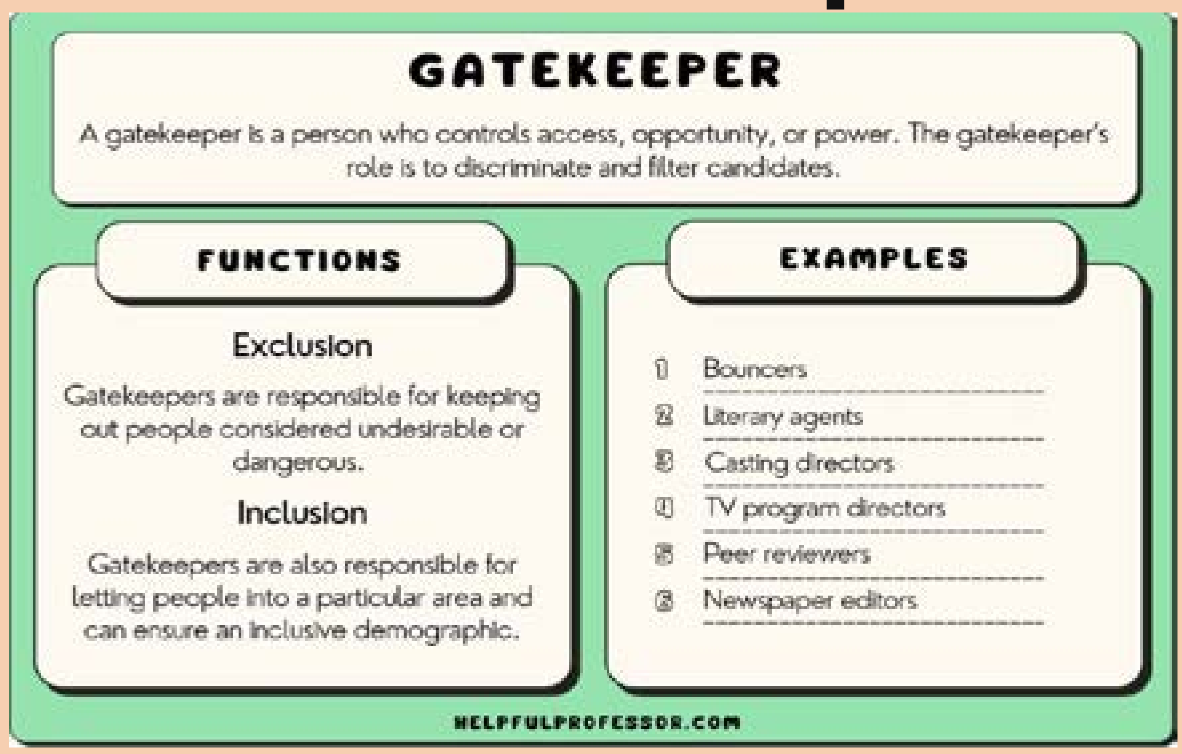
STATES & LOCAL FINANCE

The IGR Initiative

MARTIN IKE-MUONSO

Martin Ike-Muonso, a professor of economics with interest in subnational government IGR growth strategies, is managing director/CEO, ValueFronteira Ltd. He can be reached via email at martinoluba@gmail.com

Mainstreaming compliance gatekeeping strategy for subnational IGR expansion



TAX PAYMENT COMPLIANCE gatekeeping has become a pragmatic response by subnational governments to the increasing financial pressure they face and the rising risks of defaults and evasion. Worsening economic conditions and palpable government insincerity are compelling citizens not to entrust their governments with a proportion of their earnings as taxes. Ennobled by the array of evasion channels, these threats increasingly crystallise in less-than-optimal collectible revenue amounts to subnational governments. Tax payment gatekeeping involves limiting the access of potential taxpayers to specific resources and services if they are not compliant but open to passing when they comply. The concept has wide usage in computing, communication, and the medical sciences. Subnational governments provide and maintain a variety of utilities, such as water, schools, roads, hospitals and so on. Citizens enjoy them at heavily subsidised rates. Taxes provide a much-needed additional financial buffer for the government to sustain these service provisions and to expand the utilities to other uncovered areas. Evasion is rife, particularly among the informal sector operators, high-net-worth individuals and those conducting their businesses over the Internet. Unfortunately, most state and local governments cannot reasonably enforce compliance across this broad spectrum of defaulters. Using task forces has not helped matters either and may have worsened taxpayers' trust in many subnational governments. That is why mainstreaming tax payment gatekeeping as a complementary approach has become highly desirable.

Recently and in line with the provisions of Section 85 of the Personal Income Tax Act (PITA), 2011 (as amended) and Section 31(5) of the FCT-IRS Act, 2015, a valid tax clearance certificate [TCC] is required for individual and corporate business transactions with banks, government ministries, departments and agencies in the federal capital territory. Other states have also commenced the implementation of similar Acts. The legislation generally covers a wide range of areas, including government loans, registration of motor vehicles, applications for foreign exchange or exchange control permission, certificate of occupancy, award of contracts by the government and its agencies, and registered companies' approval of building plans, trade licence, transfer of real property, agent licence, pools or gaming licence, registration as a contractor, application for distributorship, confirmation of the appointment by the government as chairman or member of a public board, institution, commission, company or to any other similar position made by the government. The stamping of a guarantor's form for a Nigerian passport, applications to register a limited liability company or a business name, the assignment of market stalls, the appointment or election of officials, requests to change the owner of a vehicle by the vendor, plots of land, FCTA loans, and any other similar transactions as may be determined in the future.

Although the purpose of gatekeeping is primarily to enforce compliance and raise more revenue, gatekeepers also play a role in protecting the taxpayer. They are classifiable into three: enforcers, taxpayer protectors and cooperators. Compliance enforcers are the traditional and most popular tax payment gatekeeping category. Their cardinal role is to ensure that defaulting taxpayers suffer maximum denial of access to essential utilities and services until they fully comply. Almost all the gatekeeping activities and institutions that state and federal governments use in enforcing compliance fall within this category. The second gatekeeper class still aims to enhance revenue mobilisation, albeit by minimising possible leakages. An excellent example of gatekeeping activity within this category is asking all tax collection officers to possess and wear a tag showing their unique identification numbers and a barcode, making their identity easily searchable and verifiable on the tax agencies' websites before complying. It is well-known that illegal revenue collectors, disguising as genuinely licensed officers, steal a substantial proportion of revenue meant for subnational governments. But by making it mandatory that all revenue collection officers disclose their unique identification numbers verifiable by the would-be taxpayer, they place a gate that protects the taxpayer from swindlers and the state and local governments from the loss of revenue. Taxpayer protector gatekeeping substantially leverages information technology for real-time identity confirmation with the revenue agency. The third class of gatekeepers are cooperators. Associational taxation strategy provides one of the best examples of cooperative gatekeeping. Let us assume that the subnational government allows some associations to collect taxes from its members on behalf of the government. To be effective, such associations can create and enforce rules that make it difficult for members to default. Such rules are the gates.

Gatekeeping for enhanced revenue mobilisation has numerous advantages beyond merely raising collectible taxes. Yet there is no disputing that increased revenue mobilisation is the most critical merit. The second significant advantage of gatekeeping to enforce tax payment is building the consciousness for compliance. To illustrate this, one would expect that a child who always stays within the confines of a gated house is more likely to live a private life than otherwise. Fencing taxpayers with various gates limiting their access to many utilities and services unless they pay can make them internalise compliance behaviour much better. Gates are laws and rules pressuring the taxpayer to comply. And the more people learn to live under the law and in compliance, the more they adopt the habits. The third advantage is the heightened possibility of database integration. Let us assume that the law permits vehicle inspection officers to set up a tax gate using access to motor licences, change of ownership of new cars and driver licences as controls. To effectively sustain the gate in the long run, the database of the motor licensing office must integrate seamlessly with that of the Internal Revenue Service. Paper tax clearance certificates may suffice in the short term, albeit with significant risks of inadvertently admitting and accepting fakes. The fourth advantage is enhanced good governance prospects. There are two possible reasons for this. The first is the improvements in collectible revenue. The second is that the citizens will more likely resist bad governance when they face tremendous pressure from many sides to pay.

There are three critical prerequisites for successful gatekeeping. The first is comprehensive legislation permitting gatekeepers to act in the subnational governments' interests. While this might make it easier for government agencies to limit access to services and utilities they provide to enforce tax payments, it might not be the case for cooperating gatekeepers unless the law sufficiently backs them. For instance, a trade union permitted to collect taxes from its members on behalf of the government still requires significant legal backing if it is to use such means as locking up shops, blocking defaulting members from entering the business operating area and so on to enforce compliance. The operational limits and latitudes of approved gatekeepers must be sufficiently defined within the law to enable them to succeed. A second prerequisite is the development of comprehensive and properly integrated databases. Comprehensiveness and integration enable real-time querying and speedy detection of a noncompliant taxpayer. It eliminates the risks of receiving and accepting fake paper tax clearance certificates. The integrated databases quickly throw up the details of the target taxpayer and automatically confirm or deny the compliance status without requesting any paper. The third factor is the regular audit of the gatekeeper to ensure that they are not colluding with taxpayers. Some gatekeepers may take bribes to admit and confirm a fake tax clearance certificate as genuine. They can also bypass the accreditation process in an automated approval system. To minimise the possibilities of these risks, regularly auditing these gatekeepers is crucial to the success of the overall process.

As crucial as the tax compliance gatekeeping strategy is, it still has some downsides deserving of proper management. The first is its proneness to fraud and corruption. Approving and, most times, statutorily mandating some institutions to gate-keep tax compliance without any additional incentive or strict process monitoring may encourage some laxity and corrupt behaviour. For instance, bank officers may knowingly admit and accept fake tax clearance certificates to corner juicy transactions, particularly if the concerned taxpayer threatens to take the transaction to another bank. Again, a private school gatekeeping for the government by insisting that guardians present their tax clearance certificates before admitting their wards may also encourage and deliberately accept fake tax clearance certificates rather than lose the prospective student to another school. Therefore, a strong incentive structure must ensure that gatekeepers live up to the expectations. Secondly, gatekeeping may not provide as comprehensive a coverage of the taxpaying community as is usually painted. Admittedly, there is no reason why it should be the most wholesome form of enforcement. For instance, most rural dwellers, entrepreneurs, and urban taxpayers who do not conduct transactions mandated by law for gatekeeper monitoring will always escape the trap. The third downside is the weak compliance monitoring capacity of many Internal Revenue Services. The IRS will need more monitors and auditors to ensure gatekeepers enforce the rule satisfactorily. Unfortunately, a lot of them lack this capacity.

Finally, it is indisputable that tax payment compliance gatekeeping is a desideratum enabling subnational governments to achieve high performance in revenue expansion. States and local governments should work with critical utility and service providers such as schools [public and private], hospitals [public and private], banks, ministries for water supply, land ownership certification, landlords and so on to raise as many gates as possible to enhance compliance. To make gatekeeping at state and local government levels even more effective, subnational governments may consider incentivizing non-public sector gatekeepers with a fraction of the collected amounts. For instance, a private secondary school mandated to retain 10 percent of the tax's value it generates from the parents of their students will work extra hard to ensure that all the parents and guardians of their students comply. Hospitals, landlords and most other potential gatekeepers will most likely provide a similar response. Apart from the incentives, subnational governments implementing the gatekeeping strategy also need to build the capacity of their workforce and consultants to monitor gatekeepers' compliance effectively. Many taxpayers will still easily evade payments without adequate monitoring and auditing processes.

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