CHAPTER THREE

Local Revenue Administration

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Introduction

Tax reform requires improvements in tax administration as much as reform of tax policy (Bird and de Jantscher, 1992). The design of suitable local revenue sources (local taxes, charges, fees, etc.) must be matched by the ability of local government to administer and collect the revenue. In practice, in many developing and transition countries, performance in revenue collection is extremely poor. For the purposes of this chapter, we will refer primarily to local taxes, but the issues are similar for other revenue sources, and for all sub-national levels of government.

Local revenue administration has a number of stages:

- Tariff setting
- Taxpayer identification
- Assessment of an individual taxpayer's liability
- Collection of the tax due
- Enforcement against defaulters
- Accounting for the tax collected
- Reporting on and monitoring the results.

Local governments need to be concerned with the performance of their revenue administration. There are three possible indicators of performance.

Tax effort: The amount of tax collected compared with the economic base or taxable capacity of the local economy – taxable capacity being a measure of the size of the local economy which is amenable to local taxation. Gross regional domestic product (GRDP) is often used as a measure of taxable capacity, so that tax effort would compare actual local tax revenue against GRDP. However, the ability of the sub-national or local government to tax the local economy will depend on the tax instruments available to it – something that is generally outside its control. For example, the GRDP of the jurisdiction might be high because it is an oil-producing region, but the local government may have no instruments to tax the oil sector. Tax effort is the outcome of both tax policy (types of taxes, tax rates, etc.) and tax administration (effectiveness of tax administration). Local tax policy has been discussed in chapter 2, and is largely outside the control of local government (e.g. in the choice of taxes and setting tax bases).

Effectiveness:[1] the proportion of the tax potential that is realised. Tax potential is defined as the total amount which should be collected from each local tax levied at its specified rate if everyone pays the full amount for which they are liable:

$$\text{effectiveness} = \frac{\text{actual yield}}{\text{tax potential}} \times 100\%$$

Efficiency: the proportion of the tax collected which is used up in the cost of collection and administration:

$$\text{efficiency} = \frac{\text{collection cost}}{\text{actual yield}} \times 100\%$$

Effectiveness

One hundred per cent effectiveness would mean that all the tax potential was collected on time and accounted for in the local government budget. The problem is how to define potential. In most cases, we do not know the potential of a tax, because:

- Not all taxpayers have been identified;
- Not all taxpayers have been correctly assessed;
- There is discretion over tariffs, which means that there is no 'absolute' figure for potential.

Potential: For certain taxes we may have a reasonable indication of potential; for example, where the central government carries out assessments for property tax, local governments can regard the valuation roll as the measure of tax potential.

In the absence of such 'objective' measures, it may be possible to derive some indicator of potential from published statistics, e.g. sectoral GRDP statistics may give an indication of the tax potential for a tax on that sector; household expenditure statistics for an income tax; statistics on car sales/registrations for motor vehicle taxes; population statistics for a poll tax, etc. Although such statistics may not give a precise measure of potential, they can at least indicate if things are seriously wrong.

The main factors which threaten effectiveness:

- Failure to increase tax rates in line with inflation (unless tax rates are *ad valorem*);
- Failure to keep tax registers up-to-date with population and economic growth;
- Evasion by the taxpayer;
- Collusion between taxpayer and tax official;

- Delays in payment;
- Fraud by the tax official.

These are discussed further in the next section, in terms of the stages in tax administration.

Stages in an effective revenue administration system

Tariff setting: Ideally, tax yields should increase automatically with inflation, e.g. through an *ad valorem* basis (i.e. tax as a percentage of the price); where taxes, charges or fees are fixed in money terms, there should be a regular mechanism to review tax and charge rates, for example a review procedure as part of the annual budget or indexation to the retail price index.

Taxpayer identification: It should be difficult for taxpayers to conceal their identity. This can be facilitated where:

- Payment is automatic, e.g. a surcharge on an electricity bill;
- There is an inducement for people to identify themselves, e.g. people entering a cinema have to have a ticket which includes the tax;
- Identification can be linked to some other source of information, e.g. vehicle or land transfer information can be used to identify vehicle and property taxpayers;
- Liability is very obvious, e.g. the number of market stalls.

Identification is more difficult where the liability is easily disguised or where there is no objective data on tax objects, e.g. informal sector incomes or possession of a radio.

Assessment of the correct tax liability must be done either by the taxpayer (self assessment) or the tax official, or jointly. This involves both identifying the correct value of the tax object and applying the correct tariff.

This is helped where:

- Assessment is automatic, e.g. pay-as-you-earn (PAYE) income tax or a fixed percentage addition to hotel bills;
- Tariffs are widely known and the assessor has little discretion, e.g. standard charges for market stalls;
- There are other records which can be used as a check, e.g. types and prices of vehicles sold as a check on vehicle taxes;
- The functions of assessment and collection are separated, and there is a system of checking on assessments;

- Penalties for under-declaration and for collusion are high and the risk of being caught is high enough to be a deterrent.

The more scope there is for discretion on the part of the assessor, and for contact between taxpayer and assessor, the greater the risk of under-assessment.

Collection: The full amount should be collected at the earliest opportunity. This can be assisted where:

- Payment is automatic, e.g. an entry charge to a facility or pre-payment meters;
- Payment can be induced, e.g. where tax clearance certificates are required before contracts or licences can be obtained;
- Incentives are offered for prompt payment (but these can be costly);
- Penalties for late payment are sufficiently high and sufficiently probable to be a deterrent.

Enforcement may involve:

- Fines for late payment
- Publication of the names of defaulters
- Prosecution through the courts
- Seizure of assets
- Attachment of earnings (where a person is employed, the requirement that the employer deducts the debts from the person's wages, i.e. at source deduction)
- In extreme cases, imprisonment.

Enforcement of penalties and sanctions needs to be carried through to the logical conclusion, including court action and seizure of property, at least in a few exemplary cases, in order for defaulters to know that the local government is serious.

Effective enforcement requires:

- Administrative systems that identify the need for enforcement action in a timely way and follow through the required stages;
- Political support for enforcement action, which may be difficult to obtain;
- Legal/court processes that are efficient and are not unduly costly.

Accounting procedures: Proper accounting procedures are required to ensure that all the money collected is paid into the local government's Treasury and appears in the government's accounts. This requires:

- Adequate security arrangements to prevent loss or theft of cash, e.g. receipting systems, locks on safes and cash boxes;

- Proper book-keeping records, with arrangements for cross-checking by different officers;
- A system of auditing;
- A system of reporting on performance against potential (or targets), with follow-up action.

Efficiency

This measures the proportion of the tax yield which is used up in administering the tax. The cost of administration includes not only the direct cost of assessing and collecting the tax, but also indirect and overhead costs to the local government as a whole, e.g. police, court and other costs of taking enforcement measures.

In many cases, administration costs are not properly considered, since they are included under a different budget head from the revenues, so that comparison may be difficult. As a result, collection costs may actually absorb a large part of the revenue collected. This means that the local tax system is just a burden on local citizens without producing benefits.

The calculation of efficiency discussed so far is about average collection costs. Ideally, average collection costs should not exceed 5–10 per cent of revenue, although given the limited revenue sources of local governments in many countries, somewhat higher collection costs may be acceptable. There is also the question of the marginal cost of collection, that is, how much extra it costs to collect this additional dollar of tax revenue. It clearly makes no sense to spend more that $1 to collect $1 of revenue. However, it may still be appropriate to spend quite a high proportion at the margin (i.e. on the last dollar collected), since enforcement costs for the last dollar collected my be quite high but the credibility of the whole system depends on effective enforcement action. There will always be a balance to be struck on how much it is worth spending to collect that last dollar of revenue.

Compliance costs: It should be noted that there are also compliance costs to the taxpayer (travel costs to the tax office, time taken filling in forms and waiting, etc.), and costs in terms of public good will. Compliance costs for local taxes can often be very high, as taxpayers have to queue up to pay multiple small taxes. In addition, there may be 'unofficial costs' demanded by officials issuing licences and permits, which may greatly increase the costs to the taxpayer. Yet these compliance costs are rarely considered. While these are not costs to the local government, they are part of the overall burden of the local tax system and can have a detrimental effect on the local economy, as well as on the willingness of taxpayers to pay.

Efficiency can be assisted where:

- Assessment and collection are automatic, e.g. a fixed percentage addition to a bill;
- Several levies can be assessed or collected simultaneously;

- Collection can be linked to some other administrative process, e.g. a surcharge on a utilities bill;
- The tax liability is large, since the concern is with the proportion of the tax used up in administration.

Where taxes have to be paid in cash, the use of accessible facilities such as banks and post offices will reduce the compliance costs to the taxpayer and make it more likely that the tax will be paid. Collecting taxes door-to-door may increase yield, but the costs are enormous.

Incentives to tax officials, and to taxpayers for prompt payment, may increase yield, but may significantly increase costs.

There is obviously a trade-off between increasing effectiveness and efficiency, since the marginal costs of each additional dollar of tax revenue may be quite high. It is always possible to increase yield (effectiveness) by increasing collection costs (and hence reducing efficiency).

Effective and efficient revenue administration practices

Taxpayer identification

Maximum use should be made of records held by other agencies and departments (including central government tax departments) that give information about tax objects or subjects, e.g. business licence applications, transfers of ownership, etc.

Where there are multiple local taxes, a unified tax roll which brings together a taxpayer's liabilities to various taxes can be helpful. Computerisation can assist in cross-checking a taxpayer's liability for different taxes.

There will be a need for periodic field surveys to ensure that all tax objects have been included; in situations of rapid population growth and economic expansion, it is not enough to rely on existing tax rolls or to assume that new tax objects or taxpayers will be added to the list automatically.

Assessment

As many taxes and charges as possible should have an automatic assessment system (e.g. a surcharge to a bill or a fixed entry charge). Where there is likely to be contact between assessor and payer, the amount of discretion available to the assessor should be minimised.

Where possible, the functions of assessment and collection should be separated and staff rotated between jobs on a regular basis, to avoid 'cosy relationships' building up between taxpayers and officials.

Tax and charge rates should be publicly displayed to avoid overcharging by officials. In some cases (e.g. property tax), publication of assessments and valuation rolls can help to avoid collusion between tax official and taxpayer, since people can then see how neighbours or competitors are being assessed.

There should be regular checking of assessments by senior staff, on a random basis, with severe penalties if collusion is revealed.

Pre-printing by the local revenue office of tickets and invoices which are used to collect local taxes (e.g. for hotels or cinemas) may help to avoid under-declaration, but such pre-printed tickets and invoices must be held securely.

Penalties for under-declaration of self-assessed taxes should be sufficiently severe and probable to be a real deterrent.

Collection

Where possible, local taxes and charges should be designed to ensure full payment at the earliest date. Pre-payment meters, e.g. for water and electricity charges, are one way of doing this.

Penalties for late or non-payment should be sufficiently high and sufficiently probable to be a deterrent. Enforcement measures (e.g. attachment of earnings, seizure of property or, where all else fails, imprisonment) should be carried to their logical conclusion sufficiently frequently to avoid the system falling into disrepute. Incentives to taxpayers for prompt payment may be worthwhile, but at a cost.

Money collected should be paid into the local government's Treasury or the bank on a regular (e.g. daily) basis.

Checking and accounting

The whole system should contain adequate checks and controls. In particular, the system of recording assessments and payments should be straightforward and amenable to checking. Independent checks should be carried out as a matter of routine on the money received as compared with the relevant tax assessments.

Senior management should carry out spot checks at regular intervals, and ensure that any discrepancies are followed up and action taken against the staff responsible. All receipts must have a proper numbering system and must be held securely to prevent improper issuing.

Reporting

There should be a proper system for reporting on revenue performance. This should include information on yield compared to potential/assessment/target for the period concerned. This information should be produced regularly (monthly or quarterly) and submitted, in a timely manner, to those in a position to take action if there appears to be a problem.

There should also be regular reporting on enforcement measures taken, the level of arrears, progress in dealing with arrears, collection costs, etc.

Targets

Targets are sometimes used by revenue offices both as a stimulus to revenue effort and a guide to performance. Their effectiveness will depend on how they are set. If they are merely based on previous performance, rather than on revenue potential, they may not produce the required increase in yield (and may even discourage it, if an increased yield is seen merely to result in a higher target the following year).

Thus, targets should be based on a proper estimate of revenue potential. If the potential is so far above the previous year's realisations as to be unattainable within one year, a series of staged targets aimed at bringing yields up towards potential over a period of years should be devised.

Raising the public's tax consciousness

There is an important educational role to be played in making the public aware of the need to pay their taxes promptly. This can best be done by providing proper information on how revenues are used and by eliminating obvious examples of waste.

Soliciting the help of community leaders in presenting the information and exhorting the community to pay its taxes may have some positive results, particularly if community leaders feel they have some input into the decision-making process about how resources are to be used, and if the resources are seen to be of direct benefit to the local community.

Making it easy for people to pay, e.g. enabling taxes to be paid through banks and post offices, and avoiding unnecessary forms and bureaucracy, can help. Eliminating overlapping taxes that yield little, but require repeated demands on the taxpayer, can also help.

The public should be encouraged to demand a receipt or ticket for any payment made, in order to discourage fraud by collectors; in some cases lotteries using such tickets can provide an incentive to the public to demand tickets or receipts.

Computerisation

The great progress made in recent years in computer technology, and the rapid fall in costs, mean that there is enormous scope for the use of computer technology in the administration of most taxes. Many tasks in this field readily lend themselves to computerisation:

- Preparation of tax rolls
- Preparation of bills
- Receipting of bills
- Checking accounts
- Checking receipts against assessments
- Preparing lists of defaulters
- Preparing regular reports.

As with all computerisation, it is necessary to ensure that the manual system works properly before attempting to computerise. A major problem is likely to be the shortage of skilled personnel to operate computerised systems, and such people may be in a position to defraud the system of large amounts. There must, therefore, be adequate arrangements for the supervision of the computerised system to avoid errors and fraud.

(For examples of improved local revenue performance, see Blore, Devas and Slater (2004), chapters 4 and 5.)

Note

1 In American textbooks, effectiveness is usually referred to as collection efficiency. We prefer to use the term effectiveness, since in normal usage efficiency is a measure of the resources consumed in achieving a specified objective (and that is the sense in which we use the term efficiency), whereas effectiveness is an indicator of how far the objective has been achieved.

References

Bird, R.M. and de Jantscher, M.C. (eds) (1992). *Improving Tax Administration in Developing Countries*. Geneva: International Monetary Fund.

Blore, I., Devas, N. and Slater, R. (2004). *Municipalities and Finance: A Sourcebook for Capacity Building*. London: Earthscan.