

Rethinking Tax Collection Strategy

Need to move away from accountant-perspective to economics of institutions and behavior

Section 1

There has been much clamor about widening the tax net and increasing government revenue from direct taxes. It is commonly acknowledged that current practices in tax collections are flawed with presence of tax evasion by agencies as well as by individuals, often in collusion with the tax collecting authority. Yet, efforts during the last two decades of parliamentary governments had largely been on expanding the net of individual tax payers through making TIN (and/or paying advance income tax) mandatory during annual car registration, opening of bank accounts, and during registration of land transfers. Furthermore, incentives have reportedly been introduced to the very tax collectors who are allegedly part of the 'problem'. In the absence of inter-linked data base and real time access to various data sources, payments (such as, AIT) from individuals often eloped, and the individual taxpayers at times failed to establish claims on such payments. Yet expansions of the tax administration are proposed in terms of increased manpower operating within the same system! And various proposals are being tabled, including that of re-introducing wealth tax that will enhance the power of 'individual tax collectors' vis-à-vis 'individual taxpayers'. This paper proposes an agency-centric tax collection policy which, if implemented, will widen the net of individual tax-payers as well, raise the size of revenue from direct taxes, curtail rent-seeking behavior, and help developing a responsible and accountable governance. In order to appreciate the need for a viable tax collection policy that achieves these, one needs to recognize that the tax collection authority may act independent of the very government (policymakers) whose policies it implements. It is also important to understand the behavior of taxpayers, and not treat them merely as evaders. As an onlooker, questions are therefore posed to find ways so that all three parties may cooperate in pursuing a common goal of social progress.

The desire expressed above may be considered a fantasy by many. It would be no less a fantasy to conceive of a state without a state-machinery where all individuals follow a set pattern of behavior – always conforming with or resulting in social outcomes that maintain harmony and prosperity! In such a world of fantasy, we would need a costless 'God' meddling with actions of each and every individual on a full-time basis. But one could rightly argue that nothing comes free! In reality, one can hardly deny the need for an administration that oversees social exchanges so that social tensions arising out of dynamism may be contained within tolerable limits. There had also been the need for a 'superimposed' agency to accumulate and invest on producing and providing utilities and services necessary for human living (till the private sector grew sufficiently to replace the 'government' in providing some such services, for example, in education, health, irrigation, electricity, etc.). The fund required for all these may be raised in a number of ways; and human society, from the early days of civilization, had sought one or the other means, and had to deal with the vices that came along with it. One may recall Kautilya's *Arthashastra*, written at around 300 BC, which dealt with many issues of economic governance. In one instance, it mentioned (partial or complete) tax waiver policies to

bring new land under cultivation that would eventually increase total land revenue. It clearly recognized the need for a contract that would be gainful to both parties. Failure to appreciate the need for common ground was reflected in a policy during the time of Tughlaqs (12th century AD), when the Delhi emperor got too greedy and raised the land tax from half the produce to two-third. The move forced many to flee to the jungles and hills drying out the emperor's tax base, thus forcing a change in the ruler. Much later, Sher Shah Suri, a person much ahead of his time, groomed one of the finest Finance Adviser in Raja Todar Mal, who was one of the *Navaratnas* in Emperor Akbar's council (16th century AD). State support to farmers at times of crop failure was formalized during his time – a classic case of symbiotic relation between the administration and the citizens where each recognized the importance of the other for its own existence. The history, particularly of the eastern region of the Indian sub-continent, also reveals of the presence of intermediary classes/agencies (say, *Jaigirdar*) who were assigned to collect tax revenue on behalf of the higher authority (say, Delhi emperor). Such control over resources allured many of these intermediaries to declare 'independence', and give rise to local fiefdoms, causing frequent civic disruptions. In spite of this destabilizing character of the state living on tolls collected from its citizens or by selling resources it controls, human society is yet to find an alternative to the visible auctioneer, often self-proclaimed to be the 'God's Representative' on earth.

Without elaborations, I propose below few general observations to highlight the importance of tax revenue and the nature of tax administration.

- Need for generating revenue to run administration is a necessary 'evil'.
- If public control over resources permitted generating sales revenue, tax administration assumed lesser importance. While it allowed a dictator to be benevolent to its citizens/subjects, it also opened new areas of conflict – particularly with agencies and countries which would be keen to control those resources. There is ample evidence of such conflicts in contemporary world.
- Collection of tax revenue invariably involved intermediaries; and the latter always faltered in strictly fulfilling the objectives of the top authority. One may find instances where the top authority itself got influenced by the financial powers acquired by the intermediaries. It is however only in countries where tax revenue constitutes the bulk of government resources, such possibility may arise.
- Even though current practices are highly dissatisfactory, significant presence of domestic tax revenue hold potential for mutual dependence (and alliance) between taxpayers, government and tax-collectors. If any one in the chain ignored that dependence for short term gains, the system of governance failed to sustain. Moreover, in cases where such revenue was tied to economic prosperity of the taxpayers, the government would benefit investing on areas that brought such prosperity (for example, public investment on irrigation where the revenue was a proportion of total produce from land). The incidence of tax-collector revolting to carve out a territory in the name of 'independence' no more appears a feasible option; but they may be sufficiently 'dishonest' to undermine the moral authority of a government and cause its fall.
- In all aforementioned settings, two sources of revenue are envisaged: (i) direct or indirect taxes on citizens and goods & services the latter produce and/or consume;

and (ii) the revenue earned from selling resources that are under the control of the government. One could include the revenue from levying traders, often through control over trade routes, subsumed in these two, or, may consider it a third option. [Let us not forget that crusades were fought and religion was brutally tarnished largely due to the greed to control trade routes!] An additional source emerged with the introduction of the so called global ‘aid’ regime, particularly since the World War II. It is in the form of either loan or ‘aid’ tied to obligations. This, I believe, had far reaching implications for the behavior of each of the parties I mention above, undermining the corporate nature of national government and its accountability to its citizens. That, however, is a vast topic for debate, and not addressed here. Yet, the spirit of reinforcing the tie between the three parties is rooted in the belief that an increase in the share of domestically procured resources (and possibly, eliminating ‘aid’-dependence) for meeting government expenditure will eventually lead to greater accountability and responsible governance.

One general conclusion from the citizens’ perspective is: if we do not turn into paymaster of the people we assign the responsibility of running the country, they will concede to other interests that may not always conform to our interests. Alternatively put, unless a government is able to meet its expenses (and investment needs) from resources within – revenue from taxes and from sale of resources – the very basis of its independence may run into difficulties!

Section 2

Two major components of direct taxes are taxes on business profit and taxes on personal income. The first deals with agencies that are legal entities – self-employed business, limited companies, various agencies within the government, registered non-government agencies or microfinance institutions, international agencies working under the umbrella of development partners, and various ‘projects’ assuming independent status under some of these agencies. The second applies to all individuals liable to pay taxes on their personal incomes, be they employed by agencies, individuals, or, be self-employed. A majority of individuals who pay personal income taxes are either employee of these agencies, or, have shares in the post-tax (on profit) dividends. Two interrelated questions are posed in this section:

- Is it desirable to set targets on amount of revenue to be generated from direct (or any other) taxes? And,
- Between institutional and individual taxpayers, who should be the primary focus of an efficient tax collection strategy?

On setting targets:

It is a common practice of the management to set targets to be realized by its staffs or branch offices within a given period. Such practices are observed in banks with regards to loan disbursements, recovery and deposit mobilization; sales departments in numerous companies; commissioned agents in insurance, marketing in travel and real estate

business; etc. Sometimes, such targets act as floors to retain one's job with regular salary, and bonuses are tagged to earnings beyond the threshold. In the microfinance industry such target-setting is alleged to have led to inclusion of bad clients resulting in overlapping and bad debt. In some developed countries, targets for traffic police are alleged to have often led to ill-handling of drivers committing no or minor violations. Faced with (potential) taxpayers, some of whom evade and others who report honestly, what would a tax collector do if a target is to be met? With proper incentives, an honest tax collector would put in extra effort to reduce evasion and thereby increase collection. The same does not apply to dishonest tax collectors who are likely to be in collusion with the evaders. With weak and ill-informed individual taxpayers, more may be squeezed (by dishonest collectors) out of honest taxpayers to fulfill the targets! The incentives will however have positive effect in bringing eligible ones into the net as long as the coverage by an individual tax-collector has not yet reached one's physical limit.

Setting targets for individual collector may find rationale in terms of efficient management. But how would one justify target setting for aggregate collection – say, so many percentage of GDP, or, so much Taka in the coming year? From an accountant's perspective and for financial planning, it is important to assess the amount of revenue expected from different sources. In such instances, a financial planner 'expects' or 'anticipates', and NOT 'targets'. There may however be *ex ante* economic considerations, on efficiency and distributive grounds, to guide government's decision to define relative sizes of revenue from various sources. Taxes involve transfers from private hands to the government; and increased efficiency would demand that the government's use of the fund brings greater benefit to the society than the loss caused by reduction in private consumption, savings and investment. In case of borrowings, one needs to justify interest payments as well as the reason for buying current (government) consumption with future debt obligation. Essentially, society's benefits from government spending ought to be spelled out in order to suggest a size of transfer to government – and only under such contexts, it makes sense to set targets on collection of tax revenue. Unfortunately, we are far from such practice – and it is important to initiate the process of raising the questions; what is the net benefit from spending a Taka on our government, be it civil, political or military? And, in what ways can we ensure greater benefits? Current practices in target setting with regards to tax revenue do not appear to be rooted in any of these queries; and unfortunately, accounts-based financial planning along with managerial urge to reduce evasion through setting micro-level targets appears to dominate.

Efficiency in re-allocation of resources from private hands to the government through taxes rarely surfaces in the discourse; and we often rationalize taxes in the presence of market distortions and its role in adjusting market outcomes to socially desirable distribution of resources. Long experiences with governance failures and rent-seeking behavior of those assigned with the responsibility to govern raise doubts on the traditional expectations from fiscal policies. To put it straight, should the government tax one section and subsidize another to redistribute and in the process allow intermediary agencies to seek rent? Or, should the government oversee and provide incentives to guide private surpluses into further income and employment generation for the poor (inter-temporal redistribution overlapping with social redistribution) as well as promote

contemporaneous redistribution bypassing intermediaries? These are some of the issues that peep in while one probes into governance issues; but they soon get lost in the excessive pull of 'traditions' upheld by the very institutions that are questioned!

In the light of above discussion, it is necessary to recognize that setting targets on aggregate tax revenue collection cannot be within the jurisdiction of a tax-collecting authority – it should ideally be in the domain of policymakers. The job of the former, in case of direct taxes, is to collect tax from people and agencies legally bound to pay taxes. And in doing so, there is a need to define a tax collection strategy, which may guide the actions of the tax collecting authority. While there may be various aspects to such a strategy, rest of the paper focuses on only one and assumes that the required adoption of ICT is equally appreciated by all parties. This takes us to the second question; and it is proposed that tax collection efforts have better chance of success if the central focus is placed on agencies than on individuals. Let me illustrate the problem citing instances.

As individual taxpayers, we submit our tax returns every year and attach proofs of income earned, deductions claimed and asset accumulation. [At this point, many may go blank since there is another intermediary class on whom many depend for all these activities!] It is beyond the ability of a tax official to verify all those claims. Sometimes additional information, such as, bank transactions, are sought to check consistency in income and expenditure statements. One may note that computerization of banking data allowed officials to place more trust on bank statements. Yet, no one denies that all these papers may be 'produced'! One way to identify false statements or catch the evaders is to have individual tax inspectors go around the block to check on individuals whose visible assets (such as, an apartment, house or a car) whose value exceed the reported asset, where the latter ought to be consistent with reported income and expenditure. No one can deny the need for a huge capacity of tax authority to undertake such one-to-one searches! And yet, no one may also deny that an average tax-evader facing a tax-collector; is a weaker party vis-à-vis the latter. And it is easy to negotiate underhand deals in bilateral transactions simply because joint profit of the two parties may be maximized by a deal that deprives the exchequer completely. [I guess that is also the reason why an additional intermediary surfaces in this transaction.] Thus, individual-centric tax collection strategy is not only costly, it is unlikely to increase revenue and reduce rent-seeking practices.

Now imagine the same collector facing an agency that has an ownership and management structure in place, and employs salaried and wage workers in their payroll. Such agencies pay taxes on profit that are more than one-third for corporate profit and a quarter for family businesses. The tax burden increases since private shareholders also need to pay taxes on dividend income. Thus, gains are high if accounting malpractices can be done to lower the recorded profit; and it is no wonder that personal expenses surface in company's expense record and reported expenses are often several times of actual expenses. Anyone familiar with joint cost assessment in cases of production sharing contract with international oil companies (exploring & extracting natural gas), knows how members of assessment committees representing national interest changed allegiance and approved costs that exceeded often four times the actual costs (assumed equal to those reported by national agencies performing similar tasks). In these instances,

companies have upper hands and can tie in the individuals made responsible to oversee/guard the interests of the public. There may however be instances where individual tax collectors intend to take wrong-doers into task, in which case, they would have to seek broader institutional support from within the system. Since agencies are fewer and their registration status is relatively stable, less manpower is needed to oversee these agencies and to track individual taxpayers affiliated with those agencies.

Think of a scenario where individuals submit tax returns on their own, but information on them is availed from agencies as well. It does require computerized data; and national ID with requirement of TIN for individual employees that allows cross-checking. If a proper regulatory framework is put in place that encourages agencies and individuals to report and share information, and the tax collecting agency requiring less effort to raise revenue, we may move towards realizing the objective. What would then be required? Some of the issues are mentioned below.

The very first step is to get out of the practice (and culture) of tax-returns submission by only those who earn more than the zero tax threshold. In order to get that first step moving, **the government needs to abstain from imposing a minimum tax on all those who submit returns. Such a policy clearly runs contrary to the idea of a zero tax threshold!** One should not read this to imply that all adult citizens of the country should file tax returns and flood the tax offices with loads of papers. Initially, one may consider targeting **agencies** registered with certain regulatory authorities, located in certain areas and operating in certain sectors (or, a mix of the three). In facilitating the process, *challans* on AIT may be simplified, mentioning of employees' TIN and reporting on all employees' earnings even when AIT deduction at source is not applicable for lower income brackets. Accordingly, all individuals linked with these agencies may be brought into the tax-net. Since urban property is an important proxy of wealth and considered an indicator to identify probable tax-evaders, information on ownership stored by various city development authorities may be computerized and the government may make its sharing with the tax department legally binding.

One may add the details which, I am sure, the people in respective administration are well aware of. The essence remains the same – have the primary thrust in tax collection on getting agencies on board, the individuals will follow. And the success lies in finding ways to encourage agencies (business houses employing staffs/workers) to report on employment records (as well as achievements in terms of revenue) and yet discourage them from over-reporting expenses. Since earning of individuals can be cross-checked from two sources, and employees will resist any attempt to over-report payments to them, thus reducing the opportunities to under-report profit. Current tax structure that doubly (or triply) jeopardize agency-level profit and encourage abstention or accounting malpractice to show low taxable profit should be immediately reviewed. Since certain sectors in the economy (such as, banking) appear to have adjusted their pricing with existing tax structure, the policymakers may choose to exclude it from immediate actions and focus more on those where a revision of taxes on profits will not have negative effects on revenue earning of the government. There is also a need to introduce multiple tax return forms – a simple one pager for all (the target population to be sequentially

expanded with time and capacity-building), and an elaborate one for those who paid tax in the past. Finally, there is a need to restructure internal administration to bring about coordination among the two segments looking into agencies (including companies) and personal income taxes, possibly re-orienting the manpower.

It is time that the political leadership shows real commitment to bring about changes in the way administration is run – and restructuring tax administration for greater transparency and for eliminating the adverse effects of ‘black money’ will surely bring greater political benefits.

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