Legal Practitioner 8	Self-employed	< 10	N/A	Female
Legal Practitioner 9	Partnership	> 10	< 3 years	Male
Legal Practitioner 10	Sole proprietor	< 10	< 3 years	Male
Legal Practitioner 11	Partnership	> 10	> 3 years	Male
Legal Practitioner 12	Sole proprietor (previously run as a partnership)	> 10	> 3 years	Male

FRAMING EFFECTS ON PREFERENCES FOR THE INCOME TAX SYSTEM

Darius Fatemi[1], John Hasseldine[2]

Abstract

Lack of public support for a tax system can lead to its demise, as demonstrated by the UK poll tax debacle. On the other hand, McCaffery and Baron (2004) argue that the politicians who best frame their arguments will rally public support to sustain the tax system. The present study examines how varying the frames on income tax attributes affects underlying attitudes toward the system. Most prior tax research on framing effects has not made a distinction between different types of framing effects as it has only examined risky choice framing. This study specifically analyzes attribute frames, and particularly focuses on equivalency and emphasis framing. The findings illustrate and document significant effects for these types of frames. For example, taxpayers are significantly more positive about 50 percent of taxpayers paying 4 percent of the taxes than they are about 50 percent of taxpayers paying 96 percent of the taxes. In addition, taxpayer preferences measured using descriptors such as "fair" or "unfair", and "positive" or "negative", affect the relationship between attributes and intentions to support the current tax system. Thus, equivalency and emphasis framing not only affect attitudes toward a specific attribute, but also influence how these attributes are weighted when determining overall tax system support.

Keywords: Tax Compliance, Taxpayer Preferences, Tax Attitudes, Framing Effects, Attribute Frames.

INTRODUCTION

Recent reports have documented the importance of public support for tax systems. Despite an annual U.S. tax gap of $458 billion, most American taxpayers state that cheating on taxes is unacceptable (Internal Revenue Service Oversight Board [IRSOB], 2014), yet it is still imperative that tax administrators should solicit public opinion and respond to citizens' input. Public discourse creates an opportunity for the government to respond to citizens' views and needs. Gathering public opinion, however, is not a simple task, because attitudes can change over time and be altered by the context in which they are solicited (Hite & Roberts, 1991; McCaffery & Baron 2004, 2006).

This paper examines the impact of framing effects on the preferences that taxpayers express toward public policy. In the process, it provides insights into the stability of taxpayer perceptions by demonstrating whether, and when, participants' responses to questions depend on the phrasing of those questions. Going further, the paper then addresses whether framing effects on individual aspects of a system remain pertinent when determining overall sentiment toward a system with many different characteristics. The results are important for policymakers wishing to gauge taxpayer attitudes. In addition, the study is relevant to several research areas focusing on persuasion and behavior from a broad perspective (Petty & Briñol, 2008), in more specific areas, such as nudge (Biddle, Fels, & Sinning, 2018), and within the framework of

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[1] Associate Professor, Northern Kentucky University.
[2] Professor, University of New Hampshire.

discourse regarding political and social issues (Feinberg & Willer, 2015). Of specific relevance to our study, the paper further informs our understanding of framing in a political context (van der Pas, 2014).

Framing effects are not new to the literature, but that literature has not distinguished between the different mechanisms for framing effects (Druckman, 2001). Furthermore, the tax literature has largely focused on risky choice framing, as developed by Kahneman and Tversky (1979, 1982). Attribute framing provides us with an advantageous framework for examining taxpayer preferences on three levels. First, because it focuses on individual components instead of overall attitude, it has been less fully explored, leaving more unanswered questions. Second, small changes in tax law are easier to accomplish than large-scale reform, so a policymaker who wishes to accomplish change with public support would benefit by singling out one attribute of a tax system. Third, the quantitative nature of a tax system, as well as routine politicization, makes it subject to two forms of attribute framing in particular: equivalence and emphasis. These concepts are explained in further detail later in the paper.

This paper investigates taxpayer preferences toward the income tax system and examines how attitudes toward specific attributes of the system affect behavioral intention to vote for a political candidate who wants to keep the income tax system basically as it is. Differing frames are used to test the stability of the attributes. This paper contributes to the literature by examining taxpayers' preferences toward the often-competing tax attributes of equity, ability to pay, and redistribution, while demonstrating how those preferences are altered by using different frames. Importantly, this study illustrates that the effects of equivalency and emphasis framing extend beyond differences in mean attitude on an attribute. Equivalency and emphasis frames can also affect the resulting correlations between the framed attribute and other associated variables.

Our results show that intention to vote for a pro-income tax politician was influenced by three specific attributes: attitudes toward the equity of the tax system, whether it helps the poor, and the fact that 96 percent of all the income taxes are paid by half of the taxpayers. The effectiveness of the three factors, however, differed according to how they were framed (e.g., fair/unfair, helps the poor/hurts the wealthy, and half paying 96 percent is a positive/negative feature). In addition, respondents were significantly more positive about half of the taxpayers paying four percent of the taxes than about the other half paying 96 percent.

Understanding how different frames influence tax preferences is crucial to determining their true level of acceptability. Politicians, researchers, and policymakers should be interested in discovering which types of frame influence opinion (Boudreau & MacKenzie, 2018; Lamberton, DeNeve, & Norton, 2017). This paper proceeds by reviewing the relevant literature, explaining the research method, presenting the results, and then discussing the study's conclusions and limitations.

LITERATURE AND HYPOTHESES

Framing Effects

The theory underlying framing effects grew out of prospect theory, as developed by Kahneman and Tversky (1979). Prior research, however, has documented that framing effects explain a much larger range of behavior than demonstrated in the very early risk preference studies.

Levin, Schneider and Gaeth (1998) show that valence framing effects include at least three different mechanisms: risky choice framing, goal framing, and attribute framing.

Risky choice framing (Kahneman & Tversky, 1979, 1982) involves a choice between options with different risk levels that are mathematically identical to an alternatively stated set of options. Subjects are risk-seeking in negative frames and risk-averse in positive frames. In goal framing, the outcome variable is measured as the extent to which subjects adopt a targeted behavior (Meyerowitz & Chaiken, 1987). Thus, a nudge communication (Thaler & Sunstein, 2008) might emphasize either the positive consequences of displaying the targeted behavior or the negative consequences of not displaying the behavior (e.g., being fully tax compliant). In contrast, attribute framing examines the evaluation of an event or object based on how specific characteristics of the event or object are described (Levin, 1987). Each of these three types of valence framing effect is operationalized by presenting information in either a positive or negative manner.

Druckman (2001) categorized attribute framing as either equivalency or emphasis framing. He asserted that equivalency frames represent scenarios in which precise situations are described in alternate ways, usually mathematically or tautologically equivalent. Emphasis framing is similar but distinct. It describes situations in which attention is drawn to different aspects of the same problem, such as the harmful consequences or the potential benefits of an object or event. Although the equivalency-emphasis dichotomy is useful, the classifications are not precise. For example, Levin et al. (1998) examined the effects of having a half-full and half-empty piggy bank on the likelihood of future savings. The difference was not significant, as the treatment appeared to be overwhelmed by a series of other positive/negative descriptors and motivations for saving that were included in the scenarios. Nonetheless, the notion of half-full versus half-empty exemplifies the gray area between the categorization of equivalency and emphasis frames. The descriptions are mathematically equal, but they emphasize either a favorable or unfavorable perspective, as demonstrated by Reimers (2009).

The present study examines a mathematically equivalent frame describing how much tax is paid by a given proportion of taxpayers. Based on the IRS's Statistics of Income (SOI) data (2018), 50 percent of the taxpayers pay 96 percent of the federal individual income taxes that are paid. Alternatively stated, 50 percent of the taxpayers pay four percent of all federal individual income taxes. Mathematically, the statements are equivalent, but one statement indirectly draws respondents' attention to the top half paying a lot while the other statement draws it to the bottom half paying a little. Given the implied redistributive nature of progressive tax systems, policymakers wanting to determine taxpayers' preferences need to know whether these types of equivalency frames alter taxpayers' attitudes. Thus, we test the following hypothesis:

> **H1:** Evaluations will differ between taxpayers asked about half of the taxpayers paying 96 percent and half paying 4 percent of the income taxes.

The results of this test will document the validity of equivalency framing and provide policymakers with a framework for analyzing whether one side of the scale demands more attention than the other.

Tax System Attributes

Based on prior tax studies (Roth, Scholz, & Witte, 1989; Roberts, 1994), overall attitude toward the tax system is explained by attitudes toward specific traits of the system (Onu, 2016). However, the literature on attribute framing by Levin et al. (1998) and Druckman (2001) suggests that tax attitudes may differ with context. For example, when income tax rates were framed in percentages rather than in dollar amounts, preferences for rates varied significantly (Hite & Roberts, 1991). In addition, research by McCaffery and Baron (2004) found a penalty aversion bias because of a differential effect when the income tax system was described as either providing a bonus or assessing a surcharge. Research on framing effects supports that literature. More recently, Stanley and Hartman (2018) examined framing and found that taxpayer attitudes differed according to the way government spending was categorized.

Rothman and Salovey (1997) assert that the impact of objectively identical information is differentially affected by positive and negative frames. Building on that theory, prior tax research found that attitudes toward the income tax system differed significantly when soliciting preferences for an unfair and complex income tax system than when soliciting preferences for a fair and simple tax system (Hasseldine & Hite, 2003). The latter study did not distinguish solely between fair and unfair, because the outcome variable included compound descriptors of "unfair and complex" versus "fair and less complex." This undoubtedly encouraged agreement that the system is becoming more unfair and complex rather than disagreement that it is becoming fairer and less complex.

In the current study, the effects of equivalency framing and emphasis framing on key attributes of the tax system are examined to discover the mean differences on attitude toward the attributes themselves, as well as on their differential impact on intended behavior to support the income tax system. Given that equity, redistribution, and ability to pay have been recognized as key variables affecting attitudes toward a tax system (Porcano, 1984), attitude toward those three aspects are examined. The equity and ability to pay factors are presented in "equivalent" frames. Equity is solicited using either a "fair" income tax context or an "unfair" income tax frame. Ability to pay involves the actual statistic regarding who pays most of the federal income taxes. The top half pays 96 percent of the individual income taxes. This "96%" fact is described as either a "positive" feature of the income tax system or a "negative" aspect. The redistribution factor is presented in "emphasis" frames. Redistribution due to income inequality implies taking from upper income taxpayers to help lower economic taxpayers or the poor. This study compares taxpayer attitudes toward the income tax system when references are made to helping the poor versus hurting the wealthy.

We can then perform a precise test of the positive/negative frame posited by prior research (Payne, Laughhunn, & Crum, 1984; Druckman, 2001; Rothman & Salovey, 1997). Levin et al. (1998) point out that attribute frames have used simple negation (such as attractive versus not attractive) as well as sets of linguistic variations (such as percentage fat or lean) to accentuate either positive or negative characteristics of the item being evaluated. For example, Dunegan (1993) reported that significantly lower evaluations were given to project teams (doing funding allocations) when their performance was described as having a 40 percent failure rate rather than a 60 percent success rate.

The overriding theme in attribute framing is that the positive frame refers to some desirable aspect of the attribute and the negative frame refers to an undesirable trait. Levin et al. (1998) explain that framing effects are consistent with the concept of priming, in that positive stimulus

labels lead to more favorable evaluations. That is, the prime forms an evaluative frame which maps a path from the positively or negatively framed knowledge to a readily accessible impression. Similar concepts have been explored in subsequent research, such as in Chong and Druckman (2007). We use these prior findings to posit the following hypotheses:

H2: Equivalency framing will significantly affect voting intention toward a politician who wants to keep the income tax system basically as it is.

H3: Emphasis framing will significantly affect voting intention toward a politician who wants to keep the income tax system basically as it is.

METHOD

Households were randomly selected to participate in a telephone survey on the income tax system by a professional survey research center. Interviewers were trained prior to making the calls and read the questions at a rate of two words per second. The research center conducted the study using the Computer-Assisted Survey Execution System (CASES) software package developed by the Computer-Assisted Survey Methods (CSM) Program, which is managed by the Institute for Scientific Analysis. The research center used the Genesys list-assisted method, which allows for unpublished numbers and new listings to be included in the sample. When using this method, numbers are randomly generated, and those from a database of business and non-working numbers are purged. Household respondents had to be at least 18 years of age in order to participate. We chose a sample limited to one state in order to minimize demographic variation, as cultural differences from different regions would have introduced more statistical noise and a need for greater controls.

As a result, approximately 500 subjects participated in this study. Participants were randomly assigned into two groups. The first group was used to test the impact of the 96/4 equivalency frame. Half of this group received the 96 percent question focusing on the top half, while the remaining subjects received the four percent question focusing on the bottom half. The question was worded as follows:

Regarding federal income taxes, it is a fact that taxpayers in the upper (lower) half of the income brackets pay 96% (4%) of all the income taxes collected by the federal government. Is this a positive feature or negative feature of the income tax system?

Responses were recorded on a scale of 1 ("very positive") to 9 ("very negative"). This variable depicts an equivalent frame with a different focus for each frame: one on the top half, the other on the bottom half.

Another group of nearly 250 respondents was used to test for between-subject framing effects on three factors related to global attitudes toward the individual income tax system. Each of the three factors was alternatively framed between groups. The frames compare the following: attitudes about the equity attribute in terms of agreement with how fair (unfair) the tax system is, about redistribution in terms of agreement or disagreement that the system helps the poor (hurts the wealthy), and about the attribute for ability to pay in terms of agreement with half paying 96 percent being a negative (positive) feature. Attitudes about the equity, redistribution, and ability to pay attributes are tested for mean differences to examine the direct effects of the equivalency and emphasis frames.

The questions in the separate frames were worded as follows:

> *FAIR (UNFAIR): For the most part, the income tax system is a fair (unfair) system.*

> *POOR (WEALTHY): In the long run, the income tax system helps the poor (hurts the wealthy).*

> *96% NEGATIVE (POSITIVE): It is a fact that taxpayers in the upper half of the income brackets pay 96% of all the income taxes collected by the federal government. This is a negative (positive) aspect of the federal income tax system.*

Studies on attribute framing typically evaluate the targeted dimension that is portrayed either positively or negatively. Very few studies have examined indirect effects on related dimensions. However, a study by Levin and Gaeth (1988) found that not only did percentage of fat (lean) affect the respondents' preferences for fat or lean meat, it also affected their evaluations of its taste, greasiness, and quality. To the extent that evaluations of specific aspects of an object are influenced by valence-based framing effects, global judgments related to the object could also be affected. This link is vital to the tax research on behavioral interventions following nudge principles (James, 2017). In the tax compliance literature, for example, overall support for the income tax system could be influenced by using valence-based frames to prime various attributes of the tax system. The present study tests not only for a framing effect on a judgment about each specific tax attribute but also for an effect on how framing of the attributes affects how each attribute correlates with the overall evaluation of the tax system. This final variable was tested using the following question:

> *VOTE: If all other issues were similar for two political candidates, do you think you would vote for the politician who wants to keep the current federal income tax system basically as it is?*

RESULTS

Table 1 presents the descriptive statistics for the participants in this study. The median income of the respondents was in the $50,000 to under $75,000 bracket. The respondents' ages ranged from 18 to 98 with a median age of 43. The median level of education was the completion of "some college". Slightly more than half of them were married (53 percent) and slightly more than half of them were female (54 percent). Most (59 percent) used paid preparers.

Table 1: Demographic Statistics (n = 489)

Marital status	
Unmarried	47%
Married	53%
Gender	
Male	46%
Female	54%
Income	
<$15,000	7%
$15,000 - < 25,000	8%
$25,000 - < 35,000	10%
$35,000 - <50,000	16%
$50,000 - <75,000	29%
$75,000 or more	30%
Education	
High School or less	40%
Some College	25%
College Degree	35%
Tax preparer	
Self	41%
Paid Preparer	59%
Age*	
Median 43	
Mean 46	
S.D. 16	
Range 18 – 98	

*Age was the only variable that significantly correlated ($p < .05$) with the targeted dependent variable for voting intention.

The first attitude question that respondents were asked (labeled "good") was used as a randomization check to measure initial attitudes and to test for essentially equivalent random-assignment in Groups A and B for the differing frames. Subjects were asked whether they agreed or disagreed that the "current income tax system is a good way for the government to get revenue" (mean 4.79 on a scale from 1 to 9, s.d., 2.63). Only 36 percent disagreed while 46 percent agreed. Using an analysis of covariance with age and income level, these responses did not differ by random group assignment ($F=.259$, $p=.611$). Thus, subjects' a priori attitudes toward the system did not significantly differ in the groups that received alternate frames.

The only demographic variable that was significantly correlated with a randomization check variable ("good") and the targeted dependent variable ("vote") was age. Therefore, age is included as a control variable in the analyses of covariance (ANCOVAS) and regressions presented in this paper. In addition, given that two of the attributes focus on redistribution and ability to pay, we include the respondents' reported levels of income as a control variable.

Equivalency Framing

The first hypothesis posited that mathematically equivalent frames would lead to significantly different attitudes. The results in Table 2 support that hypothesis. Respondents were significantly more positive about the lower half of the taxpayers paying 4 percent of the taxes (mean 4.11, s.d., 2.50) than about the upper half of the taxpayers paying 96 percent (mean 4.80, s.d., 2.55). Most (54.5 percent) agreed that half paying four percent was a positive feature of the tax system, while 40.7 percent agreed that half paying 96 percent was positive. In fact, 38.2 percent thought the latter was a negative feature, but only 23.8 percent thought half paying four percent was a negative feature.

A formal test of the first hypothesis was conducted with an ANCOVA, using participants' agreement with the ability to pay question as the dependent variable. The frame (96%/4%) was the independent variable, with responses in the 96% frame reverse-coded, and both age and income level were included as covariates. Although one might expect the result to be driven by self-interest, income did not significantly vary with attitude toward this ability to pay attribute ($F=.427$, $p=.514$), as shown in Panel B. However, the effect of frame was significant ($F=4.929$, $p=.027$). The results are especially important, given that prior research (albeit in non-tax contexts) has suggested that frames using mathematical percentages at extreme ends of the scale tend not to produce framing effects (Levin et al., 1998).

Table 2: Attitude on Half Paying 96 Percent or 4 Percent

Panel A: Descriptive statistics

Frame	Mean (s.d./n)	Frequencies		
		Agree Positive	Neutral	Agree Negative
Half Pay 96%	4.80 (2.55/115)	40.7%	21.1%	38.2%
Half Pay 4%	4.11 (2.50/140)	54.5%	21.7%	23.8%

Panel B: Significance tests

Variables	Mean Square	df	*F*-test	*p*-Value
Covariates				
Age	1.747	1	.273	.601
Income	2.726	1	.427	.514
Frame	31.623	1	4.949	.027
Error	6.390	251		

The second and third hypotheses test the effects of equivalency and emphasis framing on three attributes of the tax system: equity, redistribution, and ability to pay. Table 3 presents the mean responses for each of the targeted attributes. On a scale in which 1 represents strong agreement and 9 represents strong disagreement, Panel A shows that 53 percent disagreed that the system is fair while only 44 percent agreed the system is unfair. When the responses to "unfair" were reverse coded, the means significantly differed at the .05 level (5.74 versus 5.17, *F*=3.768). Thus, the second hypothesis is supported, as an equivalency framing effect is documented in a tax context even though prior research in psychology (Highhouse & Paese, 1996) found attribute framing effects in non-tax contexts but not in a parallel tax context.

Table 3: Framing Effects on Tax Attribute Variables[a]

Panel A: Descriptive Statistics

	Mean (s.d.)	Agree %	Disagree %
EQUITY			
FAIR: "For the most part, the income tax system is a fair system"	5.73 (2.45)	31	53
UNFAIR: "For the most part, the income tax system is an unfair system"	4.83 (2.51)	44	38
REDISTRIBUTION			
POOR: "In the long run, the income tax system helps the poor."	5.65 (2.77)	35	52
WEALTHY: "In the long run, the income tax system hurts the wealthy."	6.44 (3.16)	24	69
ABILITY TO PAY			
96% NEGATIVE: "It is a fact that taxpayers in the upper half of the income brackets pay 96% of all the income taxes collected by the federal government. This is a negative aspect of the federal income tax system."	5.07 (2.60)	39	36
96% POSITIVE: "It is a fact that taxpayers in the upper half of the income brackets pay 96% of all the income taxes collected by the federal government. This is a positive aspect of the federal income tax system.	5.31 (2.48)	0	42

Panel B: Statistical tests

		Attribute								
		Fair/Unfair			Poor/wealthy			96% Positive/Negative		
Variable	df	Mean Square	F	P	Mean Square	F	P	Mean Square	F	P
Age	1	11.473	1.893	.170	1.131	.127	.722	10.133	1.592	.208
Income	1	24.216	3.996	.047	8.432	.947	.331	16.473	2.588	.109
Attribute frame	1	22.797	3.768	.054	39.313	4.416	.037	8.002	1.257	.263
Error	250	6.059			8.903			6.364		

1 represents "strongly agree" while 9 represents "strongly disagree". Original responses are reported in Panel A but UNFAIR and 96% POSITIVE are reverse coded for the statistical tests.

Although "helps the poor" is not the polar opposite of "hurts the wealthy," the two frames focus attention on different aspects of the same redistribution aspect, which is consistent with the literature that Druckman (2001) describes as emphasis framing. In reality, the tax system may actually be helping the poor more than hurting the wealthy, but that is an empirical question that field data could attempt to answer. Emphasis framing is intended to measure the strength of the psychological perception associated with the positive and negative sides of the event or concept. The results in Table 3 indicate that 52 percent of the respondents disagreed that the income tax system helps the poor, while 69 percent disagreed that it hurts the wealthy. The means significantly differ ($F=4.416$, $p=.037$) with respective means of 5.65 (s.d. 2.77) and 6.44 (3.16), which supports the third hypothesis on emphasis framing. The importance of this difference is illustrated later in this paper when the attribute's impact on support for the system is examined in a regression analysis.

Attribute framing was also tested in an equivalency frame by focusing subjects' attention on how positive or negative the 96% ability to pay feature is. The means did not differ ($F=1.257$, $p=.263$). Table 3 indicates that attitudes were evenly split when the top half of taxpayers paying 96 percent of all income tax was described as a negative aspect; 39 percent agreed, and 36 percent disagreed. When the 96 percent attribute was described as a positive feature, 30 percent agreed that it was positive, but 42 percent disagreed. This result is consistent with the data used to test Hypothesis 1. When asked whether this fact was positive or negative, 41 percent of those respondents stated that it was positive, and 38 percent stated that it was negative. The results, however, were significantly different from the responses about the half paying four percent. The implication is that the equivalency frame may well have been effective in the positive versus negative frame had the four percent complement been the targeted attribute.

Regression Analyses

The final dependent variable in this study is voting intention ("vote"). Subjects were asked whether they would support a politician maintaining the current federal income tax system. Responses ranged from 1 to 9, with 1 representing "Yes, definitely" and 9 representing "No, definitely not." Only 26 percent indicated they would vote for a politician who wanted to keep the federal income tax system (mean 5.77, s.d., 2.56); 50 percent indicated they would not vote for such a politician.

To measure the potential influence of factors representing equity ("fair"/"unfair"), redistribution ("help the poor"/"hurt the wealthy"), and ability to pay (top half pay 96 percent of all the income tax paid), these variables were used as independent variables to explain taxpayers' intentions to vote for a politician who supports keeping the current income tax system (a lower score indicates agreement). To control for rival explanations, income and age were included in the model. In addition, initial beliefs about the income tax system ("good") were included in the model to control for prior beliefs. Table 4 presents the results.

Table 4: Regression on Intention to Vote for a Politician Favoring the Income Tax System (n = 239)

Independent Variables	Beta	*t*-statistic
GOOD	.229	3.639[+++]
FAIR/UNFAIR	.234	3.675[+++]
POOR/WEALTHY	.157	2.613[++]
ABILITY TO PAY	-.077	-1.275
AGE	.160	2.648[++]
INCOME	.067	1.107

Adjusted R-square = .194
F = 10.086[+++]

[+]p < .10, [++]p < .05, [+++]p <.01

Table 4 indicates that the overall model was significant (Adjusted R^2=.194, *F*=10.086, *p*<.001). The tendency to vote for a politician who wants to keep the existing income tax system was significantly associated with those who agreed that it is a good system, that it is fair, and that it helps the poor, but who did not agree with half of the taxpayers paying 96 percent of the taxes. In addition, older taxpayers were less likely to vote for a politician who wants to keep the income tax system as it is. Income levels, however, did not affect voting intentions.

When the regression was recalculated with "frame" as an independent variable, it was not significant, and it did not alter the significant results on "good", "fair"/"unfair" and "poor"/"wealthy". To show the relative influence of each attribute frame on voting intention more clearly, separate regressions were computed for each group of frames. The results are presented in Table 5. The results for Frame A show that voting intention was influenced by whether it is a fair tax and helps the poor, but not by the 96% negative attribute. Hence, agreement that the system is fair and agreement that it helps the poor were associated with voting for a politician who wants to keep it as it is. In Frame B, an unfair tax system and the 96% positive aspect were significantly associated with voting intention. The redistribution aspect framed as hurting the wealthy was not significant. In addition, in Frame B, older taxpayers were inclined not to vote to keep a pro-income tax politician, and those who believed that the system was not good were less likely to vote for a politician who wants to keep it. In sum, the influence of attitudes on behavioral intentions to vote for the politician who supports the income tax system was affected by the frame used to measure those attitudes. Although "fair"/"unfair" was significant using both frames, redistribution was significant only when framed as helping the poor. Moreover, the 96% frame was only significant when framed as a positive aspect. Inspection of Frame B (Table 3) shows that more people disagreed than agreed that it is a positive feature. Thus, the association is mostly driven by the fact that those who disagree that it is positive do not intend to vote to keep the system.

Table 5: Regression on Voting Intention Split by Frame

Frame A		Frame B	
Independent Variables	Beta Coefficient	Independent Variables	Beta Coefficient
GOOD	.048	GOOD	.303[+++]
FAIR	.333[+++]	UNFAIR[a]	.198[++]
POOR	.204[++]	WEALTHY	.102
96% NEGATIVE	.085	96% POSITIVE[a]	-.177[++]
AGE	.031	AGE	.224[++]
INCOME	.132	INCOME	.046
Adjusted R-square	.199	Adjusted R-square	.219
F	8.606[+++]	F	6.656[+++]

[+]p < .10, [++]p < .05, [+++]p <.01
[a]UNFAIR and 96% POSITIVE are reverse coded

The results in Table 5 support the third hypothesis for emphasis framing. In Frame A, the redistribution factor focused on whether the system helps the poor, and this frame was significantly associated with voting intention (Beta .204, $p<.05$). In contrast, Frame B focused on whether it hurts the wealthy, and this frame was not significantly associated with voting intention (Beta .102, $p>.05$). Hence, framing effects extend to directional associations with related variables. The second hypothesis for equivalency framing was also supported for the ability to pay factor in its effect on related variables. Describing Frame B as a positive aspect (that the top half pay 96 percent) was significantly associated with intention to vote for a politician who wants to keep the income tax system basically as it is (Beta -.177, p<.05). The equivalent, but negative ability to pay factor in Frame A was not significantly correlated with voting intention (Beta .085, $p>.05$). It should be noted, however, that the indirect effect of equivalency framing on the related outcome variable was not supported for the equity factor, as the equity concept itself was evidently more salient than the way it was framed.

DISCUSSION AND CONCLUSION

If taxpayer compliance is linked to attitudes toward the tax system, then improving those attitudes is important when it comes to sustaining the system (Onu, 2016). Understanding those attitudes requires the identification of the relevant attributes associated with that system and then accurate measurement of those attributes without subtle biases, such as the equivalency and emphasis frames documented in this study. Furthermore, research on behavioral nudge communications (e.g. Biddle et al., 2018) must be attentive to the relative saliency of the targeted attributes versus the way in which those attributes are framed.

The saga of the British poll tax illustrates what can happen when tax laws are deemed to be unacceptable by the citizenry (Lymer & Oats, 2017). Determining acceptability, however, is more difficult than achieving consensus on opinion polls. The frame and the context in which

the opinions are solicited must be considered before researchers and policymakers begin to draw conclusions. In the present study, the framing of attitudinal statements was shown to be an important factor in affecting taxpayer responses on the attributes of a tax system, as well as global attitudes toward wanting to keep the current tax system. The average response on the specific attributes differed (equity and redistribution frames), and the frames resulted in differential effects on the association between the specific attributes and behavioral intention to vote for a politician who wants to keep the income tax system basically as it is ("fair"/"unfair", "poor"/"wealthy", "96% positive"/"96% negative" in Table 5). One implication for researchers and policymakers is to avoid affective descriptors. Even simple complements can result in unintended negativity biases or in unequal labels in terms of their emotional intensity (Levin et al., 1998). Another possibility is that researchers should attempt to measure when and why equivalent linguistic variations lead to differing attitudes and relationships with outcome variables. This type of research would be invaluable for tax research carried out under a behavioral insight framework.

Although further context-specific research is required, the results imply that concepts involving equity, redistribution, and ability to pay issues impact preferences regarding income tax systems. The significant associations for redistribution in Frame A and ability to pay in Frame B in this study are especially interesting. Respondents who disagreed that the current income tax system helps the poor tended to indicate they would not vote for a politician wanting to keep the income tax system as it is, all else being equal. The implication, then, is that policymakers wanting to keep the current system should provide information documenting how the tax system benefits lower economic groups or make changes to the system so that the benefits are more explicitly linked to the tax.

Regarding ability to pay, respondents who disagreed that having the top half pay 96 percent of federal individual income tax is positive tended not to vote for a pro-income tax politician. Researchers and policymakers need to further explore the specific reasons why some taxpayers disagree that it is a positive feature. Interestingly, most taxpayers agreed that having the lower half of taxpayers pay four percent is a positive aspect. Future research should test whether attitude on this half of the statistic influences global attitudes toward the tax system.

Within a broader perspective of framing, the study contributes to the existing academic research stream in several respects. First, it focuses on a tax concept and uses respondents who are subject to taxation and can vote in elections; in other words, the study collects data from those with a stake in the policies to which the questions relate. Second, it examines attribute framing, which has been less examined than that of risky choice. Third, it provides nuance to the literature on equivalency framing, indicating that for a given concept (ability to pay), effects can be seen with one variation in words but not with another. This was seen when the framing effect occurred with the 96%/4% juxtaposition but not with the positive/negative juxtaposition using the 96% statistic. Fourth, the paper exhibits framing effects at extreme percentages, instead of those closer to 50% partitions. Fifth, the results tie two types of framing together, linking attribute framing and goal framing by examining the impact of the former on eventual behavioral intentions. Sixth, the paper documents that the strength of a framing effect can have directional variability, as shown by the fact that phrasing regarding helping the poor impacted voting intentions but phrasing regarding hurting the wealthy did not.

This study has several limitations. Although the respondents' demographics were consistent with U.S. national data, they were only from one Midwest U.S. state. Since the purpose of the present study was not to measure national opinions precisely but to examine attribute framing

effects on global and specific aspects of the income tax system, the geographically similar respondents provided a stable sample pool. Another limitation of the present study is that the attributes targeted in this study are not the only attributes relevant to global attitudes toward the system. Moreover, each attribute (equity, redistribution, and ability to pay) has numerous characteristics that could affect judgments.

Future research should examine additional pro and con factors affecting taxpayers' perceptions of the income tax system (e.g., progressivity, marriage neutrality, and punishing or rewarding those who have saved and invested). In addition, studies could be extended to examine populations from different geographical regions. Future research should also investigate how the combination of factors affects taxpayer preferences. The present study combined three attributes for each group of subjects ("fair", "poor", and "96% negative" versus "unfair", "wealthy", and "96% positive"). Voting intentions did not significantly differ by these combinations of frames, but the empirical question of whether some other combination of attributes would affect the outcome variable remains.

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FACTORS AFFECTING PRESUMPTIVE TAX COLLECTION IN ETHIOPIA: EVIDENCE FROM CATEGORY "C" TAXPAYERS IN BAHIR DAR CITY

Abera Aynekulu Abate[1]

Abstract

The Ethiopian government has set itself long-term goals of eradicating poverty, ensuring sustainable economic growth, and becoming a middle-income country by 2025. These goals are impossible to achieve without tackling tax challenges, improving the tax administration, and generating sufficient revenue. This paper attempts to reveal major factors that influence presumptive tax collection in Ethiopia. To achieve this objective, the researcher used a cross-sectional survey design. As a result, the quantitative research approach was employed. A total of 391 self-administered, closed-ended questionnaires were distributed to category "C" taxpayers found in Bahir Dar City Administration. Given the dichotomous nature of the dependent variable (presumptive tax collection), the study employed a binary logistic regression model. As part of the process, the Statistical Package for Social Science (SPSS) Version 20 was used. The descriptive statistics reveal that the following issues were major challenges for presumptive tax collection in Ethiopia: lack of equity and fairness in presumptive tax assessment; complexity of tax rules; taxpayers' poor perceptions of tax evasion; the existence of unethical and corrupt tax officials; taxpayers' negative attitudes toward the government; and poor social norms between taxpayers and the Ethiopian Revenues and Customs Authority (ERCA). The binary logistic regression results show the following to be significantly associated with presumptive income tax collection in Ethiopia: the equity and fairness of the tax system; corrupt behavior of tax officials; the organizational strength of the tax authority; the participatory tax system; taxpayers' knowledge of tax rules and regulations; and the attitudes of taxpayers toward the government. However, social norms, mode of tax payment, and perception of tax evasion had positive but insignificant relationships with presumptive tax collection. The findings of this paper will help policymakers and other stakeholders to identify determinants of presumptive tax collection, and thereby to design and implement appropriate presumptive tax systems for small and medium-sized businesses in Ethiopia. In addition, this paper contributes to the tax literature on determinants of presumptive tax collection issues in developing countries.

Keywords: Binary Logistic Regression, Category "C" Taxpayers, Ethiopia, Presumptive Tax, Tax collection.

1. INTRODUCTION

Presumptive tax is a system for ascertaining the tax liabilities of businesses using an indirect method of assessment that differs from the regular tax assessment mechanism based on the taxpayer's account. In plain English, it computes the income tax liabilities of small businesses based on easily verifiable external factors, rather than relying on those businesses to self-report their income. Presumptive tax is applied in economies where it is difficult to tax a specific group of taxpayers in the regular tax system and tax administrative resources are limited. Thuronyi (2003) asserted that the reasons that these taxpayers are hard to tax are: there are a

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[1] Department of Accounting and Finance, Debark University, Gondar, Ethiopia.

large number of small businesses operating; their business income is low; they are not obliged to keep proper accounting records according to tax rules and proclamations; they sell largely for cash, so that application of tax withholding to collect their income is not practicable; and tax systems can be complicated and administratively burdensome. These scenarios have led many developing countries, including Ethiopia, to employ presumptive income tax systems with a view to increasing the tax base, and mitigating tax evasion and avoidance.

Taxation is considered to be the most reliable way of financing government expenditure in both developed and emerging economies. In order to avoid excessive foreign debt financing and strengthen domestic revenue mobilization, developing countries were expected to broaden their tax bases and improve their tax administration systems. However, many of them, including Ethiopia, experience a chronic gap between actual and desirable levels of tax revenue (International Monetary Fund [IMF], 2015). In terms of tax-to-GDP ratio, Ethiopia's tax revenue performance is poor, at approximately 13%; that is even lower than the average for low-income countries (Yesegat & Fjeldstad, 2016). Possible reasons for low levels of tax revenue collection are inefficiency of the tax administration in implementing the tax rules and regulations, and non-compliant behavior of the taxpayers.

Currently, Ethiopia employs the standard assessment method in respect of category "C" taxpayers, with the aim of collecting an adequate amount of tax revenue. According to the current Federal Income Tax Proclamation No. 979/2016, taxpayers are divided into three categories, namely "A", "B", and "C", based on their sales volumes and the ways in which their businesses are set up. Category "A" includes any company incorporated under the tax law of Ethiopia or in a foreign country and other entities with an annual turnover of 1,000,000 Ethiopian birr or more. Category "B" includes enterprises with an annual turnover of more than 500,000 birr but less than 1,000,000 birr. Category "C" includes taxpayers whose annual turnover is estimated to be less than 500,000 birr by the tax authority. Category "A" and "B" taxpayers must submit profit and loss statements to the revenue authority at the end of each year.

Like most developing countries, Ethiopia has a very large number of taxpayers in category "C" (small and medium-sized taxpayers). When compared to the other taxpayer categories, Category "C" is an important source of revenue for the government (Megnaka & Devi, 2014). However, this category is the most problematic one in terms of levying and collecting taxes in Ethiopia. Research conducted by Gezahegn, Desta and Adane (2014), and Mengesha and Ashebir (2013) indicated that frequent frictions and controversies are observed between taxpayers and tax administrators, which causes widespread complaints about unfairness and overstated tax by the majority of category "C" taxpayers. Recently, presumptive income taxpayers across Ethiopia contended that the tax authority had violated the existing standard assessment procedures with its practical application of them, and that the revenue offices did not conduct sufficient and appropriate tax research into category "C" taxpayers in order to levy taxes. As a result, many small and medium-sized businesses closed in protest against the tax authority's assessment and collection procedures (Getachew, 2019).

As found in various tax studies, some of the factors associated with tax assessment and collection are: the perception of equity and fairness of taxation; taxpayers' perceptions of tax evasion; the corrupt behavior of tax officials; taxpayers' attitudes toward the government; taxpayers' knowledge of tax rules and proclamations; the organizational strength of the tax authority; participatory tax systems; the mode of tax collection; and social norms etc. (Megnaka & Devi, 2014; Fjeldstad, 2003; Kebede & Tegegn, 2016; Simiyu, 2010; Umar & Tusubira,

2017; Oladipupo & Obazee, 2016; Ohaka & Zukbee, 2015; Fjeldstad, Chambas & Brun, 2014; Engida & Baisa, 2014).

However, empirical research studies on factors that influence presumptive income tax collection are scant globally and, to the best of the researcher's knowledge, there has not been any empirical evidence in Ethiopia on the issue. Therefore, examining determinant factors of presumptive income tax collection is of paramount importance in order to bridge the literature gap that exists in developing countries, and to modernize the tax administration and collection process of presumptive taxpayers in Ethiopia in particular and in developing countries in general.

1.2 Objective of the study

1.2.1 General objective

The general objective of this study is to determine the major factors affecting the presumptive income tax collection system in Ethiopia.

1.2.2 Specific objectives

- To determine the major determinants of presumptive income tax collection in Ethiopia.
- To identify major challenges encountered by taxpayers within the presumptive income tax assessment and collection processes.
- To assess taxpayers' perceptions about the current presumptive income tax assessment and collection systems and procedures.
- To suggest possible courses of action that can help policymakers and implementers to improve the presumptive income tax system.

1.2.3 Basic research questions

- What are the determinant factors that influence presumptive income tax collection in Ethiopia?
- What are the major problems encountered by taxpayers during the presumptive tax assessment and payment process in Ethiopia?
- Is the current presumptive income tax assessment and collection system in Ethiopia fair and efficient?

2. THEORETICAL AND EMPIRICAL LITERATURE REVIEW

2.1 Introduction

It has long been acknowledged in previous literature that small and medium-sized businesses have played, and continue to play, significant roles in poverty reduction, economic development, and the industrialization of developing countries. Taxing the hard-to-tax (small and medium-sized business) group has been, and is, very difficult for developing countries. Although taxes which are collected from presumptive taxpayers are significant sources of revenue for the government, the sector's performance is still poor when compared to its potential to generate higher taxes; this is partly due to taxpayers' non-compliant behavior and

the inefficiency of the tax administration in Ethiopia (The Federal Democratic Republic of Ethiopia, National Planning Commission, 2016).

Presumptive income tax is one of the oldest types of tax and dates back to the 18th century. The term refers to a system in which tax liability is computed using indirect indicators as it is difficult to implement regular tax methods (Pashev, 2005). Despite the existence of differences of opinion among scholars regarding the initiation of, and justification for, the introduction of presumptive taxes across countries, Thuronyi (2003) elaborated that the main rationales for its implementation are: improving the efficiency of tax collection through the reduction of taxpayers' administrative and compliance costs; reducing the tax authority's administrative costs in respect of compliance and enforcement management; and bridging the way from informal activities to formal activities, and from assessment based on indirect indicators to self-assessment based on actual income. However, presumptive tax regimes employed in developing countries, including Ethiopia, have always been at the center of arguments and controversies between taxpayers and tax administrators. Theoretically, there are different methods of presumptive income taxation. One of the methods of presumptive taxation currently applied in Ethiopia is the standard assessment method. Thuronyi (2003) and Pashev (2015) elaborated that the standard assessment method applies and assigns a fixed amount of tax liability on presumptive taxpayers on the basis of business activity or occupation. According to this method, tax liability is determined by calculating the average yearly sales coupled with consideration of business type, location, number of employees, total assets, and so on.

2.2 Empirical studies

Nabaweesi (2009) has conducted a study that examines the relationship between social norms, taxpayers' morale, and tax compliance among small business taxpayers in Uganda. He found that social norms have significantly affected the tax compliance behavior of taxpayers. In a similar fashion, of the findings of Mtasiwa (2013) and Masarirambi (2013) revealed that tax evasion, social norms, tax avoidance, the complex nature of tax rules and regulation, and corrupt behavior of tax officials were the determinant factors that accounted for inefficient collection of tax revenues from taxpayers in Tanzania and Zimbabwe respectively. On the other hand, the corrupt behavior of tax officials becomes a headache for many developing countries, including Ethiopia. By its nature, presumptive income tax is introduced to minimize the cost of tax administration and to reduce the frequency of contact between tax officials and taxpayers. However, presumptive taxation in Ethiopia is riddled with corruption and collusion among tax administrators. Many other studies have pointed out that corruption is a major challenge and is one of the most negative factors in the tax administration system, basically hampering countries from collecting sufficient tax revenues and causing them to fail to fulfil their tax-generating potential (Tjen & Evans, 2017; Vadde & Gundarapu, 2012; Imam & Jacobs, 2007). By the same token, research conducted by Kasimbazi (2004) found that incorrect and inappropriate assessment methods employed by tax authorities, lack of training and experience on the part of both taxpayers and tax assessors, corruption and fraud by tax collectors in the registration, assessment, and payment of tax liabilities, tax evasion, and poverty were the significant factors that negatively affect tax collection efficiency.

Another important variable that affects tax collection from micro, small and medium-sized businesses is whether or not the tax system is participatory. Allowing the participation of taxpayers in presumptive tax systems and making them stakeholders in the process from initiation through to implementation could improve taxpayers' tax compliance behavior and thereby increase the amount of tax collected. In this regard, Simiyu's (2013) study revealed

that, in Kenya, failure to take taxpayers' opinions into account when drafting and implementing the tax system resulted in tax non-compliance and hence negatively affected the tax collection process. Adimasu & Daare's (2017) study of taxpayers' awareness of tax rules and attitudes toward the government and the impact of participatory tax on tax compliance on southern African nations and Ethiopian nationals confirmed the above findings, showing that engaging taxpayers in the tax assessment and collection process helps tax authorities to increase tax compliance. However, in most developing countries, the tax authority initiates, drafts, and implements tax regimes alone, without enough discussion and consultation with the stakeholders (taxpayers) which, in turn, results in tax non-compliance.

Taxpayers' knowledge about the existing tax rules and regulations is of paramount importance when it comes to efficient tax collection. As a result, many countries in the world place great emphasis on, and invest large amounts of money into, the education of taxpayers, with the intention of collecting more taxes. Tax literature supports the idea that there is a positive relationship between taxpayers' knowledge of tax rules and regulations and tax collection efficiency. This assertion is evidenced by various empirical studies (Oladipupo & Obazee, 2016; Legesse & Shaik, 2017; Kasimbazi, 2004; Vadde & Gundarapu, 2012; Yesegat & Fjeldstad, 2016) which show that when taxpayers' knowledge and understanding of tax rules increases, the tax revenue collected from those taxpayers also increases, and vice versa. On the other hand, a study by Babu and Bayu Charie (2015) on the effect of taxpayers' attitudes toward the government on tax morale in Ethiopia found that when taxpayers have positive attitudes toward the government, both their tax morale and tax compliance levels are enhanced. Similarly, Nghaamwa's (2011) empirical study's findings revealed that the majority of respondents felt that the tax money they contributed to the government was not being utilized to improve public services and infrastructure as they had expected. As a result, they had developed a view that they would refuse to pay their taxes unless the government improved the infrastructural facilities of the country. When we come to the case of Ethiopia, the tax money collected from taxpayers has been invested primarily in political activities rather than building basic infrastructural facilities, with the intention of increasing the life span of the existing ruling regime. Generally, it can be inferred from the above findings that positive attitude of taxpayers toward the government is an indispensable ingredient for efficient tax collection.

The issue of equity and fairness in a tax system is always controversial, complex, and argumentative. According to the Association of Certified Professional Accountants (2001), the principles of equity and fairness in the tax system can be summarized as the idea that similarly situated taxpayers should be taxed similarly and differently situated taxpayers should be taxed differently. However, the presumptive tax system in Ethiopia violates the principles of fairness and equity. A study conducted by Bekele and Devi (2014), which evaluated whether the presumptive income tax system fulfills the principles of good taxation, demonstrated that the presumptive tax system in Ethiopia violates and lacks the principles of fairness and equity. This is not an unexpected result given the presence of corruption in Ethiopian tax system. Taxpayers' attitudes toward the fairness of the tax system play a significant role in efficient tax collection. When taxpayers believe that the tax system is fair, they will comply and meet their tax obligations. In contrast, if they believe it is unfair, it is difficult to make them pay their taxes. To this end, Adimasu and Daare (2017) and Kebede and Tegegn (2016) revealed that there is a relationship between taxpayers' attitudes toward the fairness and equity of the tax system and tax compliance in Ethiopia.

On the other hand, tax authorities' strength in terms of law enforcement abilities, use of the latest accounting information system technologies, and competent staff determines the tax

collection efficiency of the country. However, Ethiopia lags behind its fellow African countries in its use of accounting information systems (Abate, 2018). The Ethiopian Revenues and Customs Authority (ERCA) is not exceptional in respect of this country-level problem. According to Kebede, and Tegegn (2016) and Bekele and Devi (2014), the organizational strength of the tax authority was found to be one of the determinants of tax collection in Ethiopia.

The mode of tax payment in many developing countries is time-consuming and tedious, since both tax assessment and tax payment depend on face-to-face interaction and automated means. Simiyu (2013) found that the mode of tax payment in Kenya made things difficult for taxpayers. Enabling taxpayers to make tax payments through banks and use other types of payment technology facilitates and increases tax collection.

2.3 Summary and gaps in the existing literature

A presumptive tax system is a fiscal tool used to collect taxes from the hard-to-tax and small business group, and involves simplifying the tax system as well as minimizing the cost of tax administration. The determinants of tax collection are identified as: corruption; the organizational strength of tax authorities; the mode of tax collection; social norms; tax evasion; taxpayers' attitudes toward the government; taxpayers' knowledge about tax rules; a participatory tax system; and taxpayers' perceptions about fairness and equity. However, research in the area of factors affecting presumptive income tax collection are scanty globally. Therefore, this paper is intended to fill the research vacuums observed regarding the determinants of presumptive income tax collection.

2.4 Author's own constructed conceptual framework of the study (Figure 1)
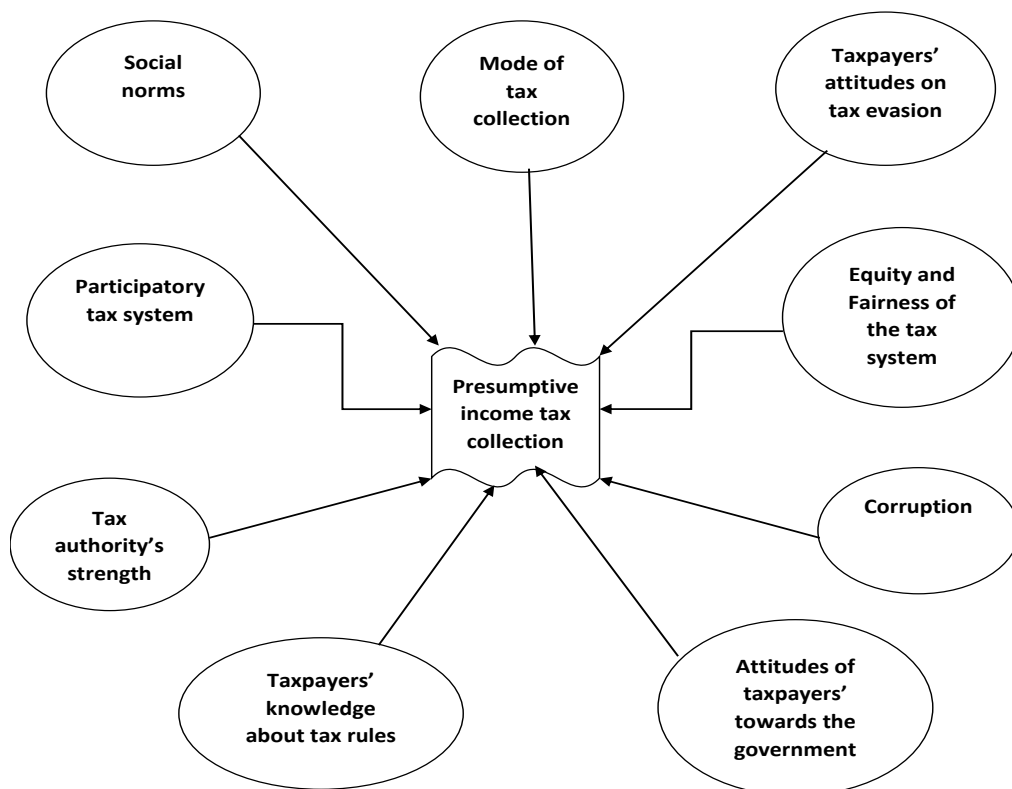
3. RESEARCH DESIGN AND METHODOLOGY

For this study, a cross-sectional survey design was found to be appropriate in order to gather information about the determinants of presumptive income tax collection in respect of category "C" taxpayers in Ethiopia. According to Creswell (2014), this survey method allows for the collection of quantitative data from a large population, which can be used to suggest possible reasons for specific relationships between variables of interest. This study also uses quantitative methods. Saunders, Lewis, and Thornhill (2009) asserted that the quantitative research approach is used for testing objective theories by examining the relationships between variables. The objectives of quantitative research are to answer the proposed pre-determined research questions/hypotheses and to produce general results about a given population in a given academic research area.

3.1 Data source and method of data collection

The primary data for this study was collected by surveying category "C" taxpayers in Bahir Dar City Administration. In this regard, a self-administered structured questionnaire was used. The questionnaire was divided into two sections: the first section contained questions pertaining to the respondents' businesses and demographic information, while the second section comprised closed-ended questions regarding the taxpayers' perceptions of factors influencing presumptive income tax collection in respect of category "C" taxpayers. With regard to this study's independent variables, respondents were asked to indicate their level of agreement on five-point Likert scale, as follows: 1 = Strongly disagree; 2 = Disagree;, 3 = Neutral; 4 = Agree; 5 = Strongly agree. The data collection instrument was prepared in the Amharic language first and then translated into English.

3.2 Target population

The target population considered in this study was category "C" taxpayers in Bahir Dar City Administration. According to the current income tax proclamation number 979/2016, category "C" taxpayers are small businesses with an annual turnover of less than 500,000 Birr (equivalent to $19,231).

3.3 Sample size and sampling design

According to the Bahir Dar City Administration Revenue Authority's annual report (2017), 16,567 category "C" taxpayers were actively operating in the area as of June 2017. To determine the sample size in this study, the Yamane (1967) formula was used. The formula to calculate the sample size is:

$$n = \frac{N}{1+N(e)^2}$$ Where: n = Sample size

N = Total population size
e = Level of precision.

Hence, the sample size is equal to: $n = \frac{16,567}{(1+16,567(.05)^2)}$

$$= 390.57 \approx 391$$

Thus, for this study, 391 taxpayers were selected. The questionnaire respondents were owners/mangers of small and medium-sized businesses (category "C" taxpayers). A simple random sampling technique was used to select them.

3.4 Methods of data analysis

In this study, both descriptive and econometric analyses were used to analyze the survey data. Although there is considerable debate in literature on the issue of whether Likert scale data should be analyzed as an ordinal or interval measurement scale, the author of this research is convinced that it should be analyzed as an interval measurement scale. A similar descriptive analysis method was employed by Megnaka and Devi (2014) and Abate (2018). Moreover, a binary logistic regression model was used in order to discover whether direct relationships exist between the determinant factors proposed as independent variables and the likelihood of presumptive tax collection. The dependent variable (i.e., presumptive tax collection efficiency) is a dummy variable which is coded as 1 = Good, 0 = Poor. A similar data analysis technique was utilized by Gezahegn et al. (2014). As part of due process, the Statistical Package for Social Science (SPSS) Version 20 was used.

3.5 Model specification

Logistic regression is ideal when the nature of the dependent variable is categorical and when the independent variables are either continuous or categorical in nature. Since presumptive income tax collection is a discrete condition (i.e. the performance of tax collection can be either good or poor), the ordinary least squares (OLS) method of estimation is too biased and inefficient to be able to predict the likelihood of presumptive tax collection in Ethiopia (Gujarati, 2003). As a result, a binary logistic regression model was developed and utilized in this study.

Hence, using a binomial logistic regression, this study estimates the probability of a dichotomous response (i.e. good/poor presumptive tax collection efficiency) for various values of explanatory variables. Accordingly, the logistic regression function is given by:

$$P(Y) = \log \frac{P}{1-P} = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots \beta_n X_n + \varepsilon_i \text{ and this results in:}$$

$$P(Y) = \frac{e^{\beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots \beta_n X_n + \varepsilon_i}}{1 + e^{\beta_0 + \beta_1 X_1 + \beta_2 X_2 + \dots \beta_n X_n + \varepsilon_i}}$$

Where:
P = Probability of the occurrence of success
Y = Binary response dependent variable
X_n = Explanatory/independent variables that influence the probabilities of the outcome of the dependent variable
e = Natural logarithm base
β_0 = Interception at the Y-axis
β_n = Coefficients of the explanatory variables
ε_i = Stochastic disturbance or error term

In the above logistic function, the relationship between P(Y) and X is non-linear. According to Field (2009), when the outcome (dependent) variable is categorical, the linearity assumption is violated. Hair, Black, Babin and Anderson (2010) and Field (2009) noted that one way of

solving the linearity problem in logistic regression is to transform the data using the logarithmic transformation. Therefore, for this study, the binomial logistic regression is written as follows:

$$P(Y) = \ln(\frac{P}{1-P}) = \beta0 + \beta1PEF + \beta2PTE + \beta3CBTO + \beta4ATG + \beta5KTR + \beta6OSTA +$$

$$\beta7PTS + \beta8MTC + \beta9SN + \varepsilon i$$

Where:
P = Probability of tax collection efficiency
Y = Tax collection efficiency (1 if tax collection efficiency is good, 0 otherwise)
B_0 = Constant of the binary logistic regression equation
PEF = Taxpayers' perceptions of equity and fairness of the tax system
PTE = Taxpayer's perceptions of tax evasion
CBTO = Corrupt behavior of tax officials
ATG = Taxpayers' attitudes toward the government
KTR = Taxpayers' knowledge of tax rules and proclamations
OSTA = Organizational strength of the tax authority
PTS = Participatory tax system
MTC = Mode of tax collection
SN = Social norms
εi = Random error term

3.6 The Reliability of the questionnaire items

In this research, Cronbach's alpha has been used to test the reliability of the items included in the questionnaire. Hair et al. (2010) suggested that coefficients of Cronbach's alpha greater than 0.70 are considered to be reliable indicators of the constructs under study. Therefore, using SPSS Version 20, the reliability test of all items used to measure the independent variables in this study were above the minimum threshold of 0.70.

Table 1: Cronbach's alpha coefficient of the research items

Constructs	Cronbach's alpha	No of Items
Taxpayers' perceptions of tax equity and fairness	.848	4
Taxpayers' perceptions of tax evasion	.801	4
Corrupt behavior of tax officials	.846	4
Taxpayers' attitudes toward the government	.835	4
Taxpayers' knowledge of tax rules and proclamations	.828	4
Organizational strength of the tax authority	.771	5
Participatory tax system	.911	4
Mode of tax collection	.767	4
Social norms	.732	4
General reliability	.848	37

Source: Survey questionnaire (2017)

3.7 Validity of the questionnaire items

In order to check validity of the questionnaire being used in this study, a pilot test was conducted with 15 category "C" taxpayers found in Addis Ababa City Administration. After the pilot test had been carried out, the researcher made minor corrections based on the respondents' feedback. The questionnaire was also assessed for content validity by one psychology expert and two accounting and finance lecturers who are currently teaching at Gondar University.

3.8 Operational definitions of variables used in the study

Presumptive tax collection efficiency – the right amount of tax liability paid by taxpayers (i.e., it is **good** if taxpayers pay the right amount of tax to the tax authority; otherwise it is poor). Similar research studies were carried out using this variable (Vadde & Gundarapu, 2012; Gezahegn et al., 2014).

Participatory tax system – the active engagement of taxpayers in the initiation, drafting, and implementation of the presumptive tax system. This variable has been adopted from Kebede and Tegegn (2016) but with major modifications.

Social norms – accepted taxpayers' ways of thinking about what they should or should not believe about tax authority and their tax obligations. This variable has been adopted from Nabaweesi (2009) but major modifications have been made to suit this study.

Taxpayers' knowledge about tax rules – the extent to which taxpayers understand and apply tax rules and proclamations in presumptive taxation. This variable was taken from Simiyu (2010) but major modifications have been made to suit this study.

Taxpayers' attitudes toward the government – taxpayers' evaluations of where and how the government spends tax monies. This construct has been adopted from Legesse and Shaik (2017) but major modifications have been made to suit presumptive taxation.

Taxpayers' perceptions of tax evasion – the level of awareness that taxpayers have about tax evasion and its consequences. This construct has been adopted from Masarirambi (2013).

Organizational strength of the tax authority – the capacity of the tax authority to equip itself with competent staff, technology, and work procedures in respect of tax collection. This variable has been taken from Kebede and Tegegn (2016) but major modifications have been made.

Tax fairness and equity – taxpayers' evaluations of the fairness of the current presumptive tax system in Ethiopia. This variable has been adopted from Megnaka and Devi (2014).

Mode of tax collection –the process of collecting tax revenues from taxpayers using the backward manual system or using sophisticated technologies. This variable has been adopted from Simiyu (2010) but major modifications have been made.

4. RESULTS AND DISCUSSION

Of the 391 questionnaires distributed to category "C" taxpayers, 111 questionnaires were not returned for various reasons. In addition, 12 questionnaires were not appropriately completed by the respondents. Therefore, 268 questionnaires were analyzed, which accounted for a response rate of 68.54%.

4.1 The respondents' demographic and business information

Table 2: Demographic and business profile

Variables	Frequency	Percentage	Variables	Frequency	Percentage
Gender			**Level of education**		
Male	160	59.7	Illiterate	67	25
Female	108	40.3	Primary education	125	46.6
Total	268	100	Secondary education	60	22.43
			Diploma and above	16	5.97
Age			Total	268	100
18 – 30	56	20.9	**Presumptive tax experience**		
31 – 40	126	47.01	Below 5 years	52	19.41
41 – 50	34	12.69	From 5 – 10 years	147	54.85
Over 50	52	19.4	From 10 – 15 years	62	23.13
Total	268	100	More than 15 years	7	2.61
Types of business			Total	268	100
Manufacturing	24	8.96			
Merchandizing	56	20.89			
Service providers	188	70.15			
Total	268	100			

Source: Own survey data (2017)

Table 2 (above) shows that the gender distribution of the respondents was comparable, with 59.7% male respondents and 40.3% female respondents. The dominant age group of the respondents was 31–40 years (47.01%), with the next largest number of respondents being aged 18–30 (20.9%). The rest fell into the 41–50 and over 50 categories (12.69% and 19.4% respectively). Regarding their levels of education, the majority (46.6%) of respondents had received primary education, with 25% being illiterate and 22.43% having completed secondary education. The remaining (5.97%) respondents had diplomas or higher qualifications. The majority (70.15%) of businesses were service providers. Most of the respondents (54.85%) had

between 5 and10 years of presumptive tax experience. This result indicated that the taxpayers included in this study were fairly experienced with regard to presumptive income taxation issues.

4.2 Descriptive analysis of factors affecting presumptive income tax collection in Ethiopia

Table 3: The presumptive tax collection efficiency of the tax authority

		Frequency	**Percentage**
How do you evaluate the presumptive tax collection efficiency of the Bahir Dar branch of the ERCA (tax authority)?	Good	117	43.7
	Poor	151	56.3
	Total	268	100

Source: Own survey data (2017)

As seen in Table 3 (above), the majority (56.3%) of respondents evaluated the presumptive tax collection efficiency of the ERCA's Bahir Dar branch as poor, while 117 (43.7%) of respondents rated it as good. This result indicates that ERCA needs to improve its tax collection efficiency by modernizing its mode of tax collection, and increasing its human and technological resources.

Table 4: Descriptive statistics result for the determinants of presumptive tax collection

No	**Parameters**	**Grand Mean**	**Grand Std. Deviation**
1	Taxpayers' perceptions of the equity and fairness of taxation	2.12	1.04
2	Taxpayers' perceptions about tax evasion	2.07	1.26
3	Corrupt behavior of tax officials	2.16	1.35
4	Taxpayers' knowledge regarding tax rules	1.85	1.18
5	Organizational strength of the tax authority	3.64	1.37
6	Participatory tax system	3.34	1.10
7	Mode of tax collection	2.92	1.09
8	Social norms	2.13	1.44
9	Taxpayers' attitudes toward the government	2.27	1.03

Source: Own survey data (2017)

Respondents were asked to indicate their level of agreement with the factors that influence presumptive tax collection using a five-point Likert scale, where 1 = Strongly disagree, 2 = Disagree, 3 = Neutral, 4 = Agree, and 5 = Strongly agree. When respondents rated items as 1 or 2, it was assumed that they disagreed with the statement, while when they rated them as 4 or 5, it was assumed that they agreed with the statement. Furthermore, when respondents rated

items as 3, it was taken to indicate that they were unsure about the effect of a factor on presumptive tax collection. The results in Table 4 (above) show that most respondents disagreed that equity and fairness were present in either the assessment or collection of presumptive taxation with a grand mean and standard deviation of 2.12 and 1.04 respectively. This means that the Ethiopian presumptive tax system lacks equity and fairness when implemented with category "C" taxpayers which, in turn, affects tax collection negatively. The standard deviation was high (>1), indicating that there was a disparity of ideas about the fairness and equity of the tax system among the respondents. The total mean for taxpayers' perceptions of tax evasion was 2.07, demonstrating that most respondents had poor attitudes toward tax evasion. This result showed that category "C" taxpayers were ready to evade tax if the tax system had been unjust. Most respondents also disagreed with the idea that there was an absence of corrupt behavior of tax officials during the assessment and collection processes for presumptive taxation, with the total mean being 2.16. Given the high level of corruption, it is likely that tax officials will demand and accept bribes while they determine presumptive tax liability. Respondents also disagreed, with a mean value of 1.85, that tax rules and proclamations were simple enough for category "C" taxpayers to understand. However, in Ethiopia, even tax officials find it difficult to understand the tax rules because of their detailed and complex nature.

This result indicated that the complex nature of tax rules prevents taxpayers from understanding and complying with the tax system, which could, in turn, affect presumptive tax collection negatively. Respondents were agreed, with a mean value of 3.64 and a standard deviation of 1.37, that the ERCA was strong enough in terms of human and technological resources, adequate complaints resolution mechanisms, and the provision of quality tax services for presumptive tax collection. This result is surprising given the poor capacity of the ERCA to levy and collect taxes from all categories of taxpayers in Ethiopia. Social norms is another important variable, with respondents disagreeing, with a mean value of 2.13 and a standard deviation of 1.44, that social norms in Ethiopia did not increase presumptive tax collection. Respondents also disagreed, with a mean value of 2.27 and a standard deviation of 1.03, that the government spends the tax revenue on things related to the socio-economic development of the society. This result indicated that taxpayers did not trust the Ethiopian government with regard to how and where it invests their tax monies. They felt that their money is wasted on unnecessary expenditures, like corruption. Respondents were unsure about the effects of the mode of tax collection and the participatory tax system with grand means of 2.92 and 3.34 respectively.

4.3 Binary logistic regression result and discussion

Goodness-of-fit test of the binary logistic regression model

Table 5: Omnibus test of model coefficients

		Chi-square	Df	Significant level
Step 1	Step	258.980	9	0.000[a]
	Block	258.980	9	0.000
	Model	258.980	9	0.000

Source: SPSS result (2017)

In order to examine the goodness-of-fit, the study used the omnibus test of model coefficients. As seen in Table 5 (above), it shows a chi-square of 258.980, which is also significant (P-value <0.0005). Since the omnibus test is significant, we can conclude that adding predictors to the model has significantly increased our ability to predict presumptive income tax collection in Ethiopia.

Table 6: Model summary

Step	-2 Log Likelihood	Cox & Snell R-Square	Nagelkerke R-Square
1	108.222[a]	0.620	0.831

Source: SPSS result (2017)

The most commonly used technique for measuring goodness-of-fit is the likelihood ratio test, which is simply the chi-square difference between the null model (i.e. the model that only includes the constant) and the model that contains predictors. The -2 log likelihood ratio statistics is 108.222. Although the SPSS does not provide statistics for the model that only contains the constant, we know it to be 367.2 (108.222 + 258.980). As seen in the Table 6 (above), the results indicated that the value of Nagelkerke R^2 is 0.831, which shows that 83.1% of the dependent variable (i.e., presumptive income tax collection) is explained by explanatory variables included in the study.

Table 7: The Hosmer-Lemeshow test

Step	Chi-square value	Df	Significance level
1	8.331	9	0.402

Source: SPSS result (2017)

As shown in Table 7 (above), the Hosmer-Lemeshow test was insignificant (P-value = 0.402). Hair et al. (2010) argued that if the significant value in the Hosmer-Lemeshow test is greater than 0.05, then the model used can feasibly be used for further analysis. In addition, the Wald test was used to measure the statistical significance of each predictor in explaining the dependent variable (i.e., presumptive tax collection). The Wald test shows whether the $\beta -$ coefficient in a logistic regression for the predictor variable is significantly different from zero. If so, then the predictor is assumed to make a significant contribution to the outcome variable.

Table 8: Binary logistic regression result

Step[a] Variables	B	S. E	Wald	Df	Sig.	EXP (B)	95% C.I for EXP (B)	
							Lower	Upper
Taxpayers' knowledge about tax rules	1.063	.361	8.776	1	.003	.343	.169	.697
Taxpayers' perceptions of tax evasion	-0.391	.293	1.786	1	.181	.676	.381	1.200
Mode of tax collection	-0.026	.405	.004	1	.949	.974	.440	2.157
Taxpayers' attitudes toward the government	1.718	.483	12.637	1	.000	.179	.070	.463
Perceptions of equity and fairness	2.879	.552	27.166	1	.000	17.739	6.027	52.529
Participatory tax system	3.249	.529	37.738	1	.000	25.774	9.140	72.680
Corrupt behavior of tax officials	-1.504	.244	4.263	1	0.039	.604	0.375	.975
Organizational strength	0.794	.327	5.881	1	0.015	2.212	1.164	4.201
Social norms	0.510	.293	3.043		0.81	1.666	.939	2.955
Constant	-8.123	2.283	12.890	1	.000	.000		

[a]Variable(s) entered on Step 1: taxpayers' knowledge about tax rules; taxpayers' perceptions of tax evasion; mode of tax collection; taxpayers' attitudes toward the government; perceptions of equity and fairness of taxation; participatory tax system; corrupt behavior of tax officials; organizational strength; and social norms.

The binary logistic result shown in Table 8 (above) revealed that presumptive income tax collection was influenced by taxpayer's knowledge of tax rules and proclamations (**β** =1.063, P <0.05). The result indicated that taxpayers' understanding of tax rules increases the tax collection efficiency of the tax authority by 34.3%. Furthermore, the research exposed that when taxpayers know their rights and obligations in a given tax system, it is very easy to levy and collect taxes without additional costs. This result is in line with the findings of Oladipupo and Obazee (2016).

Another significant variable that showed a greater tendency to influence presumptive income tax collection was taxpayers' attitudes toward the government (**β** =1.718, P <0.05). From Table 8, it can be observed that when taxpayers have positive attitudes toward the government's activity, tax collection efficiency increases by 17.9%. It is obvious that taxpayers are sensitive to "how" and "where" the government spends their money. If they perceive that the government spends the tax revenue in solving socio-economic challenges, they are more likely to pay their tax liabilities properly. In contrast, if they believe that the government is spending tax revenue on unnecessary activities, and that the money is being wasted due to corruption and embezzlement, then tax non-compliance will prevail and, hence, tax collection rates will be low. These findings are similar to those of Babu and Bayu Charie (2015), and Engida and Baisa (2014).

The results also revealed that presumptive income tax is influenced by taxpayers' perceptions of the equity and fairness of the tax system (β =2.879, P <0.05). The results demonstrated that when taxpayers perceive that there is equity and fairness within the tax system, it is 17.74 times more likely to increase tax collection efficiency than when taxpayers perceive that the tax system is unfair and inequitable. One of important pillars of a good tax system is the application of equity and fairness principles in the levying and collection of tax liabilities. The presumptive tax assessment method should treat small businesses within the same category equally, regardless of their revenues. However, in Ethiopia, frequent violation of this principle by the tax authority is observed. This result is in line with the findings of Megnaka and Devi (2014), who revealed that having a presumptive tax system that lacks equity and fairness would lead to tax collection inefficiencies in Ethiopia.

A participatory tax system is another important variable that affects presumptive income tax collection (β =3.249, P <0.05). The results clearly show that a having tax system that allows for the participation of taxpayers from inception to implementation is 25.78 times more likely to increase tax collection efficiency than having one that is non-participatory. Having a tax system that does not take taxpayers' opinions into account will cause controversies and non-compliant behaviors which, in turn, hurts the tax assessment and collection process. One way of preventing such negative consequences from arising is to make the tax system participatory for all stakeholders. However, in developing countries, including Ethiopia, the tax system is vertical (i.e., the government imposes tax rules without consulting stakeholders), and taxpayers' opinions and concerns are not incorporated at any stage, from the drafting of the tax system to its implementation.

The above logistic regression shows that presumptive income tax collection is negatively influenced by the corrupt behavior of tax officials (β = -1.504, P <0.05). Given the huge presence of corruption in Ethiopia, the result is not surprising. It is clear that corruption negatively affects countries' revenue-generating capacities. Presumptive taxation is susceptible to corruption since it requires frequent interaction between the tax officials and taxpayers. This finding is similar to those of Ohaka and Zukbee (2015), and Fjeldstad (2003).

The final variable that positively influenced presumptive income tax collection was the organizational strength of the tax authority (β = 0.794, P <0.05). Possessing organizational strength, in terms of having adequate human and technological resources, delivering quality tax services to taxpayers, possessing strong law enforcement potential, and having transparent complaints resolution procedures, is ideal for increasing tax revenue. However, Ethiopia lacks the human and technological resources necessary to be able to appropriately implement the tax system and the service quality provided to the taxpayers by the tax authority is not satisfactory. Besides, the complaints handling procedures applied by the tax authority create additional complaints because of their ineffectiveness in solving tax-related problems. This finding is in line with the results of Engida and Baisa (2014).

Mode of tax collection (β = -0.026, P >0.05), taxpayers' perceptions about tax evasion (β = -0.391, P >0.05), and social norms (β = 0.510, P >0.05) were not found to be significant at 5% probability in determining presumptive income tax collection in Ethiopia.

5. CONCLUSION AND RECOMMENDATIONS

An attempt has been made to identify the major factors that influence presumptive tax collection in Ethiopia with a view to contributing toward policy recommendations and the

improvement of the tax system. It has been established that category "C" (i.e., small and medium-sized businesses) taxpayers play an indispensable role in poverty reduction, employment creation, and economic development within low-income countries. Research has revealed that having a just tax system in place is one of the determinants of small and medium-sized firms' growth in both developed and emerging economies. However, in developing countries, including Ethiopia, the overall tax system is the source of controversies and disputes between taxpayers and the tax authority which, in turn, has resulted in inefficient tax collection. Accordingly, descriptive statistics of the study showed that lack of equity and fairness in presumptive tax assessment, the complexity of the tax rules, taxpayers' poor perceptions of tax evasion, the existence of unethical and corrupt tax officials, taxpayers' negative attitudes toward the government, and poor social norms between taxpayers and the (ERCA) were major challenges for presumptive tax collection in Ethiopia. In addition, the binary logistic regression result revealed that taxpayers' perceptions of the equity and fairness of the tax system, the corrupt behavior of tax officials, the organizational strength of the tax authority, the participatory tax system, taxpayers' knowledge of tax rules and regulations, and taxpayers' attitudes toward the government were significantly associated with presumptive tax collection in Ethiopia. However, social norms, mode of tax payment, and taxpayers' perceptions of tax evasion were not found to be significantly related to presumptive tax collection. Based on the findings of the study, the following recommendations were made.

The study found that the current presumptive taxation system is neither generating the expected revenue for the government nor contributing to the growth of small and medium-sized businesses in Ethiopia. Therefore, the ERCA should deeply analyze the presumptive tax system and make the revisions necessary in order to make it more inclusive and transparent. The study also found that the corrupt behavior of tax officials was associated with presumptive tax collection. As a result, the ERCA should set up a special anti-tax corruption department which is assigned the tasks of preventing and minimizing tax corruption practices by creating awareness about the negative impact of corruption of tax officials, and putting stricter legal and administrative measures in place in order to deal with those officials who commit tax corruption. In doing so, the ERCA could build its image positively and regain the trust of taxpayers in long run. The organizational strength of the tax authority was another significant variable that affected presumptive tax collection in Ethiopia. Thus, the ERCA should adjust itself according to the current tax administration trends that demand the deployment of adequate human and technological resources, modernized complaints resolution mechanisms, the delivery of quality tax services, strong law enforcement abilities, and the application of a fair and transparent presumptive tax system.

Taxpayers' knowledge of tax rules and proclamations was found to be an important factor when it comes to increasing presumptive tax collection. In cooperation with concerned legal entities, the ERCA should reduce the complex nature of the tax rules and organize regular awareness creation programs, such as seminars, workshops and conferences, and use either electronic or print media in order to educate taxpayers about the tax rules. This will increase tax compliance behavior and, hence, improve tax collection rates. Furthermore, the owners and managers of small and medium-sized businesses should also strive to advance their tax knowledge for their own benefit. Finally, taxpayers' attitudes toward the government seems to be one of the determinant factors of presumptive tax collection in Ethiopia. Consequently, the Ethiopian government is called upon to create and maintain taxpayers' confidence via spending their tax monies on socio-economic development programs that produce tangible benefits, showing that it is free from corruption when spending taxpayers' money, and delivering its promises to the general public as often as possible.

6. LIMITATIONS AND SUGGESTIONS FOR FURTHER RESEARCH

A study without limitation(s) is unthinkable. The limitations of this study were the lack of domestic and international literature about the factors affecting presumptive taxation, the lack of openness among respondents, and lack of finance. Additionally, the data analysis for this study was based on cross-sectional data, which is assumed to be static rather than dynamic in nature. Therefore, future researchers could consider carrying out longitudinal studies in order to provide a better understanding of the determinants of presumptive taxation over time. In addition, the study was focused on taxpayers found in Bahir Dar City, which may harm the generalization of the findings at country level. Hence, future researchers should focus on other taxpayer categories and cover wider geographical areas in order to produce meaningful and inclusive papers.

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APPENDIX

Presumptive questionnaire used in the survey

Demographic information:

Gender:

Male ☐   Female ☐

Age:

18-30 ☐   31-40 ☐   41-50 ☐   Above 50 ☐

Level of education:

Illiterate ☐   Primary education ☐   Secondary education ☐   Diploma and above ☐

Types of business engaged:

Manufacturing ☐   Merchandizing ☐   Service giving ☐

Presumptive tax experience:

Below 5 years ☐   5 – 10 years ☐   10 -15 years ☐   Above 15 years ☐

How do you evaluate the presumptive tax collection efficiency of ERCA (Tax authority) Bahir Dar branch?

   A. Good ☐   B. Poor ☐

The following questions are related with factors affecting presumptive tax collection in Ethiopia. Please circle the box that represent your agreement or disagreement with each statement. Your information is important to me.

1 = Strongly disagree (SD)   2 = Disagree (DA)   3 = Neutral (N)   4 = Agree (A)
5 = Strongly agree (SA)

Mode of tax collection

Attributes	SD	D	N	A	SA
The tax authority process tax collection using automation					
The mode of payment is time consuming and tedious					
The payment process is simple and suitable					
The authority tax collection is manual					

Taxpayer's knowledge about tax rules

Attributes	SD	D	N	A	SA
As a taxpayer, I understand presumptive tax rules					
Presumptive tax rules are difficult to understand					
The tax officials provide adequate advice on presumptive tax					
Presumptive tax rules are easy to understand					

Corruption behavior of tax officials

Attributes	SD	D	N	A	SA
Tax officials demand bribes when they assess presumptive tax					
Tax officials accept bribes when they assess presumptive tax					
Tax officials accept bribes when they collect presumptive tax					
Tax officials accept bribes when they offered to reduce presumptive tax liability					

Participatory tax system

Attributes	SD	D	N	A	SA
Government involves taxpayers in drafting tax policies					
Government values feedback about how the tax system is run					
Government considers taxpayers opinion when applying tax policies					
Taxpayers have representative in the tax authority					

Equity and fairness of the presumptive tax system

Attributes	SD	D	N	A	SA
The presumptive income tax in Ethiopia considers ability to pay					
The tax liability based on presumptive income tax is certain					
The presumptive income tax is based on equity principle					
The presumptive income tax assessment is fair					

Perception of taxpayers on tax evasion

Attributes	SD	D	N	A	SA
I think taxpayers frequently evade taxes					
Other taxpayers conceal their actual income while assessed					
Other presumptive taxpayers do not provide sufficient information for the tax authority					
I think taxpayers are late to pay taxes					

Social norms

Attributes	SD	D	N	A	SA
As taxpayers, we are always loyal to the tax authority					
In case of mistakes of the tax authority, we are patients					
We are committed to paying our tax liability to the authority					
The tax authority values our businesses					

Organizational strength of the tax authority

Attributes	SD	D	N	A	SA
The authority has adequate human and technological resources					
The authority provides awareness creation trainings to taxpayers					
The authority delivers quality tax services to taxpayers					
The law enforcement potential of the authority is strong					
The authority has transparent complain resolving procedures					

Taxpayers' attitude toward the government

Attributes	SD	D	N	A	SA
We receive good services for the tax money we pay					
The government is using the tax money to provide infrastructures					
The current government utilizes the tax money free of corruption					
Corruption is observed in using the tax money by the government					

THE REDUCTION OF PRESUMPTIVE ELEMENTS IN VAT – A COMPARATIVE ANALYSIS OF THE VALUE ADDED TAX (VAT) AND SUPPLEMENTARY DUTY ACT, 2012, AND THE VALUE ADDED TAX (VAT) ACT, 1991, OF BANGLADESH

Iqtiaruddin Md. Mamun[1]

Abstract

The Value Added Tax (VAT) and Supplementary Duty Act, 2012 of Bangladesh, which, having already been deferred a number of times following its enactment, was scheduled to be implemented from July 01, 2017, has been postponed again, amid concerns among, and opposition from, the business community and members of the public. However, the tax authority of Bangladesh claims that the 2012 Act is superior to the existing Value Added Tax (VAT) Act, 1991, in terms of revenue mobilisation and the reduction of tax evasion. While the 1991 Act is fraught with the presumptive elements that are the major sources of tax evasion and causes of departure from the standard VAT system, the proposed Act is free of presumptive elements, so it will be closer to the standard VAT system. This paper demonstrates that the implementation of the proposed VAT Act would dramatically reduce the incentives for tax evasion as the presumptive elements have been eliminated.

Keywords: Value Added Tax (VAT), Tariff Value (TV), Truncated Base (TB), Input Tax.

1. INTRODUCTION

Value Added Tax (VAT) was introduced in Bangladesh through the enactment of the Value Added Tax (VAT) Act, 1991, which took effect on July 1, 1991. Prior to the introduction of VAT, sales tax had been imposed at the import stage, while domestically produced goods and services were taxed under the excise duty regime. VAT was implemented against the backdrop of these systems' detrimental features, i.e. multiple rates, excessive exemptions, the cascading effect in the absence of credit mechanism, and the two systems' narrow tax bases. It was designed to replace them with a view to expanding the tax base, simplifying the tax collection procedure and curbing tax evasion, as well as achieving the most desired goal of mobilising an increased amount of revenue (Government of Bangladesh, 1991). Additional objectives when introducing VAT included bringing transparency and consistency to the taxation system and removing the cascading effect which was present in the existing system, i.e. taxes on taxes (National Board of Revenue, 1994). However, two and a half decades after the government of Bangladesh implemented VAT, efforts to evaluate the extent to which it has achieved its objectives and goals have had gloomy outcomes. Smith, Islam and Zaman (2011) conclude that VAT in Bangladesh has failed to achieve the desired objectives and hence they suggest reforming VAT administration by creating intensive awareness of VAT among the people,

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[1] The author has a PhD in Economics and is a Cost and Management Accountant. He currently works as an Additional Commissioner of Taxes for the National Board of Revenue (NBR), Internal Resources Division (IRD), Ministry of Finance, Government of Bangladesh. He is also an adjunct Professor at the Independent University, Bangladesh (IUB). The opinions expressed in this paper are the author's own, not those of the organisations for which he works. The author can be reached at zabirmamun@yahoo.com

revisiting the list of VAT-exempted items and increasing the efficiency of the monitoring system. The existing VAT legislation has also been reported to be fraught with excessive exemptions (National Board of Revenue, 2005). However, the most striking feature of the VAT Act, 1991, and, for that matter, of the existing VAT system of Bangladesh as a whole, is that it is dominated by presumptive elements. The existence and dominance of presumptive elements is the reason for the existing VAT system's departure from the standard VAT system. The input tax credit mechanism – the bedrock of the standard VAT system – does not work when presumptive elements are present in the VAT system. In essence, the absence of the input tax credit mechanism due to the presence of presumptive elements provides incentives for tax evasion and introduces distortion into the system, as well as causing it to deviate from the standard VAT system. Saleheen (2012) thus suggested that such presumptive elements should be eliminated from the VAT system of Bangladesh. Therefore, as part of an ongoing process to reform the tax system, the government of Bangladesh enacted the Value Added Tax (VAT) and Supplementary Duty Act, 2012, (hereinafter termed "the proposed Act"), with a view to removing the presumptive elements that result in distortions of, and deviations from, the existing VAT system, thereby bringing efficiency to the system and mobilising more revenue. As and when the proposed Act comes into force, it will supplant the VAT Act, 1991. Thanks to the fact that it will implement an overarching uniform VAT rate of 15%, the proposed Act is also expected to augment revenue mobilisation for the exchequer. Although the proposed Act was, as its name suggests, passed by the parliament of Bangladesh in 2012, it was subject to a series of deferments and wasn't scheduled to take effect until July 01, 2017. However, its implementation was further delayed, amid concerns among, and opposition from, the business community and members of the public.

2. PRESUMPTIVE ELEMENTS IN THE VAT ACT, 1991

The VAT legislation currently in force in Bangladesh, the VAT Act, 1991, contains a number of presumptive elements. These are:

- Turnover tax (TT)
- The rate and amount of value added by traders
- The truncated base (TB) for services
- The tariff value (TV) of goods and services.

These presumptive elements are, in essence, the sources of departure for the current VAT system of Bangladesh from the standard VAT system. This is because they do not allow the input tax credit mechanism, which is a basic attribute of the standard VAT system, to operate. When the input tax credit mechanism operates, input tax, i.e. the VAT paid for purchasing the inputs, is deducted from the output tax, i.e. the VAT collected for selling the outputs. Hence, in the standard VAT system, a VAT entity is, in effect, the collector and not the payer of VAT, in the sense that it collects VAT from the consumers for selling outputs to them, retains the VAT it paid for purchasing the inputs from the collected VAT and deposits the remaining amount, i.e. output tax net of input tax, to the government exchequer. However, in order for the input tax credit mechanism to operate and, for that matter, the standard VAT system to operate, the VAT entities must maintain proper books of accounts that can be relied on in order to measure tax liability. However, some VAT entities in the Bangladesh business community reason that they are not in a position to maintain proper books of accounts as doing so will increase their compliance costs, something which they cannot afford. It may be noted here that, in Bangladesh, VAT is imposed on imported as well as domestically produced goods and services which are not exempted from VAT as per VAT legislation. In other words, VAT is

imposable on the relevant goods and services at the import, the production and the sales (wholesale as well as retail) stages. Therefore, from the perspective of coverage, a wide spectrum of entities comes within the purview of VAT, ranging from petty retailers to the giant producers who vary conspicuously in terms of education, skill and income levels, and, hence revenue-generating capacity and potentiality. Consequently, since a large number of VAT entities are not capable of maintaining proper books of account, it is hard to measure tax liability based on actual transaction values due to a lack of reliable records. In tax literature, such transactions are termed 'hard-to-tax transactions'. The problem of the lack of availability of actual transaction values and, hence, the desired tax base, for the want of reliable accounts and records in cases of hard-to-tax transactions is intended to be addressed by inferring notional values based on simple indicators. Such notional values serve as the base for taxing hard-to-tax transactions and introduce presumptive elements into the VAT system. The presumptive elements, as mentioned before, which prevail in the VAT system of Bangladesh are discussed in the subsequent sections.

2.1 Turnover Tax (TT)

Turnover tax is applicable to domestically produced goods and services at the production stage and at subsequent stages of business activities, such as the wholesale and retail sales stage – which we will term as trading – if the annual turnover at the respective stage does not exceed BDT 8 million (USD 100,000/- approximately). Under such conditions, the entity concerned has to collect and remit VAT at the rate of 3% on its annual turnover and no input tax – VAT paid for purchasing inputs – credit is allowed. It may be noted here that the standard VAT rate in Bangladesh is 15%. Hence, it is argued that the standard VAT rate of 15% is still being applied to the TT entities. However, the base upon which the 15% rate is applied is presumed to be 20% of the annual turnover. Consequently, the effective rate on the total turnover applies at $(20\% * 15\%) = 3\%$. More specifically, the value added at the respective stage is presumed to be 20% of annual turnover. The phenomenon that VAT is collected on the basis of some notional value of the transactions for which no input tax credit is allowed, rather than on the basis of the actual value of the transactions, introduces a presumptive element, hence distortion in the VAT system, ultimately resulting in deviation from the standard VAT system. Despite such distortion and deviation, the presumptive element, in the form of TT, has continued to form part of the VAT system of Bangladesh. This is primarily because taxpayers prefer it, because it results in low compliance costs, as they can avoid the rigorous compliance demands of maintaining proper books of accounts and relevant records, which they argue that they cannot afford to do given their education, skill and income levels, and hence their revenue-generating capacities and potentiality. The tax authority also accepts it because they find that TT allows them to tax hard-to-tax transactions and collect at least some revenue which would otherwise remain uncollected. However, the most damaging side of presumptive element is that it provides an incentive for tax evasion, something which we will discuss later on.

2.2 The Rate and Amount of Value Added by Traders

The rate and amount of value added by traders implies the base or notional value of transactions upon which the traders may collect VAT and remit it to the exchequer. Here, traders are VAT entities engaged in business activities involving goods, without changing their form at the import stages and thereafter, or at the stages subsequent to the production of locally produced goods. The rate of VAT for the traders is 4% as opposed to the standard rate of 15%. The 4% rate essentially implies that the amount of value added or the notional value of the transactions carried out by the traders is $(4\%/15\%) = 26.67\%$ of the actual value of the transactions, for

which no input tax credit is allowed. However, a trader may also opt for the 15% rate to be applied, in which case s/he is entitled to input tax credit. This option is, in effect, free of any presumptive element and hence falls within the ambit of the standard VAT system. In Bangladesh, at present, traders may collect and remit VAT under the following presumptive taxation regime:

- VAT at the rate of 4% on the transactions at the stages subsequent to the production stage of locally produced goods without the VAT entity being entitled to input tax credit. VAT entities, i.e. traders, who may adopt this method include wholesalers, retailers, commission agents, distributors and dealers etc.

- VAT at the rate of 4% – commonly termed Advance Trade VAT (ATV) – collected from importers at the import stage for the transactions without changing the form of the imported goods at the first stage subsequent to the import. The importers concerned are not entitled to any input tax credit.

- Package VAT for small traders. When using this method, the notional value of yearly transactions upon which the VAT rate of 15% will be applied is fixed depending on the location of the traders' business premises. No input tax credit is allowed. The current schedule for package VAT is presented in the following table:

Location of business premises	Notional value of yearly transactions	VAT rate	VAT amount
Dhaka North and South City Corporation, Chittagong City Corporation	BDT 186,667/- (USD 2333 approximately)	15%	BDT 28,000/- (USD 350)
Other City Corporations	BDT 133,334/- (USD 1667 approximately)	15%	BDT 20,000/- (USD 250)
Municipality area of District Towns	BDT 93,334/- (USD 1167 approximately)	15%	BDT 14,000/- (USD 175)
Other areas of the country	BDT 46,667/- (USD 583 approximately)	15%	BDT 7,000/- (USD 87.5)

Obviously, the package VAT under the presumptive taxation regime is a preferential treatment or special benefit given to the small traders, as they only have to collect and remit a nominal amount of VAT, ranging from BDT 7,000/- to BDT 28,000/- per year, depending upon the location of their business premises, to the government exchequer. However, the most important issue, that of identifying the traders who will benefit from package VAT, is resolved through mutual dialogue between the local VAT authority and the local traders' association. Due to the current structure of Bangladesh's economy, a large number of people engaged in business activities fall within the category of small traders. Although they are not large traders in terms of the amount of capital, turnover and net income they generate, they nonetheless constitute an important segment of the whole VAT system – the final stage in the value added chain – and essentially consummate the VAT system, as the imported and locally produced VAT-chargeable goods predominantly make their way to the end consumers through them.

Nevertheless, they are hard to tax, as they claim that they lack the capability to maintain proper books of accounts and records of transactions. In such a context, the VAT authority of Bangladesh, with its limited human and other resources, is not in a position to make the large number of small and other traders who enjoy the presumptive taxation regime comply with the requirements of the standard VAT system. Therefore, package VAT is offered in order to encourage small traders to come within the VAT net voluntarily, as a first step towards collecting a fraction of the enormous amount of revenue that could be collected from these traders and ensuring that the VAT mechanism functions, to some extent, throughout the value added chain from the first to the final stages. However, package VAT and other methods of presumptive taxation offered to traders, as discussed here, result in distortion in the VAT system and deviation from the standard VAT system, since the input tax credit mechanism does not work in the presence of such presumptive elements and thus provides incentives for tax evasion.

2.3 The Truncated Base (TB) for Services

At present, the base for imposing VAT of 15% on services is truncated. More specifically, under the regime of presumptive taxation, notional values, instead of actual values, of transactions for these services are used as the base to which the VAT rate of 15% is applied. Such notional values are essentially certain percentages of the actual values of transactions. That the VAT rate of 15% is applied to certain percentages of actual values of transactions or actual bases implies that the actual bases are, in effect, reduced or truncated in order to apply VAT. The VAT legislation of Bangladesh currently contains 9 truncated bases (10%, 16.67%, 20%, 26.67%, 30%, 33.33%, 40%, 50% and 66.67% of the actual bases or actual values of transactions), which correspond to 9 effective rates of VAT (1.5%, 2.5%, 3%, 4%, 4.5%, 5%, 6%, 7.5% and 10% respectively). For example, when the 15% VAT rate is applied to the truncated base of 66.67% of the actual base or the actual value of transactions, it results in a (66.67% * 15%) = 10% effective rate of VAT on the whole actual base or actual value of transactions. As with the other methods of presumptive taxation, there is no entitlement to input tax credit when using presumptive taxation of services under the truncated base.

The truncated base for the service of providing electricity is 33.33% of the actual base or the actual value of transactions which, in turn, results in an effective VAT rate of 5% on the whole actual base or actual value of transactions when the 15% VAT rate is applied to the truncated base. Suppose an electricity provider purchases inputs for BDT 200/- and pays input tax of BDT 30/-. Since the service provider is not entitled to input tax credit, BDT 30/- will be added to the cost of inputs and the total input cost will be BDT 230/-. If the further value of BDT 70/-, which includes all costs along with profit, is added to the inputs cost of BDT 230/- in order to convert the inputs into the cost of the final service, which is provided to the consumer as electricity, the actual base or actual value of the transaction for providing this service is BDT 300/-. However, as per the present VAT legislation of Bangladesh, the truncated base of this transaction is (300/- * 33.33%) = BDT 100 and the amount of VAT collected from the consumer is (100 * 15%) = BDT 15/- or (300/- * 33.33% * 15%) = (300/- * 5%) = BDT 15/-. Finally, the consumer pays (300 + 15) = BDT 315/- in total for this service: BDT 300/- as the actual value of the transaction and BDT 15/- as VAT. However, rigorous scrutiny shows that the consumer pays (30 + 15) = BDT 45/- as VAT in total. This is because the actual value of the transaction, BDT 300/-, includes BDT 30/- in respect of input VAT, which the service provider paid when purchasing inputs but nonetheless passed to the consumer via the price of the service and finally recovered from the consumer, as the service provider is not entitled to input tax credit. The point to be noted here is that the total VAT throughout this value added

chain (BDT 45/-) is wholly paid by the end consumer. However, although the service provider collected VAT BDT 45/- from the end consumer, s/he would remit BDT 15/- to the exchequer and recognise the remaining amount of BDT 30/- as recovered input VAT paid for purchasing inputs. The seller of the inputs, however, collected VAT BDT 30/- from the service provider and would deposit the same to the government exchequer.

It is evident from this discussion that the end consumer is the ultimate payer of VAT. The intermediaries within the value addition chain are mere collectors, rather than payers, of VAT. The total VAT paid by the end consumer (BDT 45/-) ultimately ends up in the government's coffers but is deposited in two stages: BDT 15/- is deposited by the service provider and BDT 30/- is deposited by the seller of inputs. Like other methods of presumptive taxation, the truncated base of services method results in distortion, such as cascading effect (tax on tax), in the VAT system and deviation from the standard VAT system, as the input tax credit mechanism does not operate, which, in turn, acts as a potential incentive for tax evasion. As mentioned before, 9 different truncated bases are currently applicable to 15 different services within the VAT system of Bangladesh. However, the VAT legislation does not say anything about how, and on what basis, the truncated bases are determined. In contrast to the standard VAT system, whether the magnitude of total VAT revenue under truncated bases will increase or decrease critically depends on, as shown in Appendix A, the relative value of input tax to value addition and the percentage of truncated base to the standard VAT rate.

2.4 The Tariff Value (TV) of Goods and Services

Under the presumptive taxation regime, the basis for imposing VAT on locally produced goods and services is the tariff value (TV), which is essentially the notional value, rather than the actual value, of the transactions. The VAT rate of 15% is applied to the tariff value of the goods and services concerned and no input tax credit is allowed when determining VAT liability. Currently, the VAT legislation of Bangladesh stipulates the tariff values for the service of providing mobile phone SIM cards and for a wide variety of goods, such as powdered milk, tomato paste, fruit juice, corrugated iron (CI) sheets, different types of mild steel (MS) products and electric transformers.

For example, the TV per Metric Ton (MT) of MS product produced from billets or ingots is BDT 3,000/-. However, the market value of this type of MS product is BDT 60,000/- per MT. It thus implies that BDT 3,000/- is the notional value or presumptive base for imposing VAT. In other words, it is presumed that the net value addition per MT of MS product produced from billets or ingots is BDT 3,000/-. Therefore, under this regime, a producer will collect (3,000/- * 15%) = BDT 450/- as VAT per MT of MS product from its purchaser at the production stage and deposit the same amount to the government exchequer, whereas under the standard VAT system, input tax (i.e. VAT paid for purchasing inputs such as billets or ingots, and electricity and gas) is deducted from the VAT collected on the actual base or actual transaction value instead of the notional value of the transaction or tariff value, and the remaining amount is deposited to the government exchequer.

As with the TB, the criteria for fixing TV for services and various goods is not spelled out in the VAT legislation. Since input tax credit is not allowed when using the TV method, it becomes part of the cost of goods and services, and is recovered from the customers via the price of goods and services. This deviates from the standard VAT system and causes distortion, such as the cascading effect i.e. tax on tax, and can serve as an incentive for tax evasion. In comparison with standard VAT system, the revenue impact of TV depends on, as shown in

Appendix B, the relative values of TV and value added. The rationale given for their existence in Bangladesh's current VAT legislation, at the insistence of the VAT entities, is procedural simplification and reduced compliance costs, as these entities argue that it is expensive and cumbersome for them to maintain proper records and books of accounts, and to follow the stringent procedures that they are required to in order to claim input tax credit and, hence, to comply with the requirements of the standard VAT system.

The presumptive elements discussed so far are the most overt or explicit forms of notional bases prevailing in the VAT system of Bangladesh for which no input tax credit is allowed. Apart from these, the other transactions for which input tax credit is allowed, despite seeming to follow the features of the standard VAT system, in effect, implicitly contain elements of presumptive taxation from the standpoint that, even for these transactions, the tax base upon which the VAT rate of 15% is applied is not the actual value of the transaction as determined freely in the market mechanism. Rather, even for these transactions, as per the present VAT legislation, VAT entities have to declare prices to the VAT authority which, after examination and scrutiny, determines the price and, for that matter, the tax base upon which the VAT rate of 15% is applied. Such approved prices or tax bases invariably differ from the actual values of the transactions as determined freely in the market mechanism.

3. THE ABSENCE OF PRESUMPTIVE ELEMENTS IN THE VAT AND SUPPLEMENTARY DUTY ACT, 2012

The VAT and Supplementary Duty Act, 2012, i.e., 'the proposed Act', does not contain presumptive elements in any form – overt or covert. In 1991, Bangladesh entered the VAT era, replacing the sales tax and excise duty regime, which was, in essence, presumptive. Thus, the VAT Act, 1991, basically inherited its presumptive nature from its predecessor. At the outset, allowing this feature of the past regime to continue provisionally despite being an aberration from the standard system may have been to allow stakeholders some leeway when it came to being prepared for the switchover to the new regime. Additionally, the VAT authority realised that presumptive taxation was an effective tool, not only against the backdrop of a preponderance of cash transactions and unscrupulous business persons' duplicity in terms of maintaining double records of business transactions, but also due to its contribution to procedural simplification and maintaining low compliance costs, and the fact that it reflected the preferences of the VAT entities. However, such deviation cannot continue for an unlimited period. Along with causing distortions, inefficiency and incentives for tax evasion, the downsides of the inclusion of presumptive elements in the VAT system include the existence of victims who maintain true records of business transactions and who are willing to be taxed on the actual value of transactions. Now, more than two and a half decades since the introduction of VAT in Bangladesh, the government is attempting to put in place a standard VAT system by implementing the proposed Act, which would replace the existing VAT Act, 1991. In addition to eliminating of the requirement of price declaration, the essential features of the proposed Act are the entitlement to input tax credit and a single, uniform rate of VAT at 15% on the actual value of transactions at all stages along the value added chain. Such features will remove the existence of the multiplicity of effective VAT rates and the dysfunctional input tax credit mechanism arising from the presumptive elements in the existing VAT system. The fact that the proposed Act eliminates the presumptive elements will make the VAT system simple, uniform and more transparent, and will enable the input tax credit mechanism to operate effectively, reducing incentives for tax evasion. However, the business community opposes the implementation of the proposed Act, mainly because of members' fascination with

the effective rates of VAT of less than 15% which arise from the presumptive elements within the existing system.

4. AN ANALYSIS OF THE BUSINESS COMMUNITY'S REACTION

As discussed before, in the standard VAT system, the end consumers of goods and services are the ultimate payers of VAT. Entities other than the end consumers in the value added chain, i.e. intermediaries, are the collectors of VAT, not the payers. This is because, in the standard VAT system, an intermediary collects VAT – output tax – from the intermediary of the next stage or from the end consumer, receives credit for the VAT – input tax - paid to the intermediary in the previous stage and, finally, remits the balance – output tax less input tax – to the exchequer. However, certain conditions need to be fulfilled and proper documentation needs to be maintained in order for input tax credit to be claimed. Although onerous, this nonetheless ensures accountability and transparency in the tax system. Such a credit mechanism is the bedrock upon which the proposed Act and the VAT system stand and can operate properly, as well as without interruption, if – and only if – a uniform and single rate of VAT is applied at all applicable stages and in all cases. From this standpoint, the foundation of the proposed Act looks stronger and much more solid than that of the existing one, and hence the Act deserves to be accepted and implemented.

In the context of Bangladesh's present VAT system, however, which lacks accountability and transparency, the intermediaries and, for that matter, the business community mistakenly see themselves as being the payers rather than the collectors of VAT, which is one of the main reasons for their opposition to the proposed Act. They wrongly perceive that they will have to pay more VAT because a single and uniform rate of 15% would be applied at all stages and in all cases in the proposed system, rather than the rate of less than 15% rate which applies under the presumptive regime in the existing system. In fact, the intermediaries should not be worried about the rate because whatever the rate may be, they will not ultimately pay any VAT. Nevertheless, the implementation of the proposed Act has been deferred a number of times since its enactment in 2012. It was then scheduled for July 2017, but postponed again, amid concerns among, and opposition from, the business community. In my analysis, other possible reasons for the business community taking such a stance are as follows. First, intermediaries find the task of maintaining the proper documentation required in order to receive input tax credit to be cumbersome. Second, intermediaries are inordinately biased towards the rates below 15% which are associated with the truncated base, turnover tax, and tax on traders, and the apparently lower amount of VAT resulting from tariff value, while they are not aware of the fact that the net VAT resulting from the 15% rate on the usual sales value with input tax credit does not make a significant difference to the amount of VAT arising from the truncated base, turnover tax, tax on traders and tariff value methods. Third, intermediaries are not concerned about the cascading effect – VAT on VAT – which is an obvious concomitant of presumptive elements.

Some members of the business community also object as they believe that the implementation of the proposed Act will induce inflation in the economy because of the imposition of 15% VAT at all stages and in all cases. However, careful analysis reveals that this may not be the case. For example, in the current system, M.S. products and utilities, such as electricity and gases, are subject to VAT under the tariff value and truncated base methods respectively. If the market price of a ton of M.S. product is BDT 60,000/- and the tariff value of the same for imposing VAT is BDT 3,000/- , a ton of M.S. product will cost a consumer BDT (60,000/- + (3,000/- * 15%)) = 60,450/- in total under the current system. Some may come to the naive

conclusion that under the terms of the proposed Act, the total cost of a ton of M.S. product to the end consumer would be BDT (60,000/- + (60,000/- * 15%)) = BDT 69,000/- and hence it would induce inflation, as the price would rise from BDT 60,450/ to BDT 69,000/-. They may also argue that since these items, i.e. M.S. products and utilities such as electricity and gas, are the basic inputs for the production of myriad goods and services, VAT-induced rises in the prices of these inputs would result in a negative supply shock, leading to an increase in overall price levels and a decrease in the total output of the economy. However, such a conclusion and argument may not prove to be convincing when the matter has been subjected to deeper scrutiny. Under the proposed Act, the VAT exclusive price of a ton of M.S. product must fall below BDT 60,000/-, since the VAT paid for purchasing inputs and subsumed in the BDT 60,000/- must be subtracted from it. If it so happens that the amount of VAT paid for purchasing inputs and subsumed in the BDT 60,000/- is BDT 7,435/-, the VAT exclusive price of a ton of M.S. product will stand at BDT (60,000/- - 7,435/-) = 52,565/- and hence, under the terms of the proposed Act, a ton of M.S. product will cost a consumer BDT (52,565/- + (52,565/- * 15%)) = 60,450/- in total as well.

A similar exercise can be carried out for utilities, such as electricity and gas. It has been argued that the implementation of the proposed Act would increase the price of utilities and thus cause the common people untold misery. However, it can be shown, as above, that since the unit price of utilities under the current system includes VAT paid for purchasing inputs, the VAT-imposable unit price under the proposed Act will, as the input VAT will be subtracted from it, fall below the prevailing unit price to such extent that the imposition of the 15% VAT rate will make no significant difference to the total cost of electricity to a consumer.

In addition, the argument that the implementation of the proposed Act will cause VAT-induced inflation is untenable from the standpoint that more items are reported to be exempted from VAT under the proposed Act than are exempted within the current VAT regime.

The proposed Act has been heavily criticised with regard to the some of the issues relating to the transition from the current VAT regime to that laid out in the proposed Act. One such issue is the VAT Deduction at Source (VDS) on contracts made in the current regime, for which payment shall be made under the proposed Act. For example, if the VDS-excluded value of a contract for construction work made under the current VAT regime is Tk. 1,000,000/-, the VDS would be at 6%, so the total contract value would be Tk. 1,060,000/- and the contractor would expect to receive Tk.1,000,000/- after VDS. It can be argued that, had the proposed Act been implemented and the payment for this contract had been made under the proposed VAT regime, the contractor would have been adversely affected since, after the VDS at 15% of Tk. (1,000,000/- * 15%) = 150,000/-, the contractor would receive Tk. (1,060,000/- - 150,000/-) = 910,000/-, which is less than his/her expectation of Tk. 100,000/-. However, such argument is not tenable in view of the fact that the VDS-excluded value of the contract (Tk. 1,000,000/-) includes the VAT paid for purchasing all the inputs required for the execution of the contract. If the amount of such VAT is "T", the VDS-imposable value of the contract under the proposed VAT regime will be Tk. (1,000,000/- - T) and the contractor would be entitled to receive input tax credit of Tk. "T", subject to the maintenance of proper documentation. In such a case, it may be shown, in the following way, that for a certain amount of "T", the contractor will remain unaffected even though the VDS is applied at 15% instead of at 6%:

$$((1,000,000/- - T) * 15\%) - T = (1,000,000/- * 6\%)$$
Hence, T = 78,268/-

Here, T = 78,268/- is the critical value. If the contractor can produce the documents of "T" for more than Tk. 78,268/-, s/he will end up receiving more than TK. 1,000,000/- and thus will have benefited, rather than have been adversely affected, by switching from the current VAT regime to that laid out in the proposed Act.

5. THE PROPOSED ACT REDUCES THE INCENTIVES FOR TAX EVASION

The end consumers of goods and services are the ultimate payers of VAT. However, in most cases, VAT paid by the consumers is collected and remitted to the government's treasury by businesses, i.e. intermediaries operating in the value addition chain. In addition, even though intermediaries are not the ultimate payers of VAT, they nonetheless pay VAT to the intermediaries of the previous stages and collect VAT from the intermediaries of the next stages Therefore, tax will be evaded if the intermediaries:

> - do not collect VAT from the end consumers and the intermediaries of the previous
>   stages at all.
> - collect VAT from the end consumers and the intermediaries of the previous stages
>   but do not deposit it with the government's treasury.

In this paper, we argue that the proposed system essentially reduces the incentives for tax evasion that exist within the current system, mainly because the proposed system is free of presumptive elements. In any VAT system, be it the proposed or existing one, the main channel of tax evasion is through unrecorded purchases of inputs. If purchases of inputs are recorded, production according to output-input coefficients must be recorded, and sales made out of that as well as VAT imposed thereon has to be recorded and deposited to the government exchequer sooner or later. However, if the purchase of inputs is not recorded, there is no scope to record subsequent activities (production, sales and hence VAT), so VAT is evaded through the channel of unrecorded purchases of inputs. Since the proposed system is free of presumptive elements and features input tax credit, it provides entities with more incentive to record purchases of inputs than the existing system, in which input tax credit is not allowed for the sale of outputs under presumptive methods. Consequently, the proposed system provides fewer incentives for tax evasion than the existing system. Therefore, the crux of the issue with regard to mobilising VAT revenue is to ensure that purchases of inputs are recorded and, by construction, the proposed system is stronger in respect of this than the existing system.

The existing system, as highlighted by its distortion of, and departure from, the standard VAT system because the input tax credit mechanism does not work properly within it due to the dominance of presumptive elements, is more vulnerable to tax evasion, and hence the theoretical VAT revenue yield of the existing system is not sustainable. For example, inputs are bought at TV and TB at the first stage and, after value has been added at the second stage, are sold at TV at the third stage. Further value is added at the third stage and they are then sold at market price. In this process, since input tax credit is not allowed at the second stage, as the outputs are then sold at TV, there is no incentive for recording the inputs purchased from the first stage and, consequently, the theoretical VAT revenue yield of the total process is more likely to be evaded. In contrast, in the proposed system, since inputs are purchased from the previous stage at market price at every stage and outputs are sold from each stage to the next at market price, input tax credit is allowed at every stage, which provides entities with incentives for recording the purchase of inputs at every stage and thus reduces the susceptibility of the system to tax evasion.

Unrecorded purchases of inputs, be they in the proposed or existing system, are more favourable to the entities than recorded purchases of inputs. However, unrecorded purchases of inputs are more favourable to the entities in the existing system than in the proposed system. For example, inputs are purchased at TV and TB after the first stage and, after value had been added at the second stage, are then sold at market price. Hence, the input tax paid for purchasing the inputs from the first stage is allowable as credit against the output tax. However, if the purchase of inputs is not recorded, consequently, when the output has been produced and, sold, the VAT collected will not be recorded and deposited to the government exchequer. Hence, by adopting this scheme of unrecorded purchases of inputs, the entity is losing input tax credit but gaining the output tax collected from the customer issuing the fake VAT document. Therefore, the entity will make a net gain, as the amount of output tax collected will be more than the input tax credit lost. The entities will also gain when making unrecorded purchases in the proposed system. However, their net gain when doing so within the proposed system would be less than when doing so within the existing system, as shown in Appendix C. Therefore, there is more incentive for VAT entities to make unrecorded purchases of inputs in the existing system than in the proposed system. This, in turn, makes the existing system more vulnerable to tax evasion than the proposed system.

At the beginning of this section, we identified two tax evasion methods. The basic idea behind both methods is that purchases of inputs are not recorded in the books of accounts presented to the tax authority. Both methods involve unrecorded sales of unrecorded purchases but, when using the first method, the VAT is not collected from the customers while, when using the second method, the VAT is collected but is not remitted to the government's treasury. As we explained earlier, the presence of presumptive elements in the VAT system provides incentives for the adoption of such a scheme of tax evasion. It thus shows that these presumptive elements engender a lack of transparency in terms of keeping records of business transactions, leading to the maintenance of double sets of books of accounts. One of the arguments for incorporating presumptive elements in VAT legislation is the ease of taxing hard-to-tax entities whose operations lack transparency in terms of the records of business transactions kept. Presumptive elements, as is argued in this paper, on the other hand, act as a spur to a lack of transparency with regard to keeping records of business transactions. Presumptive elements and a lack of transparency with regard to keeping business records thus form a vicious circle – one reinforces other. Against such a backdrop, the fact that the proposed Act eliminates the elements of presumptive taxation would mean the introduction of transparency into businesses' record-keeping procedures and a reduction in the scope of tax evasion.

Under presumptive methods of taxation, particularly turnover tax, taxing of traders and package VAT, tax is collected on a lump sum basis. VAT entities collecting taxes under these methods find themselves the ultimate payers of VAT even though they often include the VAT element when pricing their products and therefore recover the VAT from the customers. Therefore, under presumptive taxation, which inherently lacks transparency when it comes to the keeping of business records, it is possible that the amount of VAT collected will be more than the amount of VAT remitted to the government exchequer, resulting in tax evasion. However, business entities argue that in extremely competitive market conditions, where consumers are inordinately price-sensitive, the VAT cannot be passed on to consumers within the price. They further claim that, under presumptive taxation, business entities, rather than consumers, are the ultimate payers of VAT and this reduces their profit margins. Whatever the arguments, the bottom line is that presumptive taxation, by construction, entails avenues for tax evasion. By eliminating the provisions of presumptive taxation, the proposed Act closes a window of opportunity for tax evasion.

In the existing system, the requirement to declare prices and have them approved by the VAT authority so that they can be used as bases for imposing VAT, which has been dubbed 'implicit presumptive taxation', also provides an incentive for tax evasion. Within the dynamics of a market economy in which the market conditions are continuously changing, it is hardly a reality that business transactions could always be made at fixed prices approved by the VAT authority. Nevertheless, the existing VAT legislation requires the VAT entities to collect and deposit VAT on the basis of approved prices. If the actual transaction price is higher than the approved price and VAT is collected, the opportunity exists for the entities not to deposit the VAT collected which is in excess of the amount that should be collected on the basis of the approved price. If this happens, it is clear evidence of tax evasion. On the other hand, it would go against the norms and fundamentals of business transactions to collect VAT on an approved price which is higher than the actual price of a transaction. However, under the existing VAT legislation, entities are liable to collect and remit VAT on the basis of approved prices. Therefore, in order to avoid the legal complexities and liabilities of paying VAT which is in excess of the amount they may credibly collect, entities underreport the volume of their business transactions, resulting in tax evasion. The proposed Act does not contain legal provisions for price declaration and approval – the implicit form of presumptive taxation. According to the terms of the proposed Act, VAT will be collected on the actual value of the transactions, i.e. the actual base instead of the presumptive base fixed by the VAT authority, therefore eliminating the incentives for tax evasion through the channel of presumptive taxation.

6. CONCLUSION

This paper argues that the VAT system currently in effect in Bangladesh, which is based on the VAT Act, 1991, is essentially presumptive, which provides VAT entities with incentives for tax evasion and results in distortions, inefficiency, lack of transparency in respect of keeping records of business transactions and deviation from the standard VAT system. In contrast, the proposed Act, i.e. the VAT and Supplementary Duty Act, 2012, is purged from all forms of presumptive element. The paper explains that the incentives for tax evasion will be reduced with the implementation of the proposed Act, as it does not contain any presumptive elements. The proposed Act and, for that matter, the proposed system reduce tax evasion through reducing the incentives to fail to record purchases of inputs. The proposed system thus enhances the recording of transactions, in particular, the recording of sales, by reducing the incentives to complete unrecorded purchases of inputs, as well as improving monitoring processes, ensuring transparency, and increasing accountability for both the taxpayers and the tax authority. Since reported sales are used as the bottom line for both VAT and income tax, the proposed system may yield more income tax revenue in tandem with a higher amount of VAT. Although implementation of the proposed Act was scheduled to begin in July 2017, it was postponed again amid concerns amongst, and opposition from, the business community. The paper argues that many of the business community's concerns are unfounded and hence the proposed Act deserves to be implemented. Along with removing distortions from the VAT system and bringing transparency and accountability into it, the proposed system, by construction, will yield more VAT revenue than the existing system. However, the effect of the proposed system on revenue will be more prominent because of its ability to reduce the incentives for tax evasion through eliminating presumptive elements.

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APPENDIX A: THE MAGNITUDE OF TOTAL VAT REVENUE UNDER TRUNCATED BASE (TB) AND THE STANDARD VAT SYSTEM

Cost of the input purchased at market price excluding VAT = A
Rate of VAT is a constant = C and C < 1
VAT paid for purchasing the input at market price i.e. input tax = A * C
Total cost of the input purchased at market price = A + (A * C)

Here, the final product produced from the input is sold at TB, so input tax credit will not be allowed. Under such circumstances, the input tax paid is part of the cost of the final product. Suppose, for example, further value is added to the input to produce the final product = F

Hence, the price of the final product = A + (A * C) + F
Let's assume the TB of the final product = G, where G < 1
Hence, output tax = {A + (A * C) + F} (G * C)
Therefore, the total amount of VAT that goes into the government's coffers under TB (RTB) is:

RTB = {A + (A * C) + F} (G * C) + (A * C)

The total amount of VAT that goes into the government's coffers under the standard VAT system (RSTD) is:

RSTD = (A + F) * C

For ease of comparison between RTB and RSTD, this can be simplified as follows:

RTB = [{A + (A * C) + F} (G * C) + (A * C) - (A * C)] / (F * C)
RTB = [{A + (A * C) + F} (G * C)] / (F * C)
RTB = {(A * C)/F} (G/C) + [{(A * C)/F} * G] + G

RSTD = [{(A + F) * C} - (A * C)]/ (F * C)
RSTD = 1

Therefore, the total revenue generated under TB (RTB) will be greater than the total revenue generated under the standard VAT system (RSTD) if RTB > 1.

Whether the RTB will be greater than 1 or not depends upon (A * C)/F and (G/C), i.e. the relative value of input tax to value addition and the percentage of truncated base to the standard VAT rate.

APPENDIX B: THE MAGNITUDE OF TOTAL VAT REVENUE UNDER TARIFF VALUE (TV) AND THE STANDARD VAT SYSTEM

Cost of the input purchased at market price excluding VAT = A
Rate of VAT is a constant = C and C < 1
VAT paid for purchasing the input at market price, i.e. input tax = A * C
Total cost of the input purchased at market price = A + (A * C)

Here, the final product produced from the input is sold at TV, so input tax credit will not be allowed. Under such circumstances, the input tax paid is part of the cost of the final product. Suppose, for example, further value is added to the input to produce the final product = F

Hence, the price of the final product = A + (A * C) + F
Let's assume the TV of the final product = H
Hence, output tax = (H * C)
Therefore, the total amount of VAT that goes into the government's coffers under TV (RTV) is:

RTV = (H * C) + (A * C)

The total amount of VAT that goes into the government's coffers under the standard VAT system is:

RSTD = (A + F) * C

For ease of comparison between RTB and RSTD, this can be simplified as follows:

RTV = [(H * C) + (A * C)) - (A * C)] / (F * C)
RTV = H/F

RSTD = [{(A + F) * C} - (A * C)]/ (F * C)
RSTD = 1

Therefore, the total revenue under TV (RTV) will be greater than the total revenue under the standard VAT system (RSTD) if RTV > 1.

Whether RTV will be greater than 1 or not depends upon H/F, i.e. the relative values of TV and value added.

APPENDIX C: THE NET GAIN TO ENTITIES IN RESPECT OF THE UNRECORDED PURCHASE OF INPUTS IS LOWER IN THE PROPOSED SYSTEM THAN IN THE EXISTING SYSTEM

Cost of input purchased at TV excluding VAT = A
TV of the input for imposing VAT = B
Rate of VAT is a constant = C and C < 1
VAT paid for purchasing the input at TV, i.e. input tax = B * C
Total cost of the input purchased at TV = A + (B * C)

In this case, the final product produced from the input is sold at market price. Therefore, input tax credit will be allowed. Under such circumstances, the input tax paid is not part of the cost of the final product. Further value added to the input to produce the final product = F

Hence, the price of the final product = A + F

Under the presumptive regime:
Output tax = (A + F) * C
Input tax credit = (B * C)

Under the standard VAT system:
Output tax = (A + F) * C
Input tax credit = (A * C)

When adopting the scheme of not recording purchases of inputs, the entity loses input tax credit but gains from the output tax collected from the customer who issues the fake VAT document.

The net gain to the entity under the presumptive regime (NGP) is:
NGP = (A + F) * C - (B * C)
NGP = F * C + (A - B) * C

The net gain to the entity under the standard VAT system (NGS) is:
NGS = (A + F) * C - (A * C)
NGS = F * C

Since, by construction, A is always greater than B:
NGS < NGP

CHALLENGES OF THE NEW ORGANIZATION OF THE TAX ADMINISTRATION IN ALGERIA

Khaled Senator[1]

Abstract

In the 50 years since Algeria gained its independence, and following the evolution of the tax system, the instability of the organization of the Algerian tax administration has been recognized. In 2000, the government implemented a new program which involves the reorganization of the tax administration based on taxpayer segmentation, which is a very difficult choice for Algeria, due to other sectors' levels of development, and the culture of the tax collectors and taxpayers.

Keywords: Tax Administration, Organizational Structure, Functional Organization, Taxpayer Segmentation.

I. INTRODUCTION

Tax administration is the instrument that shapes tax system objectives. It is the main mediator in the relationship between the legislator, who approves tax laws, and taxpayers, who are subject to those laws. Efficacy is the main factor that determines the success of a tax system that aims to ensure the regularity of public treasury financing, but also to achieve the other tax policy objectives pertaining to economic policy and the distribution of income (Pulse & Kamenov, 2013).

Despite this, the tax administration in Algeria has not achieved the stability necessary to enable it to become more efficient. Moreover, disturbance and repeated rapid restructuring have negatively affected not only the accumulation of the required administrative traditions but also the accomplishment of the tax administration's objectives and the continuity of its relationship with taxpayers.

The tax administration has undergone two big reorganizations since 1992, when general reforms were made (one reorganization approximately every 10 years). The first of these took place just after the 1992 reforms and focused on major concepts, mostly taken from the French model.[2] The second occurred after the promulgation of the law on tax procedures (Law 01-21 pertaining to the Law of Finances 2002), and focused on simplifying the tax administration and adapting it to suit its new tasks.

Although the reorganizations affected the entire structure of the tax administration, there is less interest in the central organs that set tax policy but do not, directly, intervene in the management of tax operations themselves. This is in contrast to external services that are, indeed, the

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[1] Divisional Inspector, Algerian Tax Administration & KDI School of Public Policy and Management, Republic of Korea. Email: senator.khaled@kdis.ac.kr
[2] The French tax system distinguishes between State taxes and local taxes, and recognizes three main types of tax: taxes on capital, taxes on income, and taxes on consumption. In terms of the tax administration, the General Directorate of Taxes (DGI) was established in 1948 and is the organization is in charge of all tax operations.

interface of the tax system, since they are permanently related to and in direct contact with taxpayers, and are in charge of all tax operations.

On the other hand, the new model was rapidly adopted with the objective of responding to important amendments to tax laws, because the tax administration had experienced many difficulties when trying to execute the different tax operations in their original form (McLaren, 2003). Moreover, this new model has been adopted by many countries and has proved to be efficient in them (Jacobs, Jiminez, Crawford, Osinski, Murdoch, Hinsz, Hodges, Pulse, Lethbridge, & Kamenov, 2013), but the situation in Algeria may be different if we take into consideration other factors, such as payment methods, and the level of information and communication technologies available.

Additionally, and regardless of the principle of tax law autonomy, the new model requires additional modifications to be made to the tax administration's legal arsenal. This is because the organization is subject to other laws and regulations, particularly the law pertaining to public accounting, which would contradict the new organizational chart, and to the law on the organization of the local authorities (provinces and municipalities).

In fact, when adopting this model, the government's objectives were simple and clear, and can be assumed in the research for more efficiency. However, when it was first implemented, there was ambiguity, not only because of the negative effects of the selective treatment of taxpayers, but also because the tax administration was not ready to benefit from the advantages of this new organization and the taxpayers were not able to understand how the new system worked.

In order to evaluate the impact of the adoption of the new model on the tax administration, this paper uses the descriptive analytical method and, when necessary, the comparative method, because the model was mainly inspired by the French model, with some modifications.

To be more practical, this paper will try to follow the evolution of the organization of the tax administration since Algeria became independent, and will then focus on the new model, its potential risks, and the conditions needed in order to deal with the new situation. I will then analyze how the reorganization has influenced each structure's tasks, and how it has impacted the principles of public finances and public accountancy. Finally, it is necessary to evaluate the preparations made by the tax administration before adopting this new model.

II. MODELS OF TAX ADMINISTRATION ORGANIZATION AND THEIR APPLICATION IN ALGERIA

The aim of the tax administration is to achieve the tax system's objectives, including collecting taxes with the minimum of costs, using the new methods to popularize tax culture (Pulse & Kamenov, 2013). In fact, "a fundamental task of any tax administration is to collect revenues with lowest possible costs" (Martinez-Vazquez & Timofeev, 2005). Therefore, before establishing a new organizational model, it is necessary to find an equilibrium between two variables: the costs of communication when using a large number of small administrative entities, each of which is in charge of a single task, and the cooperation costs involved when using one large entity which is in charge of all tax operations.

In order to achieve the objectives of the tax system with regard to setting and collecting taxes, countries around the world follow different models, depending on their levels of development and the qualifications of the tax officials in charge of leadership, management, and execution

within them. Specialists distinguish between three main models (Kidd, 2010), but a mix of two or all three models can be used (Fjeldstad & Heggstad, 2011). These models are the type of taxes model, the functional model, and the taxpayer segment model.

II.1 The type of taxes model

This model is based on the distinction between taxpayers according to the nature or the types of taxes they are subject to. Therefore, every taxpayer deals with more than one sub-department, since the tax administration itself is organized on "separate multifunctional departments for each tax that were largely self-sufficient and independent of each other" (Organisation for Economic Co-operation and Development [OECD], 2004), and that should comprise all necessary structures (the tax base department, the tax collection department, the tax audit department, the tax disputes department etc.). Consequently, the tax administration would include at least the following sub-offices: an office in charge of taxes on income, an office in charge of taxes on capital, and an office in charge of taxes on consumption.

According to the OECD (2004), this is the oldest model. It has been implemented by many countries, including the UK, which used it until the end of the 17th century, and the US, which used it until the end of the Second World War. The structures of New Zealand and Australia's tax administrations have been based on type of taxes since their creation, except for some short periods of time. Many other African countries (such as Mozambique, Tanzania, and Zambia) adopted this model before their tax systems were reformed (Fjeldstad & Heggstad, 2011).

This model permits efficient audit of each tax because officers become specialists, which enables them to set and collect taxes with fewer errors (Kidd, 2010). However, it has been widely criticized because of the high costs involved in the management model and the repetition of tasks required, which negatively affect its efficiency (e.g. the same list of taxpayers is created and updated more than once and for each sub-department. Finally, it requires all the necessary structures to be in place for each sub-department, including human resources, office supplies, and even the tax officers' department (Jacobs et al., 2013).

Taxpayers experience complications, since they have to deal with more than one sub-department according to their activities. Therefore, they need to submit periodic declarations and pay the amounts required by every sub-department, which increases dissatisfaction and facilitates tax fraud (Dobrovič, Dobrovič, & Dobrovičová, 2014). Moreover, it is not easy for the many different sub-departments to cooperate in order to determine a taxpayer's effective income or sales turnover (Mookherjee, 1997), or even to make comparisons. Finally, in addition to causing delays and additional costs (Adimoolah, 2009), it increases the possibility of corruption existing because, due to "the important number of points of contact between tax collectors and taxpayers and multiplying rules across different taxes, a type of tax structure opens greater opportunities for discretion in the application of tax laws, and hence, corruption" (Federal Board of Revenue, 2011).

In Algeria, the external services of the tax administration were organized according to types of tax (Executive Decree (87-212), 1987), as follows:

  - Inspectorates for direct taxes;
  - Inspectorates for indirect taxes and sales taxes;
  - Inspectorates for registration fees and fiscal stamps.

However, the organization of the central structures was different; it was based on the functional model, with two directorates, the first in charge of tax audit, and the second in charge of studies and tax legislation.

This model has since been totally abandoned because of its limitations in relation to cooperation, particularly the fact that that tax offices were the responsibility of municipalities' treasurers, which has negatively affected their ability to perform their principal function, that of collecting taxes (Algerian Accounting Court, 1997).

II. 2 The functional model

The functional model is based on the theoretical approach of gathering similar taxpayers and similar activities within the same tax departments because they require similar skills and similar instruments of control, which allows for deep specialization in a single activity, such as tax scope, tax collection, or tax control (METAC, 2010), instead of dealing with all tax operations within the same department (Kidd, 2010). This model is less complicated than the previous one. It permits all taxpayers to fall within one administration that covers all tax operations regardless the nature of the tax itself (Kidd, 2010). Therefore, each taxpayer would have contact with a single tax office instead of contacting a different entity about each type of tax (Hőgye, 2008).

This model permits more efficiency and reduces administrative costs, since there is a single organ in charge of all administrative issues and human resource management (Dobrovič et al., 2014). Consequently, it allows for a greater focus on tax operations, especially tax scope and control, since there is one organ in charge of collecting all taxes, regardless of their nature. Furthermore, tax evasion becomes more difficult because all transactions are controlled by the same organ, which enables the tax administration to perform better. Even tax officers lose some of their discretionary authority because it is easy to discover any illegal privileges or misapplications of the law.

However, this model also has many limitations with regard to service quality because each organ focuses on its specific functions separately to the others, which devolves responsibilities and means that additional costs are incurred in order to ensure good coordination (METAC, 2010). Furthermore, the centralization of all decisions could create congestion at the Ministry of Finance, which intervenes in the management of the system, although that is outside the scope of its original tasks (Kidd, 2010). On the other hand, taxpayers can find themselves in uncertain positions because several organs could be involved; one in charge of tax scope and calculation, another for tax collection, and a third for disputes and control.

Algeria implemented the functional model within tax reforms that took place in 1992, when inspectorates of direct taxes were merged with inspectorates of indirect taxes to form a single inspectorate in charge of all tax operations within its territorial jurisdiction, while tax offices were responsible for the collection of all taxes regardless of their nature.

The central administration was also organized into central directorates and sub-directorates following the functional model (Executive decree 90-190, 1990). However, the central directorate of tax disputes was organized according the nature of taxes, including sub-directorates for VAT, income tax, and so on (Executive decree 95-55, 1995), which created some difficulties in terms of cooperation. Furthermore, the organization of the central offices was often based on the nature of taxes, e.g., the office of tax on income, the office of VAT, the

office of indirect taxes, the office of hydrocarbon taxation, and the office of real-estate taxation etc. (Inter-ministerial order of February 21, 2009).

II. 3 The taxpayer segment model

This model is a result of the non-compatibility between large and small taxpayers. "Large business taxpayers have different characteristics and tax compliance behavior and, therefore, present different risks to the revenue" (OECD, 2009). Although large taxpayers represent less than 1% of the total taxpayers, their contributions represent the largest part of the public resources, thus the tax administration would prefer to treat them better and give them priority rather than fragmenting its efforts on other taxpayers (The World Bank, 2004). Consequently, and inspired by the way in which customers are treated within the private sector, a national entity was created to ensure that large firms received better treatment with regard to taxation (European Commission, 2007), as the tax administration would treat taxpayers as clients of the national community otherwise (Baurer, 2005).

According to the OECD's Centre for Tax Policy and Administration:

> the common identification criteria used to define taxpayers as large business or to place them under the responsibility of the large business unit include:
>
> - amount of turnover or gross sales;
> - value of assets;
> - amount of tax paid;
> - operating in certain business sectors (e.g. banking, insurance, oil, etc.);
> - engaged in international business activities; and
> - number of employees. (OECD, 2009)

This model overcomes the limitations of the two previous models. First, it allows for the clarification of responsibilities and the avoidance of the devolvement of responsibilities, because the same organ deals with all tax operations for one taxpayer from the beginning until the cessation of his activity. Second, it allows for the clarification of the relationship between taxpayers and the tax administration, because taxpayers deal with one entity which is in charge of all tax activities, including tax scope, tax collection, dispute resolution, tax control etc.

However, this model is characterized by the multiplication of the administrative costs, as these would be repeated for every organ. It also allows for the centralization of the most highly qualified tax officers, who are likely to be put in charge of large taxpayers, meaning that the other offices could suffer from marginalization, which would affect their efficiency. In the worst cases, the centralization of all tax operations within a single entity would facilitate incorrect behaviors and corruption, because the responsible parties would be able to plan cases to avoid any contradictions.

In 2003, the Algerian government updated its legal framework to adopt this new model, but made some modifications to it to account for country-specific issues and in order to take the realities of other sectors into consideration.

III. TAXPAYER SEGMENTATION: THE SPIRIT OF THE NEW ORGANIZATION OF THE TAX ADMINISTRATION

The new model based on taxpayer segmentation was adopted with the objective of responding to the heterogeneity of taxpayers, but some difficulties were encountered during its application, even before all offices had implemented it. Moreover, it requires an integrated system of information and communication technology that permits the prompt and efficient transfer of information between the different organs and, therefore, allows for virtual management of tax documents to take place. Finally, it is worth noting that the lack of utilization of information technology by taxpayers, banks, and financial institutions make it very difficult for the tax administration to get the necessary data in real time.

As such, the tax administration should ensure that it has a physical presence in order to verify the real situations of all taxpayers who are supposed to visit tax offices and present their documentation during a period of 30 days, according to art. 183 and art. 192 of the Law of Direct Taxes (2018). However, these 30 days are, in fact, resumed on two days of receptions for a maximum of six (6) hours per week and, taking into consideration the huge number of people that would come in every time, and the very few officers in charge of reception and orientation, this may lead to a real crisis within the tax offices and negatively affect taxpayers interests (Gutierrez, 2002).

III.1 The dual criteria to determine jurisdictions

Law 02-11 of December 24, 2002, pertaining to the Law of Finance, 2003, required the creation of a directorate for large taxpayers, and tax centers for small and medium-sized taxpayers. This re-organization was implemented by an executive decree pertaining to the organization of the external services of the tax administration and its tasks (Executive Decree 06-327, 2006). This new organization classifies each corporate taxpayer, firstly according to their global sales turnover, and also according to other factors, such as the nature of their activity and their geographical location, in order to determine which tax centers they should deal with.

In respect of the large taxpayers' directorate, Algeria used almost the same criteria as other OECD countries, but with some differences. The following table (Table 1) summarizes the different variables used in this model.

Table 1: Comparison of the characteristics used to determine the scope of the large taxpayers' directorate in Algeria and selected OECD countries.

	Algeria	**France**	**Canada**	**Ireland**	**UK**
Sector of activity	Hydrocarbons	Not applicable	Not applicable	Banks and financial companies	Not applicable
Turnover level	More than 100 Million DZA	More than 400 Million €	More than 250 Million Can$	More than 162 Million €	More than 50 Million €
Owing tax	Not applicable	Not applicable	Not applicable	More than 16 Million €	More than 43 Million €
Number of employees	Not applicable	Not applicable	Not applicable	Not applicable	More than 250
Foreign companies	Applicable under some conditions	Not applicable	Not applicable	Not applicable	Applicable under some conditions

Source: (OECD, 2009)

III.1.a Sales turnover is the base used to determine the field of competence

Taxpayer sector of activity is the main criterion used within the tax administration's new organizational structure to allocate taxpayers to departments. Therefore, taxpayers working within the hydrocarbon sector and taxpayers whose total turnover exceeds 100 million DZA are within the Large Companies Directorate. Taxpayers with a total turnover of between 30 million DZA and 100 million DZA use tax centers. Finally, taxpayers subject to the single flat tax and taxpayers with a total turnover of less than 30 million DZA use local tax centers

However, the organization of the central administration is mainly based on the functional model: the directorate for tax legislation, the directorate for disputes, the directorate for tax operations and tax collection, the directorate for control and tax audits, and the directorate for administrative issues. The same rule applies to the organization of the sub-directorates, but these are sometimes based on tax type (e.g. the directorate of disputes includes a sub-directorate for Value Added Tax disputes, a sub-directorate for the revenue tax disputes, and so on). Offices are often organized according to tax type, with some exceptions.

III.1.b The declining use of geographic criteria

Geographic criteria are becoming less important and the new organizational structure is primarily based on taxpayer sector of activity. However, the size of Algeria (2.4 million km^2) pushed the government to determine the geographic jurisdiction for each organ. Therefore, the large taxpayers' directorate has a national competence, but the jurisdictions of tax centers and local tax centers were determined by the Minister of Finance, who took levels of economic activity and total numbers of taxpayers into consideration in order to respect the constitutional

principle that devolves the administration to local level if that best serves citizens (Hőgye, 2008).

Although local tax centers have not yet been established all over the country, the Ministry of Finance has had the final word: there is one tax center for every province (Ministerial Order of August 1, 2013). This decision may have created some difficulties in terms of management, especially in provinces where important economic activity takes place and large provinces in the south of the country that are very difficult to control.

III.2 The risks of adopting the new administrative organization

The adoption of this new model requires some preliminary conditions to be in place within the tax administration and related organs that are absent at the moment:

- It would have been preferable to deliver the necessary professional training before implementing this new model (Mookherjee, 1997) following the same principle used in many other countries, because it is not possible to continue with the old ideas and the old leaders (Bejaković, 2001). In fact, without professional training, tax officers could confuse tax centers with the old inspectorates of taxation, because their tasks are sometimes similar (The World Bank, 2004). According to the OECD (2009), "most participating countries provide training to their employees not only in the technical tax area but also in other personal, managerial and leadership skills, such as communication, negotiations, managing employees, and conflict resolution and project management."
- It is also important to improve the payment methods available, especially with regard to electronic payments and electronic filing. This new model was, in fact, inspired by the model used in France, which is a developed country, and its administration and citizens are habituated to using information and communication technology.
- In addition, this new model would result in more overlapping tasks, which is contradictory with other laws and regulation, especially the principle of separating public accountancy and authorization tasks (Law 90-21, 1990).

III.2.a Possibility of overlapping functions

The application of the new organizational model brings new challenges. Total sales turnover fluctuation is a serious issue, because a taxpayer who realizes a turnover of 100 million DZA one year may not realize the same turnover in subsequent years, requiring his tax file to be transferred from the large taxpayers' directorate to a tax center if he realizes a turnover of more than 30 million DZA, or to a local tax center if the turnover is less than that. If his turnover increases again, his file must be returned to the large taxpayers' directorate, and so on.

Of course, transferring tax files from one administrative entity to another is not easy and creates many complications, especially as tax files are ordinary sheets of papers and no other copies are kept. Therefore, much information may be lost or disappear during transportation, leaving the tax administration unable to determine responsibilities.

In addition, transferring tax files from one entity to another can confuse taxpayers and make their positions unclear, as they must wait for their records to be reviewed each year in order to find out which administrative entity is in charge of their tax management. In fact, it is in a taxpayer's interest to realize or to declare a lower turnover in order to avoid moving to the capital (for the large taxpayers' directorate), or one of the provinces' capitals (for a tax center),

which goes against the government's objective of creating large exporters and competitive corporates, and certainly involves additional costs (transportation, information transfer etc.).

Additionally, there are always long discussions about the importance of the regional tax directorates, because these entities have, essentially, been created in order to assist with professional training and retraining. However, they are dependent on the central services of the General Directorate of Taxation (Executive decree (91-60), 1991), which has negatively affected their work (Algerian Accounting Court, 1997). Therefore, many specialists recognize this organ as an additional bureaucratic barrier between the central administration and its external services in charge of tax operations (Hőgye, 2008).

The role of the provincial tax directorate has fluctuated between supervising inspectorates and tax offices, including the provision of the necessary instruments (human and material resources), without forgetting that the provincial director is the Minister of Finance's representative within the tax sector. However, the new organizational model devolves a significant number of the tasks allocated to the provincial director to the chiefs of the tax centers and local tax centers, creating some overlapping jurisdictions. Otherwise, the provincial directors' new tasks would be limited to human management and general management, and they would lose an important part of their essential missions with regard to the management of tax operations.

III.2.b Impact on the principle of separation between the public accountant and authorizing officer

The separation between the authorizing officer and the public accountant is a fundamental principle of the Algerian public financial system (Shah, 2007). It is dealt with by Law 90-21 of August 15, 1990 pertaining to public accounting, which determines each player's role (Chouvel, 2003). This principle requires that each player must be independent from the other although their functions are related. Therefore, the public accountant, who collects taxes due (Chouvel, 2003), "does not report to the authorizing officer. He or she is a staff member of the ministry of finance's treasury. The public accountant is empowered to reject any irregular payment orders issued by the authorizing officer" (Shah, 2007).

Generally, and regardless of the difficulties in realizing it in tax administration when compared to realizing it in the administration of public expenditure, this principle of separation has been always respected. The inspectorate of taxation determines the scope of taxes and their exact amounts, and the tax collection services ensure that taxes are collected. There is no hierarchical power between these two organs, which gives tax collectors (and the public accountant) a large amount of autonomy.

Even though the provincial director is the unique representative of the Minister of Finance and is, consequently, the legal authorizing officer, his relationship with the tax collectors is purely administrative, and limited with regard to human resources and general administrative issues. The rule is that tax collectors are part of the public accountant's network, as defined by Law 90-21 pertaining to the public accountant.

There is a serious disruption of the principle within the new model, because the director of large taxpayers, chiefs of the tax centers, and chiefs of the local tax centers are authorizing officers, and have hierarchical power over the tax collectors (the public accountant), which is, in fact, working in a service related directly to its authority (Inter-ministerial order of February

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21, 2009). This new order would put the principle of public accountant autonomy in doubt and raise serious questions about the responsibility of the authorizing officers, since they are also involved in tax assets and collection operations. Additionally, would they be subject to the special rules that make public accountants personally financially responsible for compliance and administrative errors?

IV. CONCLUSION

Tax administration has different objectives around the world, which makes it difficult to develop a uniform model which is able to achieve all objectives. The fact that a tax administration needs to perform complicated tasks in a changing climate means that any organizational model developed cannot be definitive. However, specialists recognize the importance of tax administration organization when it comes to the reform of a tax system.

During the last twenty years, Algeria sought to improve its tax administration's organization in order to improve efficiency and to facilitate its relationship with taxpayers. However, the results were limited when compared to how other sectors had evolved, making the tax administration more removed from society.

This and other factors would make the adoption of any new model a problem in itself, because the new organs are seen by tax officers and taxpayers as high, intermediate and low level versions of the old inspectorates: a large one in Algiers (directorate of large taxpayers), a medium-sized one in each province (tax centers), and small ones – dependent upon the decisions of the Minister of Finances – (local tax centers). This is, in fact, incorrect because it is a new organization with radically different competences and tasks, requiring more work to be carried out with regard to training and the dissemination of information (The World Bank Group, 2011). It is also necessary to take the resistance to change that would develop as a result of the new distribution of authority into account. Therefore, we must take sufficient time to evaluate the results attained by using this model when compared to its objectives and tools.

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REFORMING THE TAX SYSTEM OF THE FEDERAL GOVERNMENT OF SOMALIA

Abdinasir Abdullahi Mohamud[1], Najibullah Nor Isak[2]

Abstract

Domestic revenue mobilization is a high priority for the Federal Government of Somalia. Homegrown revenue offers a promising and sustainable financing option. Building the capacity to raise revenue through taxes is particularly important in Somalia, as it reduces dependence on aid and helps to finance the provision of public goods and services. At the same time, it strengthens the social contract between the state and citizens, and can fortify intra-societal relationships. Somalia has recently made a number of fiscal reforms in agreement with the International Monetary Fund (IMF). In addition to that, the Somalian government has adopted many revenue reforms in the last two to three years. This study investigates the status of the Federal Government of Somalia's reforms; that is, its achievements and the outcomes of these reforms. Successfully implemented tax reforms have included the adoption of new tax policy measures, revenue law updates, and revenue administration improvements. These reforms have been fruitful, resulting in an increase in government revenue, simplified tax collection processes based on a self-assessment approach, increased efficiency of operations through automation, and significant contributions being made to state-building. The study recommends that the Somali authorities further develop policies related to the expansion of tax bases in states and build tax relations with federal member states more effectively through fiscal federalism discussions. This will contribute to the efforts being made to mobilize domestic resources beyond the capital city.

1. INTRODUCTION

A tax is a mandatory charge or another type of levy imposed upon a taxpayer (an individual or another legal entity) by a governmental organization in order to fund various public expenditures, and can be either direct or indirect. Tax administration is the management, direction, and supervision of the execution and application of a government, country, or state's taxation laws and related statutes.

The legal taxation history of Somalia began in the colonial era, with Italy and Britain taxing the northern and southern regions of the country differently. Most of the tax laws they introduced are now outdated and either need to be amended or replaced with new ones so that modern features can be included. In addition, under the military regime of Siad Barre, the economy was under the command and control of the state, and there were fewer private sector companies in certain sectors. The situation continued in same way until 1991, when the Somali Civil War broke out.

From 2000 until 2011, there were governments that tried to introduce some taxes and duties, such as customs duty, but they found it difficult to administer these, as they were transitional and their powers were limited. Before 2012, the Federal Government of Somalia faced multiple constraints, including a lack of resources with which to provide much-needed public

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goods and services. The government's ability to raise revenue was weak due to: its application of old and unsuitable taxes; a lack of modern tax law, procedures and ICT equipment; and a lack of properly trained, disciplined staff. Other challenges faced by Somalia after its transitional governments, as found by Isak (2018), include: an inability to deal with members of "Hard-to-Tax" sectors; poor administrative capacity; insecurity and political instability; the incomplete transition to the federal system; outdated laws and poor enforcement of those laws; and sustained customs-related problems.

The Federal Government of Somalia wishes to increase revenue by (1) increasing the tax base, (2) adjusting the tax rates, and (3) harmonization. The government is committed to adopting a reform program aimed at restructuring and justifying its policies and procedures for trade in Mogadishu, and then the whole country, through expanding its fiscal power to the states. The government has tried to face these challenges, and made substantial efforts to reform the tax administration and its systems. In this paper, we discuss some of the reforms that Somalia has implemented in order to improve its tax system and the positive outcomes that these reforms have had.

This brief paper presents three aspects of the Federal Government of Somalia's recent revenue reforms: policy changes, legal improvements, and administrative updates. Currently, the federal government's tax base only comprises Mogadishu, the capital city: all other states collect taxes in their own way and tax harmonization is still a work in progress. As a result of this, the paper only focuses on the federal government's current territory, i.e., the Mogadishu/Benadir region.

2. BACKGROUND

A tax is a mandatory charge or another type of levy imposed upon a taxpayer (an individual or another legal entity) by a governmental organization in order to fund various public expenditures. Taxes consist of direct or indirect taxes. Tax administration is the management, direction, and supervision of the execution and application of a government, country, or state's taxation laws and related statutes.

A tax system is a legal system for assessing, collecting, managing, and regulating taxes. A tax itself can be defined as a taxpayer's (an individual or another legal entity's) obligatory contribution to the government, and this contribution is used by the government to finance its activities. Tax administration is one of a government's key responsibilities, and involves the collection of different taxes and the implementation of different tax laws through interaction with taxpayers. According to Hussein (2017), if a tax administration system is functioning well, the tax system performs better and makes a significant contribution to the government's budget. Although Somalia faces many challenges, it has still made significant improvements to its tax administration system. However, these changes have not improved the administration to the level required.

Tax reform is the process of changing the way in which taxes are collected or managed by the government so as to improve the tax administration process. According to Granger (2013), tax reform is commonly carried out to improve the efficiency and effectiveness of tax administrations, and to maximize the economic and social benefits that can be achieved through a tax system. Tax reform can include simplifying the tax system and making it more understandable or accountable. The need to increase revenue is obvious in countries with significant budget deficits and short-term revenue pressure can lead governments to make

changes that are counterproductive in the long run. The goal of tax reforms was perceived to be simply to raise tax rates in order to increase revenue with the goal of efficiency (Gray, 1989). In Somalia, the reforms implemented have been characterized by the huge challenges that they have posed and the fact that they are costing more than would usually be expected. These tax reforms should change most or all of the key operations undertaken by the administration and may not be liked by some taxpayers. For instance, the customs reform project was challenged by traders and the Somali Chamber of Commerce and Industry (SCCI) when they realized that the reforms would mean that a sales tax must be made at the port in respect of imported goods. They argued that the sales tax should be paid by the end consumer of the goods rather than the traders. However, the government insisted that it must be collected at the port (1) as a result of a cost benefit analysis of collecting sales tax at the port or at the market, (2) because the revenue departments argued that some of the goods are directly transported to regions outside of Mogadishu and those destination states do not collect sales taxes, and (3) as an enforcement mechanism because the regulations can be enforced in the ports more easily than in the markets.

With the adoption of the Sustainable Development Goals (SDGs), taxation has once again taken a central spot on the international development agenda. To fund these ambitious goals, the international community is not only calling on private capital to step in, but also on governments in developing countries to increase their domestic resource mobilization through tax system reforms and, in particular, tax administration (United Nations [UN], 2015). Looking back, the 1970s can be understood as a period in which theory had a significant impact on the design of tax reform in the tax administration and the tax system in general, and prominent British economists, such as Atkinson, Mirrlees, and, of course, Meade, were associated with this (Blundell, 1996). The reform of the tax administration and its system has long been of concern to those related to developing countries but, as discussed by Cummins et al. (1996), major tax reforms took place in many developed countries during the 1980s. If a government persists in reforming the tax administration and other systems in the country, it will contribute to the timely collection of sufficient revenue through the enforcement of tax law. A government, therefore, provides public goods and services, delivers them to the citizens, and then intervenes to balance the country's economy.

In developing countries, tax administration reforms are required due to the poor functionality of the government, and every country needs to generate enough revenue. Most African countries have revenue administrations, but these do not function well enough to produce enough revenue to finance government expenditure (Bird, 2015) and, as a result, these nations struggle to mobilize and reform their fiscal revenue systems. Somalia is one of the fragile countries having to reform its systems, in its case due to its system's poor functionality as a result of its devastating civil war.

Furthermore, according to Bahl and Bird (2008), the average tax share in industrialized countries has increased from 30 percent to about 35 percent during the course of the last three decades because of tax reform. In developing countries, however, the tax share of output increased only slightly. Indeed, since the 1980s, their tax shares have been almost constant, representing a remarkable slowdown. Developing countries' individual problems and the trade liberalization which took place towards the end of the 20th century were obviously driving forces behind tax reform in these nations, as were the widespread adoption of Value Added Tax (VAT) and the continuing improvement of their administrations.

Table 1: Domestic Revenue to GDP ratio for Selected Countries

Country	2015	2016	2017	2018
Federal Government of Somalia (States Excluded)	1.7	1.6	2.0	2.5
Democratic Republic of the Congo	13.6	9.2	8.5	9.3
Afghanistan	10.0	11.2	12.3	12.3
Kenya	18.7	18.4	18.2	18.4
Uganda	13.5	13.9	14.4	14.8

Source: IMF and the World Bank

According to the table above and other sources, such as Isak (2018), Somalia has the lowest domestic revenue to the gross domestic product (GDP) ratio in the world. Afghanistan and the Democratic Republic of the Congo are fragile countries, and are in similar situations to Somalia, while Kenya and Uganda are neighbors. Somalia needs to mobilize its domestic resources in order to increase its revenue to GDP ratio. The Federal Government of Somalia recognizes that it's not fair to compare Mogadishu based revenue with the national GDP, but this comparison could be soon be confirmed with consolidated fiscal data, putting Somalia's ratio at more than 2.5%.

African countries, including Somalia, face several challenges relating to accountability and transparency within their tax systems, tax policies, and tax administrations, and when implementing and enforcing tax laws, and engaging in public dialogue in order to satisfy their taxpayers. However, as mentioned by Yusuf (2017), the combination of an extensive decline in development and a weakened macroeconomic situation in Africa is driving governments throughout the continent to seek alternative means of increasing their income and reforming their tax systems. States that have formerly focused entirely on obtaining revenues from natural resources are now strengthening their tax laws to improve compliance. They recognize that taxation is at the heart of growth and development, and that it will provide the funds they need to build infrastructure, for example, in future. A possible alternative method for achieving fiscal sustainability is to generate continually increasing tax revenues, but accomplishing this is not an easy task. If governments get it right, the increased tax revenue will not only enable them to build infrastructure but will also pave the way for market reforms that would promote progressive economic and social policies.

In Somalia, taxation started during the colonial era, and Somalia's tax and financial laws were inherited from the Italian and British colonial administrations in place a century ago. Therefore, these tax laws have become outdated. In addition, during the military regime of Siad Barre, the economy was under the command and control of the state. There were about 30 public sector enterprises that were inefficient, putting strain on government treasury. The state system was extracting resources from the private economy without reinvesting and that led to the breakdown of the economy. Under the military regime, Somalia had a planned economy where private enterprise played an insignificant role. The government did not encourage private sector development and the public-private sector relationship was volatile. The private sector was neither consulted nor "educated" about tax payments because the government had the power to enforce tax laws without properly engaging with taxpayers.

Businessmen were labeled "capitalist bloodsuckers" and perceived to be plotting against the socialist regime. The Somali business community was composed of Somalis, Italians, Indians,

and Arabs, who were law-abiding taxpayers, and conversant with commercial, banking, and tax legislation. During this period, tax collection was easy, as people paid tax readily and voluntarily, either by cash or by check, as commercial laws and financial laws were respected and enforced. Government tax and non-tax revenues were predictable even though the ratio of tax to GDP was lower in Somalia than in the region's other states. The civil war then broke out, continuing for many years, and there was no tax system in Somalia during that period. However, after the establishment of a federal system of governance within the country, the Ministry of Finance developed a short to medium-term revenue strategy, which explains the list of required tax reforms in 2017, 2018, and so on (Randa, Ngumbau, Carey, Abdullahi, Scek, Karni, & Lubisia, 2017).

Somalia, like other African countries, faces multiple constraints, including a lack of resources with which to provide much-needed public goods and services. The government's ability to raise revenue is weak due to its application of unsuitable, old tax systems, and its lack of modern tax laws, procedures and ICT equipment. As discussed by Isak (2018), some of the challenges that Somalia faces are dealing with "Hard-to-Tax" sectors, poor administrative capacity, insecurity and political instability, the incomplete transition to the federal system, outdated laws and the poor enforcement of those laws, and customs-related problems.

The Federal Government of Somalia wishes to increase tax revenue. It has committed to the adoption of a reform program, with the aim of rearranging and justifying its policies and processing procedures in respect of trade, firstly in Mogadishu and then the rest of the country. It has been trying to resolve its issues and is making significant efforts to reform its tax administration and its taxation system. In addition, the Ministry of Finance has developed a short to medium-term revenue strategy which includes the tax reform packages introduced in 2017 and 2018. Despite the challenges that it has faced and the difficult conditions in which it is working, the government has continued to implement this strategy, and this has resulted in better revenue collection results.

Data gathering for this study was achieved through observation. As the authors are Ministry of Finance staff members, they had the opportunity to observe the Federal Government of Somalia's ongoing tax reforms. The Ministry of Finance began to take revenue reform measures, including policy and legal reforms, and revenue administration improvements, in 2013. The authors have witnessed these reforms and present their findings below. They consider the extent to which tax policy and legislation has been reformed, and improvements have been made to revenue administration, as well as the results of these reforms and improvements.

3. TAX REFORMS AND OUTCOMES

Based on the authors' observations, Somalia has successfully implemented some reforms in regard to its tax systems and these reforms have had positive impacts, making significant contributions to the government's revenue and to the governance system in general.

3.1 Reforms

Successfully implemented reforms have included (1) the adoption of new tax policy measures, (2) the updating of tax laws by either amending them or drafting new ones, and (3) the introduction of revenue administration improvements.

3.1.1 Tax/Customs Policy Reforms

In order to resolve tax policy issues, Somalia's Ministry of Finance developed new instruments designed to raise government revenue simply and as soon as possible. These instruments consisted of two types: taxes and customs charges.

The tax measures implemented included the reintroduction of sales tax and the broadening of the income tax base. This was the first time that sales tax had been collected since the civil war began in 1991. It was imposed on goods and services within the telecommunications, transport and hospitality sectors, and other industries. The government also ruled that sales tax on the imported goods must be paid by traders. Originally, this tax was supposed to be paid by the end consumer of the goods, but the government altered this in order to reduce administrative costs and increase enforceability in view of the ongoing security challenges that the country faced. In respect of income tax, the Ministry of Finance broadened the base within both the private sector, with regard to personal income tax for employees and corporate income tax, and non-profit organizations, with regard to employees' income taxes. This is a good example of broadening tax base throughout a country.

On the customs side, increased sin tax rates were adopted by all levels of the government. The items affected by this included khat, tobacco, and cigarettes, drugs imported in large volumes.

As well as increasing revenue, these tax and customs policies had other purposes. These included the improvement of the application of existing tax laws, the reduction of the informality of the process by requiring businesses to register with the tax authority, and tackling the massive levels of drug consumption by young Somalis by lowering demand through the use of tax instruments.

In addition, the need for states to commence sales tax collections as soon as possible while keeping their existing revenue sources secure was raised at the intergovernmental fiscal forum meetings that took place. It was also agreed that all regions of Somalia should have a common customs procedure going forward. However, at present, there is no single, national tax/customs policy in place, and most critical issues are still unresolved and under discussion. A framework for this matter would explain the layout of the tax powers and answer tax assignment questions for the federal, state and local governments.

3.1.2 Legal Reforms

Some legislation in Somalia dates back to the colonial era, with British and Italian rulers having created it in the pre-independence period. Other regulations were based on the premise that a unitary government with absolute power over the nation was in place and made socialist assumptions, such as presuming that privatization plays a limited or no role, and that most businesses are run by state-owned enterprises (SOEs). However, everything has changed, and Somalia is now a federal republic, not a unitary one, with a free market economy rather than a socialist one. Privatization has been increasing and there has been a wide range of technological advances, as well as social and trade changes, and there are is legal provision for these modern indicators in the existing regulations.

Since 2012, when it was fully recognized, the Federal Government of Somalia – in particular, the Ministry of Finance – has been struggling to cover the legal gaps relating to revenue collection. The recent legal reforms were introduced in several stages. Firstly, the Ministry of

Finance started to reimplement and reapply the existing tax laws, which had been enacted before the civil war. These included pre-independence laws, such as the Registration Tax Law of 1921, and post-independence laws like Customs Law of 1961, the Income Tax Law of 1966, and the Sales Tax Law of 1984.

Secondly, the cabinet started issuing ministerial orders and regulations to cover some of legal gaps relating to tax collection which were not provided for in the existing laws. These ministerial orders were issued with the aim of legalizing some taxable areas and adjusting a few of the tax rates applied to certain goods and services. The cabinet did this for two reasons. The first was that it takes a long time to take full laws thorough parliament and this would not suit the government's urgent need for revenue. The second was that some federal member states were at the formation stage and only negotiating with a few other states. The constitution encourages discussions among different tiers of government leading to full agreement on federalism.

Finally, while these amendment efforts were ongoing, the ministry drafted new revenue administration and allocation bills, and altered customs laws. All of these bills and laws were submitted to Parliament after receiving cabinet approval. The revenue administration bill explains the management procedures, while the allocation bill explains the revenue-raising power that different levels of governments have. The amended customs law has some new features, including a modern classification of goods. In addition, the Ministry of Finance is consulting with the Ministry of Petroleum and Mineral Resources in order to draft a new law for a fiscal regime for extractive industries, i.e., the taxation of any process that involves the extraction of raw materials. Examples of extractive processes include oil and gas extraction, mining, dredging, and quarrying. This law will help the government of Somalia to manage its natural resource taxes to ensure it contributes to economic growth and the reduction of poverty.

The existing laws are characterized by the use of old administration methods, a traditional tax system, and weak enforcement mechanisms. Although some gaps have been covered by ministerial orders and regulations, Somalia still requires fully-fledged tax regulations which address current and potential tax issues. The ministerial orders being undertaken cannot serve as the final legal reference point for revenue rules and regulations but will instead cover the existing gap until the bills currently with parliament can be enacted. In the near future, we will see how far Somalia's revenue laws can help to increase the amount of revenue available to fund the government's increasing security operations and operational costs, and the delivery of public goods and services in a transparent manner.

3.1.3 Revenue Administration Improvements

The Federal Government of Somalia has made some important changes to its revenue administration systems. First, the ministry has established a specialized office for large and medium-sized taxpayers. The duty of the Large and Medium Taxpayers Office (LMTO) is to focus on activities by large and medium-scale business entities in Mogadishu and to serve them better, while taking the responsibilities of operations management, including assessments, tax collections, compliance tasks, audits, and verifications. They also provide these taxpayers with relevant information and advice, and help them to interpret the laws. The high concentration of large taxpayers is a recent phenomenon and if these taxpayers are noncompliant, it can result in the loss of a significant amount of government revenue.

Second, the Federal Government of Somalia introduced unique tax identification numbers (TINs). It began this process in early 2018, with the aim of registering taxpayers and making businesses formal according to the revenue authorities. TINs facilitate the sharing of information among different revenue offices and the efficient use of taxpayers' information. They also eliminate the possibility of taxpayers registering multiple times, increase compliance levels, and widen the tax base by ensuring that all entities, whether they are businesses, non-profit organizations or individuals, are registered.

Third, the Ministry of Finance developed a modern tax collection system. Previously, payments were made by taking cash to the revenue offices, and bank and mobile money payments could not be accepted. The new strategy ends this old way of collection, and taxpayers can – after their tax assessments have been completed – directly deposit money in the Central Bank of Somalia or in designated accounts in the private banks, which are opened and managed collectively by the Ministry of Finance, the Accountant General, and the Central Bank of Somalia. The system also eliminates the cashiers between the taxpayers and the treasury. Making the Central Bank of Somalia the collection point, using the commercial banks, and accepting mobile money payments has helped to speed up the payment process, bringing it in line with modern financial systems. Additionally, it eliminates the need for taxpayers to carry cash in insecure environments and reduces theft opportunities for cashiers.

Fourth, the Ministry of Finance centralized the collections of other government agencies and cancelled several private revenue collection contracts. This is a part of the ministry's strategy to consolidate the administration until all operations come under its full control, and is the starting point in its plans to regain its role as the sole authority responsible for the country's public financial management, both in terms of collecting revenue and spending it through the budget.

Fifth, the ministry automated its key operations by adopting a new systematic way of doing business. The aim, in this case, was to digitize operations and get rid of manual processes. The Somalia Financial Management Information System (SFMIS) was installed at most of the revenue collection points. Preliminary systems were introduced to collect road taxes and registration taxes, while the customs system is connected to the SFMIS. This automation has helped the government to increase revenue in speedy way and capture the information it requires about taxpayers.

Finally, a number of customs administrative improvements were undertaken recently. These developments included: the adoption of a single administrative document for declaring goods imported to and exported from Somalia; the use of a harmonized system of classification; the digitalization of some key operations; and educating traders about the new procedures. The aim of these reforms was to improve customs management by increasing government revenue, facilitating trade, securing ingoing and outgoing goods, and establishing a strong statistical background. The second phase is to extend the reforms to the states and equip their customs offices with good administrative systems.

3.2 Reform Outcomes

The reforms have yielded some positive results including: (1) an increase in government revenue; (2) process simplification and a move to self-assessment; (3) increased operational efficiency due to automation; and (4) a contribution being made to state-building. These outcomes are explained in the following paragraphs.

3.2.1 Increase in Government Revenue

The Federal Government of Somalia's domestic revenue has gradually increased, more than doubling within five years, from $69 million in 2013 to $183.5 million in 2018. This performance is very good. Revenue generation is the one and only way to get rid of the aid dependencies.

Figure 4.2.1: Federal Government Revenue in Millions of US$2013-2018
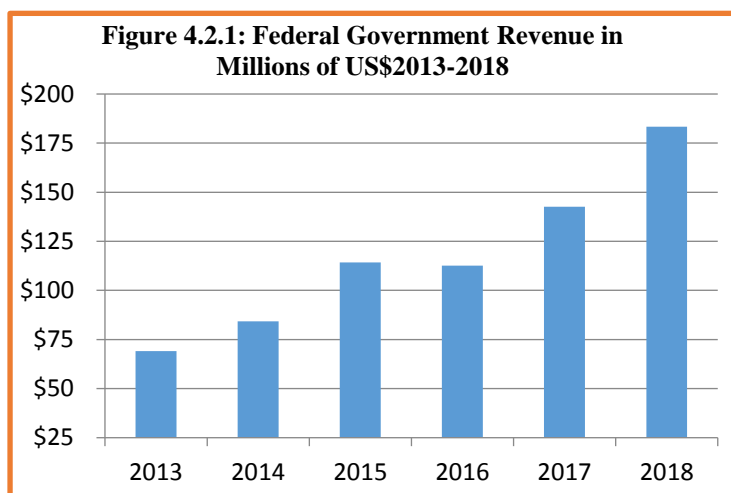
The literature and secondary fiscal data provided by the Ministry of Finance reveal that the amount of revenue received is positively related to the reforms. Although fragile states' economies usually grow faster, the graph shows that the reforms yielded an increase in the government's domestic revenue. However, untapped resources still exist. These resources need to be mobilized nationwide so that necessary expenses are covered domestically.

Source: Ministry of Finance, Federal Government of Somalia.

3.2.2 Process Simplification and the Move to Self-Assessment

A self-assessment system is a system in which taxpayers take on the primary tax responsibilities of assessing the amount of tax due themselves. These duties were historically the responsibility of tax officers. Self-assessment compromises completing tax returns accurately while computing tax liabilities (Udin & Wahab, 2013). Before 2018, although Somalia's taxation history was not much better than that of other societies, the federal Ministry of Finance started to hand the primary responsibility of tax assessments to taxpayers. Self-assessment has been practiced in Mogadishu since last year. The Inland Revenue and the Customs department introduced taxpayer education programs, and cooperative ways of calculating and assessing the taxes and duties due, with taxpayers completing return forms and the offices concerned only invoicing them based on their declared statements. This has resulted in positive integration between the two sides. A well-designed self-assessment system and simple tax payment methods have become the foundation for a good taxpayer-government relationship, and integrated the parties involved in a positive way.

The tax payment system has been simplified in three ways. Firstly, although the ministry only used to collect cash payments, it now generally accepts modern forms of payment, including checks and mobile money payments. Secondly, in the past, taxes were only handled by revenue cashiers, but they can now be deposited to any of the licensed private banks in Mogadishu in a transparent manner, which reduces corruption. Finally, while tax assessment was previously based on ad hoc judgements by tax offices, it is now the joint responsibility of taxpayers and tax officers, and most calculations are made by automated systems.

3.2.3 Increased Operational Efficiency due to Automation

Automating the revenue administration's processes has helped to increase the speed of its operations and make revenue collection easier. Previously, much of the work involved was manual and the system was characterized by: its human-dependent, time-consuming processes; its physical documentation; its poor information-capturing capabilities; its unreliable reporting mechanisms; and its high administrative costs. All of these problems were solved through the digitization of operations. Taxpayers are now dealt with in less time, through the use of sophisticated systems that can capture information simply and quickly generate reliable reports. The automation also contributed to efficient revenue collection while reducing the cost of tax administration. These improvements, in conjunction with the acceptance of mobile money payments and the use of banks for collection, have created an efficient environment where collection is done in less time, at reduced costs, and without attempted corruption. Automation was the key contributing factor in the significant revenue increase experienced by the Federal Government of Somalia. The evidence shows that all of the automated sources are currently generating far more revenue than the former manual collections, and this automation is paving the way for the new IT systems to be rolled out to the subnational governments' revenue collection points. The efficiency of automated revenue collection processes has also been seen in Kenya (Henry, Bogonko & Ong'iyo, 2018), Nigeria (Gidisu, 2012), and other countries.

3.2.4 State-Building

Somalia is struggling to state-build and consign the prolonged civil war to the past. The fact that the Federal Government of Somalia is the only official tax collector in Mogadishu allows it to show society how different it is to other non-state actors. Key factors contributing to Somalia's state-building efforts are: the collection and management of taxes; the financing of public goods and services, including security; and the existence of an enforcement authority. The idea that tax collection is a part of state-building, not only in Somalia but also in developing countries, is noted by Fjeldstad and Moore (2007). Their study shows that tax reforms contribute to state-building through (1) providing adequate revenue, (2) shifting toward more appropriate revenue sources, (3) creating effective tax administration, and (4) establishing state-society engagement. Informal sector taxation, urban wealth and improved tax exemption management are some important revenue sources which contribute to both governance and state-building.

The achievements made by the Federal Government of Somalia in respect of improving revenue collection and administration has resulted in the receipt of funds from donors to finance the revenue reforms and improve public financial management. These will contribute to state-building in Somalia.

4. CONCLUSION AND RECOMMENDATIONS

The ability of any administration to satisfy the needs of its citizens depends on the mobilization of its domestic resources. Mobilizing revenue generates public income, and is a foundation for both state-building and peacebuilding. Building the capacity to raise revenue through taxes reduces dependence on aid and helps to finance service delivery. The Ministry of Finance finds itself in a challenging position; the prolonged civil war shattered operational functions, so there was no tax collection culture, and the current tax base is incredibly small. At present, the ministry can only manage to tax the capital city of Mogadishu. Three decades of conflict severely affected the components of the revenue system: tax policy, revenue administration,

and overall economic activity. Furthermore, there is lack of policy consensus about fiscal federalism issues, hence it poses challenges to revenue mobilization and weakens the ability of the federal government to support economic activity. Nevertheless, the ministry stated openly that its objective was to increase domestic revenue, and consequently developed and implemented a domestic revenue mobilization strategy.

The Ministry of Finance has taken several measures to improve tax collection in recent years. It has established the basic infrastructure for a functioning revenue administration, which includes buildings, equipment, and trained personnel. Revenue mobilization has improved considerably during the last six years. The government implemented revenue administration reforms, adopted new tax policy measures, updated a number of tax laws by amending them, and drafted new laws. The outcomes of these achievements have included an increase in government revenue, the introduction of a simplified collection process and a move to self-assessment, increased operational efficiency, and a contribution being made to state-building. The study recommends that Somalin authorities further develop policies relating to future taxation matters and other fiscal issues. However, the states are operating their own tax systems, which are characterized by weak administrative capacity, poorly laid-out policies, regionally enacted laws and a lack of federal cooperation. Hence, the study strongly recommends that the Federal Government of Somalia continues to mobilize domestic revenue by expanding these reforms to federal member states, and builds both the country's tax system in general and the capacity of subnational governments in particular. The authors also urge the government to improve discussions within the intergovernmental fiscal forum committee, which is responsible for finalizing the fiscal pillars of the newly adopted federal system.

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REVIEW OF RECENT LITERATURE

Various Contributors[1]

A selection of recently published papers is reviewed below. The aim is to bring together tax administration-related papers from the diverse range of outlets in which they are published. The review is necessarily selective and the Journal welcomes suggestions for inclusion of papers in subsequent reviews.

TAX POLICY EXPERIMENTS

Abramowicz, M. (2019). Tax Experimentation. *Florida Law Review, 71*(1), 65-122.

In this highly stimulating and thought-provoking article, the author discusses the design of, and issues associated with, randomised control trials for tax policy which are akin to those commonly used for medical treatments. The author initially examines revenue-neutral experiments, whereby changes in the treatment group create benefits for some taxpayers but do not change the total level of tax paid when compared to a control group. The author discusses a variety of key features for experimentation, including methods of evaluation, along with a number of potential pitfalls of tax experiments, notably the inability to disguise the treatment group that an individual belongs to, which may influence the behaviour of subjects. The paper presents a number of different policies that could be investigated using revenue-neutral tax experiments before discussing how the findings could be scaled up for implementation. The final section of the paper discusses how tax experimentation might be considered for larger, non-revenue-neutral programmes, particularly in situations where treatment assignments result in extensive horizontal inequalities.

INDIVIDUAL COMPLIANCE

Bornman, M., & Wessels, J. (2019) The tax compliance decision of the individual in business in the sharing economy. *eJournal of Tax Research, 16*(3), 425-439.

In this article, the authors discuss the compliance implications for tax administrations arising from technology platforms that form part of the sharing economy, where individuals utilise assets, resources or skills they already have in order to earn income. This relates, in particular, to home-sharing through platforms such as Airbnb. The authors present a review of the academic literature in relation to home-sharing based on an extended framework of compliance by small business owners. The framework has the core elements of the perceived opportunity for non-compliance, the extent of tax literacy with regard to an individual's obligations, the homeowner's decision-making processes, and the characteristics of the person. The paper concludes that the framework may offer a conceptual tool for profiling the compliance behaviour of individuals operating in the sharing economy.

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[1] Tanapoom Chansawang, Shaun Grimshaw, Osita Mba, Luca Salvadori and Felix Wilson – Tax Administration Research Centre, University of Exeter.

Gűzel, S. A., Özer G., & Özcan, M. (2019) The effect of the variables of tax justice perception and trust in government on tax compliance: The case of Turkey. *Journal of Behavioral and Experimental Economics, 78***, 80-86.**

In this paper, the authors report on a survey conducted with a sample of 392 accounting professionals in Turkey in order to examine the effects of trust in government and the perception of tax justice on tax compliance. An individual's level of trust in the government is found to correlate positively with both their attitude toward tax compliance and their perception of tax justice. The authors demonstrate the presence of a significant indirect effect between trust in government and tax compliance, mediated by the perception of the fairness of the tax system (tax justice). The authors note that their result runs reverse to that reported in other studies, where the perception of tax justice was found to affect levels of trust in government. The authors argue that this could be attributable to cultural differences between the societies being examined. One interesting observation within the research is that the survey questions used to gauge the respondents' attitudes toward tax compliance appear to be personal or related to a specific business, rather than focussed on the actual professional activities of the accountants, which may have given more insight into the important role that accountants play in the tax decisions of other actors within the economy.

Guerra, A., & Harrington, B. (2018). Attitude-behavior consistency in tax compliance: A cross-national comparison. *Journal of Economic Behavior and Organization, 156(C)***, 184-205.**

This paper compares the results of tax compliance games conducted in two countries which had previously been reported as having different levels of tax morale, with surveys showing a higher degree of tax morale in Denmark than in Italy. Student subjects in the two countries undertook a laboratory tax compliance game with a real effort task to generate earnings that had to be reported over nine rounds with treatment variations of the tax rate, the probability of an audit, and the extent of redistribution of the taxes raised. The actions of other experimental subjects were elicited in each round, with no feedback on outcomes until the end of the experiment. The authors report a lower degree of evasion among Italian students than among Danish ones in contrast to the declared degree of tax morale, and conclude that self-reported tax morale does not predict tax compliance behaviour relative to other factors. The authors conclude that this finding is in line with numerous results from social scientific research on attitude-behaviour consistency, in contrast to a central theme in the taxation research literature that posits that high levels of tax morale correlate to high levels of tax compliance.

DeBacker, J., Heim, B.T., Tran A., & Yuskavage, A. (2018). Once Bitten, Twice Shy? The Lasting Impact of Enforcement on Tax Compliance. *The Journal of Law and Economics, 61***(1), 1-35.**

The paper investigates the impact of randomised audits on the future compliance behaviour of taxpayers, using the U.S. as a case study and employing a difference-in-difference approach. By exploiting data from both the universe of tax filers and the National Research Program (NRP) dataset, enriched with further information on the audits provided by the Audit Information Management System (AIMS), the authors find a pro-deterrence effect of audits substantially driven by self-reported income. Specifically, according to this study, audits increase tax payments, on average, by about 2.9% in following years, but the largest effect in percentage terms is on self-reported income (13%, 10 times higher than the effect on wage income). Thus, while third-party reporting and tax withholding makes it very difficult for wage

earners to underreport income, employees have considerable leeway when it comes to claiming expenses that can be deducted from gross earnings to reduce net taxable income. The persistency analysis presented in the paper shows that this effect is short-lived, being very strong in the first years after the audit, but rapidly turning downward toward the preaudit levels in following years. With regard to the drivers of the specific deterrence effect, the authors find that both volatility and sophistication matter. Indeed, business income also differs from labour income in terms of its volatility, which allows taxpayers to change reported income from year to year more easily. The result is that the effects of audit are not as persistent for business income as for labour income. Sophisticated taxpayers, proxied by the ones with more experience in filing tax returns, are also found to be less affected by tax enforcement.

Slemrod, J. (in press). Tax compliance and enforcement. *Journal of Economic Literature***.**

The paper reviews recent economic research in tax administration, compliance and enforcement. After presenting the conceptual framework which forms the basis for the economics of tax evasion, the author focusses on the most recent empirical contributions provided by both published studies and working papers. The paper first discusses the methodologies and data which have facilitated these contributions. In this light, the increased access that researchers have to extensive administrative data and the use of randomised controlled trials, as well as other credible identification strategies (e.g. Regression Discontinuity Research Designs) employed when working outside of the randomised paradigm, have played crucial roles in helping this relatively young literature to grow. A second contribution of the paper is to critically summarise what has been learned, firstly about the magnitude and nature of evasion. Thirdly, the author discusses the most prominent new development – randomised controlled trials, mostly delivered via letters from the tax authority – and reviews recent research about the impact of the principal enforcement tax policy instruments, audits, information reporting and remittance regimes. Finally, several underexplored issues worthy of more research attention (e.g. the role of tax professionals, firms, networks and penalties, and the distributional impact of evasion and enforcement) are discussed. The paper closes by outlining a normative framework for optimal tax enforcement based on the behavioural response elasticities now being credibly estimated that allows us to assess whether a given enforcement intervention is worth doing.

TAX ADMINISTRATION

Andini, M., Ciani, E., de Blasio, G., D'Ignazio, A., & Salvestrini, V. (2018). Targeting with machine learning: An application to a tax rebate program in Italy. *Journal of Economic Behavior and Organisation, 156***, 86-102.**

This paper discusses how machine learning methods for targeting a tax rebate, enacted in Italy in 2014 to increase household consumption, may be used to increase the effectiveness of the policy, which cost an estimated 7 billion euros. The authors use a survey of household income and wealth in order to examine the impact of a bonus of 80 euros a month, which is paid automatically to employees within a low salary range, on food consumption at home, and determine that the impact is greatest on households which report having the most difficulty in making ends meet. The authors present a number of different machine learning methods designed to identify households as being consumption-constrained. There is a specific focus on the decision tree algorithm as a mechanism that produces solutions which are easy to describe and can, therefore, be implemented as policy more pragmatically, as well as a comparison with other methods. The generated policy identifies target consumption-

constrained households largely based on their income and wealth. A test of the impact of food consumption by households that were paid the bonus shows that those selected by the algorithm were found to have increased consumption in line with the observed level, whereas those excluded were not found to have altered their consumption. The authors demonstrate that improvements could be made by excluding households that were paid the bonus but that were not consumption-constrained, and reallocating the money to other households identified as consumption-constrained.

de Clerq, B. (2019). The 'Uberisation' of e-Filing in South Africa. *eJournal of Tax Research, 16*(3), 440-473.

The paper presents an interesting analysis of compliance challenges faced by taxpayers in South Africa through an analysis of the queries posted to a new online tax preparation software tool (TaxTim). A thematic coding of the queries allows the author to identify the key problems taxpayers face in substantive (the 'what' of the taxpayers' obligations) and procedural (the 'how') dimensions. The analysis identifies and quantifies a number of the key themes. The author argues that, in light of the co-adjoined nature of many queries, which focus on both the 'what' and the 'how' of the tax system, tax simplification should be approached in a 'holistic' manner, addressing both substantive and procedural elements concurrently. Furthermore, the paper presents specific examples of queries that highlight where taxpayer education may be lacking, identifying potential areas to target.

Garz, M., & Pagels, V. (2018). Cautionary tales: Celebrities, the news media, and participation in tax amnesties. *Journal of Economic Behavior & Organization, 155*, 288-300.

The article investigates the impact of coverage of celebrities' tax evasion on other taxpayers' behaviours. The analysis is based on information compiled between 2010 and 2016 in Germany. All of celebrities in the study had earned 'celebrity status' before their tax evasion was investigated. The evasion cases were heard publicly by the German court and reported on by national and local newspapers. According to the author's analysis, the amount of self-declared tax evasion has a strong relationship with the news coverage. The percentage of tax evaders who voluntarily disclosed their illegal tax arrangements and participated in a tax amnesty scheme increased by 22.5 per cent after the celebrities' tax evasion was reported. The data on participation in the tax amnesty scheme was provided by Germany's Federal Ministry of Finance. The author notes that these findings might limit the extent of capital gains tax evasion and the results cannot be generalised to other types of tax.

DIGITALISATION

Leighton-Daly, M. (2018). Identity theft and tax crime: Has technology made it easier to defraud the revenue? *eJournal of Tax Research, 16*(3), 578-593.

This paper discusses the notion that the increased use of modern technology has created an environment in which fraudsters may be finding it easier to defraud the Australian Tax Office (ATO). The author focusses on a criminal investigation and prosecution concerning mortgage fraud, which was based on, among other factors, false income tax returns. The author uses this example to create financial crime typologies connected to both the revenue and taxpayer information, which are then used to consider how effectively current legislation can cope with similar crime. The paper begins by introducing the concept of financial crime and discussing

the 'fraud triangle', and then gives in-depth consideration to the main facts of the case study referred to throughout the article. The latter section of the article focusses on financial crime prevention, emphasising that governmental organisations are committed to preventing and controlling fraud, and that this may also be improved if such agencies and action are appropriately resourced.

Warren, N. (2018). Estimating tax gap is everything to an informed response to the digital era. *eJournal of Tax Research, 16*(3), 536-577.

In this paper, the author discusses how tax gap analysis can be used to help bring transparency and understanding to some of the more complex issues that may arise from the digital era, and how the tax gap can be used as a tool to help make informed changes to tax policy, administration and legislation. The author believes that the traditional, technical use of the tax gap may be limiting what can be learned about the performance of a tax system when an economy becomes subject to change. The author first begins by establishing what the tax gap is (accepting that it is the difference between the tax theoretically due and that actually collected) and broadly classifying it into compliance and policy gaps, before examining, in detail, the various methodological issues that may arise when calculating the tax gap. This is followed by a discussion around the question of 'the reliability and meaningfulness of tax voluntary paid', and how much of this revenue can be assured. The author then looks at the various dependents of the tax gap, covering the impact of tax rate and base, as well as how each of the different stakeholders in the tax gap may have different interests and uses for that data, and the conflicts that this can create. Finally, the author highlights the way in which different stakeholders can use the tax gap in order to practice informed decision-making in the digital era, focussing on legislators, in particular. The paper concludes by suggesting that whilst tax gap estimation is still in its infancy, it highlights how tax is connected to every aspect of economic and social life.

TRANSPARENCY

Lugarić, T. R., & Klemenčić, I. (2018). Tax Secrecy and its Limitations: Is There a Balance? *Central European Public Administration Review, 16*(1), 99-118.

The article analyses three different degrees of tax secrecy and their limitations (tax transparency). The author uses the comparative method to identify provisions of laws in relation to tax secrecy and their functions in five countries. Germany treats its taxpayer information as an absolute secret. The United States, France and Croatia also treat such information as a private, but with some exceptions. In contrast, Swedish law allows members of the public to obtain tax information from the authorities. The article further discusses the limitations of the secrecy rule in three types of circumstances when tax transparency might be required: when it is in the public interest; when it could improve voluntary compliance; and for the purpose of exchanging information in order to combat tax evasion. The author points out that the role of tax secrecy might vary depending on the particular goal of each country. Tax secrecy could be used as an instrument to create a synergistic climate between revenue authorities and taxpayers, and could help to increase tax compliance because taxpayers trust that the authorities will keep their information confidential. On the other hand, tax transparency, such as information exchange, could facilitate tax authorities to implement efficient procedures and help them to decrease tax evasion. The author concludes that it is impossible to balance tax secrecy and its limitations perfectly. The solution largely depends on the specific aims of a particular country.

Mazzoni, G. (2018). (Re)defining the Balance between Tax Transparency and Tax Privacy in Big Data Analytics. *Bulletin for International Taxation, 72*(11), 656-663.

The article discusses the conflict between using Big Data for tax efficiency and effectiveness, and the concept of data protection. In this article, Big Data refers to the processes of collection, analysis and usage. A massive amount of data will be gathered from several sources and then analysed by a computer algorithm. The results of the program can be prescriptive and descriptive. From a tax perspective, the author views that the use of Big Data does not align with the key principle of data protection, i.e. purpose limitation and data minimisation. However, it is not necessarily true to conclude that Big Data would eliminate data privacy; whether this was the case or not would depend on the extent to which data privacy applied in particular circumstances. The right of privacy might not always have the same scope when applied to tax matters as when applied to non-tax matters. The author concludes that Big Data is favourable but should be used in an ethical way. By using Big Data, tax authorities could identify potential tax evaders before they have been audited; however, they should be aware that not all taxpayers are potential tax evaders.

Ring, D. M. (2017). Corporate Migrations and Tax Transparency and Disclosure. *Saint Louis University Law Journal, 62*(1), 175-192.

Throughout this contemporary paper, the author argues that the modern focus on tax transparency and disclosure has been primarily caused by the ease with which corporations have been able to facilitate cross-border migration. The author begins by discussing the impact of the 1970s 'deregulation' and the benefits of technological advancements, indicating the roles they have played in the increase of cross-border mobility. A review of the current trends in both transparency and disclosure, discussing the influence of country-by-country reporting and additional regulations that have led to today's focus on combatting corporate tax avoidance behaviour, follows. Finally, the author pulls together the ideas presented so far, exploring the connections and implications of the increase in cross-border flexibility, and transparency and disclosure. The author uses evidence presented throughout the paper to further explain the rationale for the link, and also recognises that gaining a clear picture of the global operations of multinational enterprises (MNEs) is a continuing and complex issue for national tax administrations.

DISPUTE RESOLUTION

Dimitropoulou, C., Govind, S., & Turcan, L. (2018). Applying Modern, Disruptive Technologies to Improve the Effectiveness of Tax Treaty Dispute Resolution. *Intertax, 46*(11), 856-872.

This article seeks 'to encourage the various policy organizations working on making tax treaty dispute resolution more effective to consider the potential of disruptive technologies in their work'. It argues that the emergence of new and disruptive technologies, such as blockchain, artificial intelligence, shared-data platforms and cloud-based solutions, can complement the Mutual Agreement Procedure (MAP) and international tax arbitration by making them more effective and efficient, reducing costs and establishing trust between tax administrators and taxpayers.

Jone, M. (2018). The Internal Revenue Service's Future State initiative and its impact on the tax dispute resolution system of the United States: a dispute systems design perspective. *eJournal of Tax Research, 16*(3), 824-851.

This article provides a Dispute System Design (DSD) evaluation of the tax dispute resolution system in the US in the context of the Internal Revenue Service (IRS)'s Future State initiative (FSI), which aims to improve taxpayer service, enforcement and operations through the use of technology. It evaluates the prevailing US tax dispute resolution system, and considers the impact of various aspects of the FSI and the potential implications on voluntary compliance. This includes the reduction in the availability of face-to-face interactions between IRS employees and taxpayers in resolving tax disputes as a consequence of the introduction of online and digital alternatives. The article also discusses possible lessons for tax administrations undertaking similar modernisation or digitalisation programmes in other jurisdictions.

Oosterhoff, D. (2018). New Rules to Resolve Tax Disputes. *International Transfer Pricing Journal, 1*, 11-19.

In October 2016, the European Commission proposed the 'Council Directive on Double Taxation Dispute Resolution Mechanisms in the European Union' and, in October 2017, the Economic and Financial Affairs Council (ECOFIN) adopted new rules for resolving tax disputes, which seek to give taxpayers involved in double taxation disputes more certainty. This article discusses both the new rules and the proposed directive. It concludes that the potential benefits include: an enforceable obligation on EU Member States to resolve all disputes that originate in tax treaties and affect the tax positions of businesses and citizens; a clearly defined and enforceable timeline with a standard period of 18 months; an extension to all tax disputes that derive from tax treaties and other international agreements; an obligation to notify taxpayers and publish abstracts of the arbitration decisions; and a recourse for taxpayers to national courts to unblock procedures. It also concludes that the proposed enforceable obligation may be avoided in practice by the individual member states' interpretations of the exceptions in cases of wilful default and gross negligence.

Pauwelyn, J. (2018). Baseball Arbitration to Resolve International Law Disputes: Hit or Miss? *Florida Tax Review, 22*(1), 40-76.

This paper assesses a new approach to resolving international law disputes which seeks to preserve a crucial role for neutral, third-party adjudication while putting more responsibility on states to work out positive solutions themselves. Baseball arbitration, or final offer arbitration (FOA), is where each party offers an answer to the dispute (their 'final offer') and the adjudicator's task is strictly limited to picking one answer ('hit or miss'). The paper argues that FOA can enhance efficiency and accuracy, and facilitate settlement and long-term cooperation, while putting states, rather than tribunals, in the driving seat. It concludes that FOA can unlock state consent to arbitration where traditionally it is lacking or heavily contested.

Perrou, K. (2018). The Ombudsman and the Process of Resolution of International Tax Disputes – Protecting the "Invisible Party" to the MAP. *World Tax Journal, 1*, 99-129.

This article explores the possible involvement of tax specialist ombudsmen in the Mutual Agreement Procedure (MAP). It argues that, with the MAP still facing criticism for a lack of

efficiency and transparency, and international tax arbitration only being adopted by a handful of states, alternative solutions should be considered in order to enhance the MAP, while adequately protecting taxpayer rights. It argues that the involvement of the ombudsman in the MAP could prove beneficial, as it combines the use of non-adversarial dispute resolution methods with the power to monitor the behaviour of the tax authorities and respect taxpayer rights during dispute resolution procedures.

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BOOK REVIEW: TAX AND TRUST: INSTITUTIONS, INTERACTIONS AND INSTRUMENTS.

John D'Attoma[1]

Goslinga, S.. van Der Hel-van Dijk, L., Mascini, P., & Van Steenbergen, A. (Eds.). (2018). Tax and Trust: Institutions, Interactions and Instruments. The Hague, The Netherlands: Eleven International Publishing.

Trust is a buzzword in the social sciences these days. It's on the minds of academics across the social sciences, policymakers, and funders. People want to know why trust has declined precipitously over the last 40 years in most countries and how we can begin to rebuild it. Scholars argue that trust is fundamental for cooperation. In *Tax and Trust: Institutions, Interactions and Instruments*, the authors are concerned with a specific kind of cooperation: paying taxes. Of course, there is a huge body of literature on trust and taxation, and this edited volume brings together an impressive list of scholars from political science, law, economics, psychology, and fiscal sociology so as to address these issues from a variety of different angles.

First, the editors, Sjoerd Goslinga, Lisette van der Hel-van Dijk, Peter Mascini, and Albert van Steenbergen, perform an important service by surveying how we measure trust, and identifying some of the difficulties and limitations encountered when measuring trust. This is something that scholars have grappled with for decades. How do we accurately measure trust? Are we talking about generalized trust or something more specific? Who is the object of trust and how do we measure the reciprocal nature of trust? Moreover, how do we define trust? This volume addresses how these issues relate to taxation.

In Chapter 2, Bart Nooteboom introduces the reader to the concept of trust and begins to address some of the issues mentioned above. The author describes trust as something which derives from our expectations. When expectations are not fulfilled, trust begins to decline. Trust is fundamental for individuals, organizations, systems, and institutions. Chapter 3, by Sven Steinmo, concerns how institutions, social norms, and cognitive consistency interact to shape tax compliance behavior. Steinmo argues that effective and trustworthy institutions can reinforce the social norms that lead to a positive tax compliance environment. These two chapters differ significantly from Sonja Dusarduijn's chapter (Chapter 4), in which she examines how tax legislation can shape trust in the tax system. She argues that, in order for citizens to trust the tax system, the tax legislation must reflect three core values: equality, certainty, and clarity.

These three chapters lead fluidly into the next set of chapters, which examine interactions between taxpayers and tax administrations. In Chapter 4, Janina Enachescu and Erich Kirchler provide an overview of the Slippery Slope Framework, a well-known framework in tax compliance literature. The framework was originally designed by Kirchler, Hoelzl, and Wahl (2008), and has since been adapted and utilized across a wide range of disciplines and in many countries. The framework analyses tax compliance using two dimensions: trust in authorities and power of authorities. Enachescu and Kirchler survey the literature and claim that the interaction between these two dimensions is not yet perfectly understood. They also discuss some of the ways in which researchers can move forward with the Slippery Slope Framework.

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[1] Lecturer in International Politics and Business, University of Exeter.

In Chapter 6, Judith Freedman examines how trust and transparency relate to corporate taxation. She argues that transparency can, at times, undermine trust because the public does not always understand the intricacies of, for example, international taxation. Transparency can thus lead to misperception and decreased tax morale. However, the public's push for increased transparency derives from its lack of trust in multinational enterprises and the tax authority itself, something which needs to be addressed by improving our institutions and our tax laws.

In Chapter 7, Steven Van de Walle and Shelena Keulemans provide their findings from two surveys conducted with tax inspectors from the Netherlands and Belgium. They focus on the image that tax inspectors have of taxpayers, which tends to be quite positive.

The last three chapters reflect on the various tools tax administrations use to facilitate tax compliance. Chapter 8 discusses the possibilities for digital technologies, such as blockchain and machine learning. Sander Klous and Nart Wielaard argue that although digitalization can drastically improve efficiency and effectiveness, it also requires a paradigmatic shift in models for organizing and oversight. Bart van der Sloot, in Chapter 9, discusses the legislative environment for big data and how governments can address the future of digitalization legislatively. Finally, Chapter 10 examines the use of "behavioural-informed instruments", also known as nudges. Koos Boer and Hans Gribnau argue that legal environment within which these nudges operate needs to be considered more often and before taxpayers are "nudged".

In sum, this volume is a much-needed piece of work that introduces tax specialists to many of the issues surrounding trust and taxation. It provides the reader with a great overview of the literature and a number of new insights from renowned tax experts from around the world.