

STATES & LOCAL FINANCE



The IGR Initiative

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Sources of SNG IGR collection risks

patronage underlying many revenue contractor appointments is essentially for prebendal kick-backs. The more the size of illicit rents, the more likely the contract extensions and the contractor's incentives to divert some of the collected funds.

Again, when subnational government revenue collection institutions are weak, they unwittingly create opportunities for the emergence of external fraudsters. Fake revenue collectors generally succeed because those institutions do not have clearly defined and adequately communicated payment and collection processes, including collector verification mechanisms. Payment automation, including website verification for authenticity, considerably minimises the preponderance of fake revenue collectors. Former members of staff of the IRS and contracted revenue collection agents have successfully defrauded unsuspecting taxpayers by posing as revenue collectors. But this happens, for instance, because the IRS has not provided taxpayers with a continuously updated list of approved collectors instantly verifiable using various means such as photo displays and digital identity cards electronically cross-checkable in real-time on the website. The same is true for fraudulent or scam emails and text messages purportedly from revenue collection institutions seeking personal information.

Cases of revenue collectors' embezzlement are rife and make up a sizable portion of the so-called revenue leakages. Low levels of digitalization of payment processes largely account for a considerable chunk of this risk exposure. Good examples include commercial vehicle parking fees and tax collectors working in the informal sector, where transactions are substantially cash-based. There have been allegations that these categories of officers working with market women and commercial motorists would fraudulently print their receipts and use them in place of governments'. This criminality is possible because of the presumptive nature of the assessment and the absence of accurate databases capturing each artisanal or informal sector tax/fee payer. Besides, apart from tax payments, market participants and motorists pay some of these fees daily in some states. Payments may also depend on whether they are plying the road or their wares in the market. When printing fake receipts becomes difficult or impossible, revenue collection officers may waive a considerable proportion of the amount payable if the fee payer pays an agreed bribe sum. Some states, such as Anambra, now require the database capture of all motorists who must pay directly into the government's purse with their identification numbers. This initiative tactically eliminates the revenue collection intermediaries that have been diverting much of the funds that should come to the government.

Additionally, some fraudulent



tax collection officers leverage low levels of understanding of subnational tax laws, mainly by the small business owners and artisans and multiplicity of taxes, levies, and fees payable, to collect above the amounts authorised by law. While this criminal act may not directly result in revenue losses to the government in the short term, it adversely affects the level of compliance and indirectly the size of collectable revenue in the medium to long term. Another variant of this criminality is the engagement of enforcers outside the ambits of the law. As these fraudulent means of collecting monies from unsuspecting tax/fee payers become increasingly lucrative, those involved get bolder and even engage illegal enforcers to ensure their victims pay. NURTW, or the motor park touts' approach to enforcing compliance with its levy collection, is one of the best examples. That approach and the perceptions of illegality and fraudulent entitlements usually breed violent rows among them.

At least five factors account for the lucrative illicit collusion between tax and nontax revenue collection officers and payers (tax, fees, and levies). The first is the complexity of tax laws, making its understanding challenging to people with low education and poor knowledge of tax issues. Unfortunately, many tax collection officers, who could remedy the situation by rendering some tax education, would, on the contrary, prefer to take advantage of the ignorance of this category of payers. A soft landing by bribing revenue collection officers has become a desirable option, with revenue collectors' painted pictures of even more complicated scenarios of the laws. The second reason is the low levels of transparency and accountability of revenue collection officers. For instance, the expected demand for accountability would become improbable if the overall leader of the tax collection team or the administration benefits from the illicit windfalls. Regrettably, that is the whispered norm in many subnational tax administrations.

Thirdly, such situations also result in the deliberate creation of loopholes to sustain the fraud and sharing of illicit gains with little or no risk of being caught. Fourthly, opportunities for such illicit collusion would also be challenging to realise without the extensive discretionary powers held by tax administrations and tax officers. To a significant extent, revenue

officers conduct payer assessments when there are no objective means of deciding the size of obligations. There is rarely a thorough review of such assessments to determine the presence or otherwise of fraudulent collusion and profiteering. Even when such reviews indict the collection officers, the consequent punishments are majorly lenient and hardly discourage a repeat.

Most of the risk exposures from outsourced revenue collection internal administrations result from the high cost of fully internalising the process. The associated logistics and wage costs for solid revenue mobilisation performance are often too weighty for the administration's complete internalisation of the collection process. Most revenue collection institutions already deal with a substantial size of fixed operating costs. Comprehensive territorial coverage for revenue collection using their salaried professionals may require doubling or quadrupling their current staff size alongside procuring supporting infrastructure such as vehicles and communication equipment. On the contrary, revenue-collecting contractors can considerably minimise their fixed costs and tie their logistics and wage costs strictly to performance commissions and bonuses.

Aside from the make-or-buy decisions justifying the use of contractors in some instances, internal decisions regarding the integrity of the workforce, particularly those in the competition, tracking and reconciliation departments, are fundamental. Combined with inadequate internal audits, these departments' personnel make it easier for field collection officers to perpetrate fraud. Regular effective internal audits and audit reviews should significantly reduce this risk exposure. The challenges are that sometimes the internal auditors and audit reviewers become even complicit. Again, inadequate training of revenue collection officers covering integrity, ethics, and professionalism is an essential requirement rarely prioritised in most subnational IRS and other revenue collection institutions. In addition to the workforce formation on ethics and professionalism, regular risk identification, analysis and mitigation strategy design sessions deserve prioritisation.

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ALL EFFECTIVE STRATEGIES accord significant attention to associated risk identification, quantification, ranking and robust mitigation programme implementation. Subnational independent revenue collection efforts are no exception. Continuously enhanced revenue collection successes are likely unachievable without proper attention paid to the sources of risks that may disrupt it. Most such risk exposures are classifiable into three.

The first is revenue collection officer-aided payer non-compliance. Taxpayers, users of subnational government-provided utilities and lessees of government assets in collusion with the collection officers of the revenue class (tax and nontax) typically generate this class of risks. Excellent examples include tax evasion, fraudulent reduction of the actual amount payable and other sundry illegal defaults. The second class of risk exposure is administration based. Weak tax and nontax revenue-collecting institutions inadvertently create opportunities for various fraudulent behaviours affecting collection prospects. Internally, they orchestrate operational risks that further strengthen internal fraud. Externally, they provide a window for fraudsters to pose successfully as revenue collectors and defraud those willing to comply. The third class comprises those risks primarily driven by the structure and performance of the economy. For instance, the elevated level of informality and consequent huge underground economy makes revenue collection more challenging than it should be with enhanced sector formalisation. Socioeconomic difficulties such as high inflation may also present undesirable incentives for non-compliance and challenging revenue collection.

Sometimes enshrined in the risk management strategy document, ethical expectations provide an excellent shield against most of those exposures. Forward-looking IRS teams and other revenue collection institutions usually have copious documentation of collection risks as part of their overall risk management programme. Generally, as a minimum, ethical expectations demand that revenue collection institutions and officers, either acting alone or collusively with taxpayers, fees and utility bills paying clients, should not shortchange the government of its revenue receipts. But even collecting any amount higher than what the law prescribes is forbidden. The laws of most subnational governments also forbid licensed revenue collectors from subcontracting or outsourcing the revenue collection responsibility. De-

spite these rules and expectations, the scale of revenue collection fraud is still significant in many states and local governments.

Regardless of which party – i.e., payers or collectors of revenue – initiated the fraudulent complicity, bribes frequently change hands to reduce the amount payable. Although electronic payment systems may have considerably reduced some dimensions of this corruption and payment (tax, utility bills, fees) evasion risks, it is still relatively prevalent in many states and local governments. Some fraudulent tax assessors and collection officers can (and often) request bribes to severely underestimate the amount of tax payable. Although corruptly profitable for both parties, it considerably harms the revenue prospects of the subnational government. Another dimension of this corruption risk is using the revenue collection window for money laundering. Income from illicit activities can sometimes receive deceptive legitimacy through fraudulent tax collection officers who accept their fraudulent classification. For instance, briber-induced tax assessors may accept as accurate the criminal classification of a marijuana packaging company registered as a tea-making organisation. By collecting taxes on such forbidden activities, their income receives some measure of legitimization by a vital government organisation. Another variant of this crime is hoax tax waivers. Under this arrangement, ineligible taxpayers receiving this usually over-bloated illicit bonanza share it behind the curtain with the tax officers that facilitated it afterwards.

The collection administration requiring the use of contractors often presents loads of risks also. The first is through the sometimes-unnoticed loss of control over the contractor's operations. This loss of control is the most significant risk, as much damage would have occurred to the reputation of the IRS or other kindred institutions before noticing it. Revenue contractors are often driven more by the commission they earn on the size of their collections than by stipulated ethics and contract terms. And because of that motivation, they usually make extensive collections, prompting most IRS to overlook the several payer rights violations and infringements they perpetrate. The second is that many revenue-collecting contract opportunities are contingent on political patronage and corruption. In turn, the unwritten expectation is that they extend patronage through under-assessments, tax holidays and other unholy support to taxpayers connected with the source of the contracts. The third is the accountability problem. Crony's

