

## STATES &amp; LOCAL FINANCE



## The IGR Initiative

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**S**UBNATIONAL TAX ADMINISTRATIONS are always better off situating their IGR expansion efforts with sustained high levels of voluntary compliance. Aside from accomplishing the revenue objectives, the route is more consistent with efficiency, reduced administration cost, and taxpayer convenience. Sadly, the reality on the ground is usually not consistent with this desirable as non-compliance levels remain astronomical. The compliance improvement programme [CIP] focuses primarily on finding areas where compliance gaps are beyond the expected thresholds, determining the underlying causal factors for the observed non-optimal levels, and creating appropriate strategies for addressing them. The three critical elements of this programme are compliance risk identification, the development of initiatives for boosting voluntary compliance, and a plan to bring tax evaders to book. However, these elements are stretchable to eight depending on tax administrations and context.

Taxpayers must comply with four essential obligations. These obligations include timely and accurate registration, filing tax returns on time within the dates set by law, ensuring that the declaration is also complete and accurate and finally, that payments are consistent with the dates set by the law. But taxpayers face significant threats in their efforts to meet these obligations. Therefore, an adequately designed compliance improvement programme places a reasonable premium on successfully identifying the risks that taxpayers contend with to satisfy these obligations. Ideally, that should be the first step. The second is to articulate robust sets of options for mitigating each of the identified risks and determining the most optimal for adoption. These processes are better off and more result-yielding with substantial stakeholder involvement. The tax administration research and risk management department strengthen this process through well-designed group studies.

Subnational tax administrations worth their oil do not gamble with taxpayer compliance, which is central to their survival. The key is to avoid making improvement decisions based on hunches and intuitions but through solid processes for determining and tracking compliance gaps. Unfortunately, more than 70% of state and local governments IRS does not collect relevant data and systematically process the same to determine their compliance rates and gaps. It's pointless to suggest that the successful measurement of a phenomenon is the most fruitful step to controlling it. Therefore, not paying attention to the size of the non-compliance gaps

implies gambling with it. When tax administrations successfully track compliance gaps and understand the underlying risks, they can better develop the right set of initiatives to close them. Tracking compliance gaps makes it easier to understand trends and their sensitivity to other identified risk factors and threats.

The compliance pyramid provides the underlying thinking for developing effective CIPs. The pyramid decomposes taxpayer attitudes to compliance into a four-group hierarchy. At the foot of the pyramid is a group of taxpayers willing to do the right thing. This "doing the right thing" group is associated with low levels of compliance costs. A robust CIP would make it easier for this group to comply with their tax obligations. The second group are those taxpayers making visible efforts to comply but who do not always succeed. This category requires help to adhere successfully. Again, the CIP must devote significant energy to understanding why these people find it challenging to comply and provide whatever is necessary to mitigate the identified risks. In many instances, it is evident that good tax education resolves most of the challenges hindering those that fall within this group from performing their obligations. But more of such relevant mitigation initiatives exist depending on the risk factors and contextual peculiarities. Category three consists of taxpayers that do not want to fulfil their tax obligations. Ideally, dealing with this category of people would require a better understanding of why they choose not to comply, respond to the concerns, and apply appropriate deterrent measures, including enforced collection. The final group consists of those that have decided to comply. In many instances, taxpayers in this group typically face criminal liability, and it can be quite an uphill task to force them to comply. Use of the full force of the law is always the last option.

A standard CIP has about six components. It could be more or less depending on the peculiarities of compliance challenges that the tax administration faces. The first is clarity around the tenor-in-focus of the programme. The number of years of a standard CIP can align with the typical strategic planning time dimensions: short, medium, and long-term. Most short-term-focused CIPs only require annual or biennial reviews and minimal revisions. Those with medium and long-term dimensions usually require more in-depth recalibration and a total overhaul. The second component identifies areas posing a significantly higher risk of non-compliance. At this stage, tax administrations' research and intelligence units play significant roles. Risk

# Effective compliance improvement programmes for sub-nationals



identification usually follows the four hierarchical categorizations consistent with the compliance pyramid already explained. But they also drill down to other factors such as the socio-economic conditions of a location, predominant culture and the general perceptions of the ease of compliance. Generally, this component provides background information to enable the design of specific actions to address perceived risks which is the third component of the CIP. It also contains specific actions for detecting and deterring non-compliance and initiatives for encouraging taxpayers. Finally, a good CIP must also comprehensively show the significance and expected impacts of the programme.

The centrality of CIP's goal is to resolve many of the challenges and risks of compliance. For instance, tax administrations know that the attitude and willingness of taxpayers to fulfil their obligations strongly influence compliance. In turn, an inexhaustive number of factors, including culture, religion, the socio-economic conditions, inform people's attitudes. In this respect, the first duty of the tax administration is to profoundly understand these causative factors and how they influence compliance behaviour. Again, poor taxpayer understanding of their obligations may also significantly influence compliance. It is not debatable that many tax laws are in languages that are not easily comprehensible by people with certain levels of education. Such taxpayers find it challenging to comply mainly because they do not even understand these obligations.

The CIP may need to articulate robust streams of taxpayer education to support and facilitate this category's understanding of tax rules. In addition, it is also essential that the consequences of non-compliance are adequate to discourage non-compliance and spelt out and communicated. This level of clarity is necessary to address non-compliance by

categories of people who may just be dragging their feet because they do not see the consequences of tax evasion as inconveniencing enough to pressure them into fulfilling the obligation. Usually, such measures take both monetary and nonpunitive forms graduated in line with the severity of non-compliance. Taxpayers must also know that tax administrations have well-oiled mechanisms for detecting non-compliance members of society.

Designing a robust CIP requires at least five key steps. The first is to ensure the adequacy of data sources for conducting requisite analysis to understand the extent of non-compliance better. The typical mechanisms for relevant data generation for CIP design comprise data stored in internal databases of subnational tax administrations. They include returns, data sources from third parties such as banks and MDAs and targeted data-gathering exercises using opinion polls and surveys. The second step is conducting a robust compliance analysis across four domains of taxpayer obligation fulfilment: registration, filing, declaration and payment, and the four layers of the compliance pyramid. This analysis will show the nature of compliance risks and the depths of the problem across the obligation fulfilment and compliance pyramid domains. The third step is risk prioritisation. A comprehensive risk table analysis shows the probability of occurrence and the magnitude of the impact of such risks. Leveraging that information, tax administrations can rank and quantify the compliance risks they face across different domains and demographics. The first step is the development of implementable strategic options for mitigating the identified risks. Options ranked as the best among them are implemented after the fifth step requiring the determination of the likely effectiveness of the risk treatment strategy.

The adequacy of the governance structure for managing the entire

CIP is critical. Although much of the governance arrangement for the CIP may depend on the subsisting organisational structure and processes yet, there may be a strong need for a special vehicle within the organisation to drive this process. This special purpose vehicle has an oversight function on the CIP's design, implementation, and monitoring. The special structure can be a committee consisting of persons from various departments led by the research and strategy team [where they exist as such]. This committee interfaces with other stakeholders and the rest of the teams within the tax administration. They also have the responsibility for approving and overseeing the CIP and assigning responsibilities to specific departments regarding the programme.

Finally, subnational tax administrations must prioritise the IGR expansion strategies, risk management and the Compliance Improvement Programme. These three interdependent activities are the foundations for solid tax administrations and substantial revenue expansion. Their successful implementation also results in the establishment of powerful database intelligence, tax education and dispute resolutions. To prioritise this trivalent, tax administrations must also set up adequately funded research and strategy units or departments led by someone that is both competent and passionate about data-driven IGR revenue expansion. Subsidiary but equally essential objectives would incorporate proper alignment of the rest of the organisational structure of the tax administration to symbiotically reinforce each other's effectiveness in achieving the revenue expansion goal. Until the subnational IRS begins to pay closer attention to database improvement and consciously articulates revenue growth and compliance improvement strategies premised on such databases and across chosen time dimensions, they will continuously operate at their current undesirable levels.