STATES & LOCAL FINANCE

The IGR Initiative

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How governments discourage taxpayer compliance

VOLUNTARY TAX COMPLIANCE is unarguably the gold standard in IGR expansion strategy. First, increasing marginal compliance rates consequent on such expanding levels of compliance also indicate taxpayers growing internalization and response to their moral, civic, and legal obligations in tax payments. Second, it revs up the operational efficiency of tax administration as increasing the voluntary compliance rates correlates negatively with costs of collection. Third, naturally growing the size of tax revenue through improved voluntary compliance disincentives the government from raising the financial burden via such windows as rate increases and multiplicity of taxes. For these reasons, high levels of voluntary tax compliance have become the goal of most subnational governments tax revenue optimization. However, typical of a snake swallowing its tail, the same government desirous of enhancing the size of voluntary compliance through the combination of worsening trust concerns, inefficient expenditures system, burgeoning economic burden, and little interest in promoting civic knowledge, ends up discouraging its growth.

Unarguably, tax compliance levels in Nigeria are low compared to several other countries. By relating the average direct taxes paid by each citizen to the average tax payable using an eight per cent proportional tax rate, we arrived at an indicative average compliance rate of 14.7% for Nigeria. Comparatively, this compliance rate is far from South Africa, Angola, and Botswana, with approximately 26%, 43% and 32%, respectively, as of 2013. In the US, non-compliance rates of self-employed persons are about 30%. Based on random estimates from several studies, the average tax compliance rates in most developed countries are more than 60%. Based on our calculations, states like Lagos, Anambra, and Ogun, with compliance rates of 13.2%, 11.1%, and 10.4%, respectively, fall below this national average and point to the enormous revenue prospects that remain unexploited. Rivers State has a compliance rate of 33.7%, while Katsina tops the list with 39.0%. And like Katsina states, the citizens of some relatively poor states such as Zamfara, Borno, Bauchi and Sokoto have demonstrated much more willingness to comply with the tax obligations than most other more economically stable states. Without a doubt, therefore, there is an urgency in many states of the country revving up the voluntary tax compliance rates.

The government discourages taxpayers when they do not live up to social contract expectations. A significant support base for compliance is that optimal levels of symbiosis exist between the payers and the statecraft managers entrusted with the responsibility of judiciously expending the collected revenue. Over the decades, the Nigerian government has failed to live up to these 'trust' expectations in several ways: distributive unfairness, the neglect of service and client's approach to its fiscal management, partiality in administrative and disciplinary procedures, and its promotion of corruption culture. Citizens pay taxes because they trust the government to provide critical public goods such as adequate policing and general security, justice, and other essential social infrastructure to support their entrepreneurial efforts. Nigerian governments have repeatedly demonstrated low levels of trustworthiness as a wise spender of collected tax revenues. The adequacy level and quality of public goods are inconsistently lower than the quantum of publicly owned resources received for putting them in place. Our public infrastructure does not measure up compared to several countries with far fewer financial resources.

Consequently, while taxpaying citizens wish to experience a "service and client" disposition from the government, the latter unleashes a "cops and robbers" hounding of non-compliant culprits. Sadly, that approach only draws some resistance from the public who feel cheated off what they rightly should enjoy from the colossal revenue available to the government over the years. There have also been concerns regarding procedural fairness in the administration of taxes. A good example is several subnational governments' use of task forces to collect taxes. Because these contracted agents are only concerned about the size of realizable rents and commission, which grows with the size of collected revenue they have, in almost all circumstances and across all states where they apply, use brute and uncourteous approaches to compel taxpayers to comply. In some instances, taxpayers are intimidated to pay multiple times or even far more than they should.

In some cases, tax administrators concoct discriminatory and incorrect assessments of taxpayers to raise the collectable amounts. There is also an invocation of this approach to punishing those not in the government's good books. Tax institutions' lack of full operational autonomy in many states contributes significantly to this unhealthy situation.

It is also a well-known fact that a significant share of the cronies, senior party members and filial associates of Governors and Chairmen of local governments do not pay taxes. Yet these categories of people dominate the business enterprise environment. Still, many state Internal Revenue Services cannot force them to exercise their civic obligations because of the former's umbilical ties to state and local government leadership. Not even the courts can handle such situations as the judges, and the top echelons of most state judiciary are the Governor's appointees. But that is not majorly where the problem lies. In states where such situations are rampant, other taxpayers quickly learn how easy it is to refuse to pay with no consequences. They join the bandwagon of the non-compliant and use the non-paying Governor's associates and relations as reference points.

A related shade of the same problem is the widespread discrimination in penalties against defaulting taxpayers. Those favoured by their connections to the power corridors may not be penalized in most cases, while the ordinary people suffer the full wrath of the law. Many may argue that most of the subnational government Internal Revenue Service already have statutory independence. While this may be true, a lot of them lack operational autonomy. Statutory independence suffices only when the level of complementing functional self-government is high. The situation also means that state revenue boards do not go cap in hand to the Governor for their everyday operations. This elevated lack of operational autonomy among some subnational governments makes it more challenging for state boards of internal revenue to implement their strategies proactively and independently with minimal encumbrances. Even in some instances where the IRS has statutory backing to keep a certain fraction of revenue receipts, they still experience substantial constraints in fully exercising their autonomy in bringing politically connected defaulters to book.

The increasing economic difficulty often orchestrated by governments' poor policy design and implementation similarly constricts many taxpayers' compliance capacity and willingness. Challenging financial situation attacks income earners from two ends. On the one hand, it reduces their capacity to earn more income, and on the other, it reduces available disposable income. This dilemma heightens as the government responds to fiscal stress by increasing tax rates and the number of taxable assets. The government's budgetary pressure also leads to multiple uncoordinated layers of taxation and the use of contractors. However, the inefficiency of government expenditure from the tax revenue viz. a viz. actual value that taxpayers receive further pushes the latter into non-compliance. It is irritating when sub-national governments drag their feet in providing essential public goods such as water, roads, medical facilities, facilitating entrepreneurial activities that are the sources of tax income. The absence and inadequacy of some of these critical public goods further worsen the cost of production and make production activities inefficient and the resulting products uncompetitive.

Poor tax education is another often-neglected reason for high non-compliance in most state and local governments. Aside from the apparent complexity in understanding compliance requirements such as applicable tax rates, self-assessment, and filing returns, the government has not lived up to public expectations to educate citizens to appreciate better the sometimes-complicated tax compliance protocols. For instance, illiterates and poorly educated persons are hardly part of the tax policymaking. Highly educated people do so and equally make the process difficult for those less educated to understand them easily. Unfortunately, regardless of the numbers of educational certificates we brandish, a substantial fraction of our population consists of uneducated and poorly educated persons who find it challenging to understand tax rules and comply as required. Public tax education is unquestionably the duty of the government. Yet most state and local governments have done an awful job of it. It is safe to guesstimate that over 50% of rural dwellers do not understand the civic obligations regarding tax payment. How would they know when there is no significant public education to teach them? One would have expected governments at various levels to work with multiple state-level information and orientation arms, religious organizations, and membership associations, among others, to conduct regular pro-tax compliance education periodically. Even workers responsible for tax revenue need a solid formation in courteousness and professionalism as such values facilitate better communication between them and taxpayers. Sadly, many state boards of internal revenue rarely show interest in equipping their workforce with such required skills and aptitudes for efficiency.

It is deplorable that some governments desirous of expanding their tax revenue are guilty of frustrating their increased collection and growth. This challenge's taproots are the misguided motivation and unclear vision of those who manage many states affairs. Those motivated by the hunger to develop their state and local governments know that they must build a high voltage of trust with the governed, which gives the latter reason to pay their taxes voluntarily. But building up such trust requires sustained satisfaction of the public's expectations in wisely spending their commonly owned tax resources. In most instances where this client service approach is nonexistent, essential public goods that enable entrepreneurial and general economic activity growth are equally lacking. Citizens consequently have no option other than to privately provide those facilities that ideally should be the government's responsibility. Of course, these private provisions of substitutes to the expected government-provided public goods feed into production and living costs. The added burden in many contexts justified the resulting non-compliance.