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Sustaining Growth in Developing Economies through Improved Taxpayer Compliance: Challenges for Policy Makers and Revenue Authorities

Margaret McKerchar and Chris Evans¹

Abstract

The existing body of literature on taxpayer compliance has developed over some 30 years or more and has predominantly emanated from developed economies. However, policy makers and revenue authorities in developing economies face quite different challenges and constraints. These include limited administrative resources and expertise, weak tax administration, widespread evasion, corruption and coercion, low taxpayer literacy and morale, and negative attitudes towards government. This article explores these challenges and constraints in developing economies. It identifies strategies to improve taxpayer compliance and the necessary steps to implement them in order to achieve sustainable economic growth.

1. INTRODUCTION

Taxes, and tax systems, are fundamental components of any attempts to build nations, and this is particularly the case in developing or transitional nations. As Brautigam has noted, “[t]axes underwrite the capacity of states to carry out their goals; they form one of the central arenas for the conduct of state-society relations, and they shape the balance between accumulation and redistribution that gives states their social character”.² In short, taxes build capacity (to provide security, meet basic needs or foster economic development) and they build legitimacy and consent (helping to create consensual, accountable and representative government).

A key component of any tax system is the manner in which it is administered. “No tax is better than its administration, so tax administration matters – a lot”.³ And an essential objective of tax administration is to ensure the maximum possible compliance by taxpayers of all types with their taxation obligations. Unfortunately, in many developing countries, tax administration is “usually weak and characterised by

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² Brautigam, D., 2008, ‘Introduction: Taxation and State-Building in Developing Countries’, in Brautigam, D., Fjeldstad, O-H and M. Moore (Eds) *Taxation and State-Building in Developing Countries: Capacity and Consent*, Cambridge University Press, Cambridge, pp. 1-33, p. 1.

³ Bahl, R. and R. Bird, 2008, ‘Tax Policy in Developing Countries: Looking Back – and Forward’, *National Tax Journal*, June, pp. 279-301, p. 296.

extensive evasion, corruption and coercion. In many cases overall tax levels are low, and large sectors of the informal economy escape the tax net entirely”.⁴

A considerable body of literature and much ‘best practice’ knowledge and experience currently exists in respect of both tax administration and taxpayer compliance. This is understandable given the fundamental contribution that taxation makes to the achievement of the many goals (including economic and social) of governments and their constituents. However, the reality is that much of this literature, knowledge and experience has emanated from developed countries and the extent to which they apply to developing economies is uncertain. Given this gap of knowledge, together with the fact that tax administration is one of the most important but least studied aspects of fiscal reform in developing economies,⁵ there appears considerable scope for further research.

The purpose of the article is to identify the most appropriate and effective strategies to improve taxpayer compliance in developing economies. This is an ambitious task as taxpayer compliance in itself is a complex phenomenon that takes place in a dynamic environment with many factors at play including tax policy and tax administration.

The balance of the article is presented in three parts. Following on from this introduction, Part 2 of the article presents an overview of the taxpayer compliance literature and presents findings on how behaviour is influenced by a range of strategies commonly adopted by revenue authorities. The underlying challenges for policymakers are also considered. The intent of this part is to be both broad and general in its approach and not be necessarily constrained by domestic, economic or other considerations. In Part 3 of the article strategies for improving taxpayer compliance that are considered most appropriate to developing economies are identified and discussed. Some concluding comments on tax policy, tax administration and tax compliance are made in the fourth and final section of the article, in addition to the identification of areas where further research may be fruitful.

2. FACTORS AFFECTING COMPLIANCE

2.1 Obligations and managing risk

The fundamental goal of any revenue authority is to collect taxes and duties payable according to the law. However, when it comes to the obligations imposed on them by law, taxpayers are not always compliant. A compliant taxpayer is one who fulfills every aspect of their tax obligations including:

- registering with the revenue authority as required;
- filing the required returns on time;
- accurately reporting tax liability (in the required returns) in accordance with the prevailing legislation, rulings, return instructions and court decisions;
- paying any outstanding taxes as they fall due; and

⁴ Brautigam, D., note 2, p. 3.

⁵ Bird, R. and M. Casanegra de Jantscher (Eds), 1992, *Improving Tax Administration in Developing Countries*, IMF, Washington DC., p. vii.

- maintaining all records as required.⁶

A non-compliant taxpayer is one who fails to satisfy any one or more of these aspects and poses a risk to revenue collection. Research has shown that non-compliance may be as a result of a deliberate decision by the taxpayer, or it may be unintentional.⁷ Further, there is a range of possible compliance outcomes driven by a variety of factors including demographic (including age, gender and level of education), personal (including attitudes, experiences, morale and financial circumstances) and aspects of the tax system itself (including tax rates, penalties, audit probabilities, enforcement strategies, complexity and costs of compliance). As many of these factors are not constant, it is to be expected that compliance behaviour can change over time and a compliant taxpayer one year may be non-compliant the next.

From the perspective of the revenue authority, the ideal is to have all taxpayers fully compliant at all times. If this were the case, the tax gap (the difference between what a revenue authority theoretically should collect and what it actually does collect) would not exist. The ideal is obviously not attainable. But to be able to work towards this ideal, the revenue authority needs to be able to identify and understand the various types of compliance outcomes and then develop and apply appropriate strategies to modify (or reinforce) taxpayers' behaviour accordingly. As the revenue authority normally has limited resources at its disposal, it needs to be strategic if it is to be efficient and effective in managing its risks. This will require the authority to identify and prioritise its risks, to tailor and target specific activities to each identified risk, and to allocate resources accordingly. This is commonly referred to as a risk management approach to compliance and is widely adopted in many jurisdictions, and in particular, where taxpayers are required to self-assess their tax liability.⁸

The 2004 OECD report notes that "the benefits of pursuing a risk management approach are well established. For a revenue authority they include:

- a structured basis for strategic planning;
- a focus on the underlying drivers (not symptoms) of non-compliance, and promotion of diversity in the treatment of major tax compliance risks, rather than the adoption of a 'one size fits all' approach;
- better outcomes in terms of programme efficiency and effectiveness (e.g. improved compliance with tax laws leading to increased tax collections and improved taxpayer service);
- a defensible approach that can withstand external scrutiny (e.g. by external audit officials); and

⁶ Roth, J., Scholz, J. and A. Witte (Eds) 1989, *Taxpayer Compliance Volume 1: An Agenda for Research*, University of Pennsylvania Press, Philadelphia, p. 21.

⁷ McKerchar, M., 2003, *The Impact of Complexity Upon Tax Compliance: A Study of Australian Personal Taxpayers*, Research Study No. 39, ATRF, Sydney.

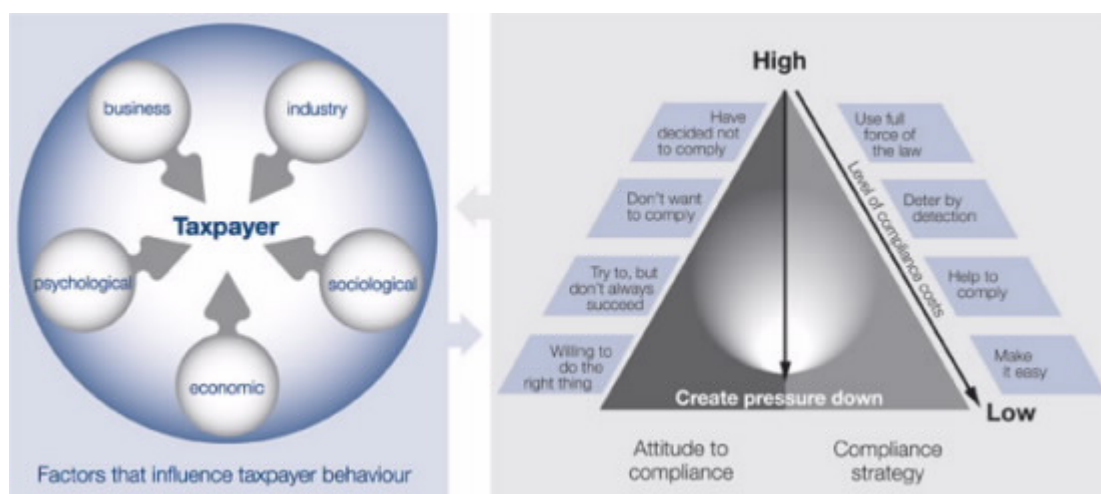
⁸ For example, the Australian Taxation Office, the New Zealand Inland Revenue Department and the OECD have adopted compliance models which are based on a risk management approach and this approach is endorsed by the OECD. See OECD, 2004, *Compliance Risk Management: Managing and Improving Tax Compliance*. OECD, Paris available at <http://www.oecd.org/dataoecd/44/19/33818656.pdf> accessed 18 August 2008.

- a stronger foundation for evidence-based evaluation.”⁹

The Australian compliance model (see Figure 1)¹⁰ is typical of the models currently being operated by revenue authorities in many developed countries. The models are based on the premise that the revenue authority can influence behaviour through its responses and interventions. The focus is upon the causes rather than the symptoms of non-compliance, requiring an understanding of the business, industry, sociological, economic and psychological factors that drive taxpayer behaviour.

The model’s core principle is to make compliance (including access to entitlements and benefits) as easy as possible for those who want to comply. At the other end of the spectrum, the full force of the law is applied when taxpayers willfully seek to abuse the system.

FIGURE 1: THE AUSTRALIAN TAXATION OFFICE COMPLIANCE MODEL



The underlying assumption in the risk management approach is that all risks can be identified and measured to some extent. The reality is likely to be quite different. The discussion that follows serves to illustrate that there are many dimensions to compliance behaviour and that it is a complex and multi-dimensional problem. A standard solution to the problem has thus far proved to be elusive and it continues to pose a formidable challenge to tax administrators globally.¹¹

⁹ OECD, note 8 at p. 8.

¹⁰ Australian Taxation Office, *Compliance Program 2008-09*, Commonwealth of Australia, Canberra, available at <http://www.ato.gov.au/corporate/content.asp?doc=/content/00155156.htm&page=12&H12> accessed 29 August 2008.

¹¹ Brooks, N., 2001, 'Key Issues in Income Tax: Challenges of Tax Administration and Compliance', paper presented at Asian Development Bank 2001 Tax Conference, 8 September 2001, p.6; and more generally, Freedman, J. (Ed.), 2008, *Beyond Boundaries: Developing Approaches to Tax Avoidance and Tax Risk Management*, Oxford University Centre for Business Taxation, Oxford.

2.2 Understanding compliance behaviour

Over the last thirty years or so, a considerable body of literature has developed in the area of taxpayer compliance from which has emerged two significant and widely accepted findings. Firstly, taxpayer non-compliance is a continual and growing global problem that is not readily addressed. Secondly, despite a great deal of research emanating from a wide variety of disciplines, there is not a great deal of consensus about why people do, or do not, pay their taxes or otherwise comply with their tax obligations. Nonetheless, strategies to improve compliance need to be embedded in sound theory, so an understanding of the compliance literature is an important starting point for the revenue authority seeking to improve the efficiency of its collections.¹²

Models and theories of compliance behaviour tend to reflect one of three schools of thought commonly referred to as economic deterrence, social psychology, and fiscal psychology (the latter representing an evolution of the other two).

Economic deterrence models

Economic deterrence models¹³ in general are based on the theory that behaviour, in a wide range of contexts including tax evasion, is responsive to punishment or sanctions. Economic deterrence models tend to have a narrow, theoretical view of behaviour, reducing its dimensions to numerical measures and assigned probabilities from which outcomes can be predicted using calculus. In order to determine behaviour in this manner, economic deterrence models tend to rely upon a wide range of fundamental assumptions that are generally unrealistic. For example, that all people respond to a change in any one variable in an identical and predictable manner; that all taxpayers have a full knowledge of the probability of being audited; and that all taxpayers have the same level of risk preference. Although empirical testing has been limited, the theoretical principles of economic deterrence have been widely adopted by tax administrations in developing enforcement strategies that rely principally on penalties and the fear of getting caught.

There is evidence to support the relevance of deterrence strategies to addressing non-compliance, but it appears that their impact may not be captured by a single mathematical expression. For example, the fear of getting caught, or the probability of detection, has been found to be an effective strategy to induce truthful reporting where the assumption that taxpayers were risk neutral was relaxed.¹⁴ Further, in an Australian study it was found that individual tax evasion behaviour was not solely determined by the monetary value of expected gains, but that 'moral' factors also

¹² It is noted that while most of the research has been conducted in the context of income tax, there is no reason to suggest that the theories are not equally applicable to compliance in respect of other forms of taxation. For a recent study on the compliance behaviour of VAT taxpayers in Ethiopia see Yesegat, W., 2008 "Estimating VAT Administrative Costs in Ethiopia", in Walpole, M. and C. Evans (Eds), *Tax Administration: Safe Harbours and New Horizons*, Fiscal Publications, Birmingham, UK, pp. 377-400.

¹³ For example, see Becker, G., 1968, 'Crime and Punishment: An Economic Approach', *Journal of Political Economy*, Vol. 76, pp. 169-217; Allingham, M. and A. Sandmo, 1972, 'Income Tax Evasion: A Theoretical Analysis', *Journal of Public Economics*, Vol. 1, pp. 323-338.

¹⁴ See Reinganum, J. and L. Wilde, 1985, 'Income Tax Compliance in a Principal-Agent Framework', *Journal of Public Economics*, Vol. 26, pp. 1-18.

influenced this decision.¹⁵ These results suggest that the economic deterrence models have relevance to compliance behaviour, but that there are other influences to be considered.

Social psychology models

Social psychology models are concerned with the prediction and understanding of human behaviour, or how people make decisions, using a range of methodological approaches including compositional modeling, attribution theory and equity theory.

Compositional modeling is characterised by the view that individuals undertake deliberate and reasoned action according to their personal preferences.¹⁶ This approach assumes that people consider the implications of their actions before they decide, or form an intention, to engage or not engage in a given behaviour. Further, this approach assumes that intention directly translates into behaviour, without any further influences. The model then seeks to explain how intention is formed.

According to the theory of reasoned action, an individual's intention is a function of two basic determinants, one personal in nature and the other reflecting social influence. The personal factor is the individual's attitude toward the behaviour and is assumed to be either positive or negative. The second determinant of intention is the subjective norm, or the person's perception of the social pressures to perform or not perform the behaviour in question. Generally, individuals will intend to perform a behaviour when they evaluate it positively and believe that others (whose opinion they value) think they should perform it. In testing this theory in the context of tax evasion it was found that the intention to comply could be improved by directly communicating to taxpayers their personal and social responsibilities.¹⁷

Attribution theory is based on the assumption that individuals rationally interpret and analyse events in order to understand causal structures.¹⁸ People have internal (personal) and external (situational) attributes. In judging the behaviour of others, people will generally attribute the outcome as being caused by their own internal attributes. In judging their own behaviour, people tend to believe the cause is due to external attributes. For example, *he* is a tax evader because he is a bad person; *I* am a tax evader because the government wastes my taxes (and that's not *my* fault).

These social psychology models highlight the importance of equity theory in the study of compliance and taxpayer behaviour. Equity theory proposes that individuals are more likely to comply with rules if they perceive the system that determines those rules to be equitable. Where there are perceived inequities, individuals will adjust their inputs to the exchange until equity is restored. Based on equity theory,

¹⁵ Baldry, J., 1987, 'Income Tax Evasion and the Tax Schedule: Some Experimental Results', *Public Finance*, Vol. 42 No. 3, pp. 357-383.

¹⁶ Azjen, I. and M. Fishbein, 1980, *Understanding Attitudes and Predicting Social Behaviour*, Prentice Hall, Englewood Cliffs, NJ.

¹⁷ Cialdini, R., 1989, 'Social Motivations to Comply: Norms, Values and Principles', in: Roth, J. and J. Scholz (Eds) *Taxpayer Compliance Volume 2: Social Science Perspectives*, University of Pennsylvania Press, Philadelphia, pp. 200-227.

¹⁸ Kelley, H., 1973, 'The Processes of Causal Attribution', *American Psychologist*, (February), pp. 107-128; Hite, P., 1987, 'An Application of Attribution Theory in Taxpayer Noncompliance Research', *Public Finance*, Vol. 42 No. 1, pp. 105-118.

addressing inequities in the exchange relationship between government and taxpayers would result in improved compliance.¹⁹

Fiscal psychology models

Fiscal psychology models draw on both the economic deterrence and the social psychology models and generally view tax enforcement as a behavioural problem, one that can be resolved by co-operation between taxpayers and tax collectors. To obtain this co-operation, the role of the tax system itself in providing the positive stimulus (such as decreasing penalties) is emphasised. This stimulus is then expected to generate a more positive attitude in taxpayers that will in turn impact on their compliance decisions.

The fiscal psychology models place considerable emphasis on taxpayer attitude. It has been held that tax mentality, feelings of tax tension, and tax morale were the three psyches that together made up a taxpayer's attitude. The more positive the taxpayer's attitude towards paying tax the greater the level of co-operation with the tax authority and the greater the willingness to pay tax.²⁰ However, fiscal ignorance may be a negative influence on a taxpayer's attitude.²¹ Further, there is evidence to suggest that the threat of sanctions is a negative influence on taxpayers in low socio-economic groups and that appeals to conscience are less effective than the threat of sanctions on taxpayers in high socio-economic groups.²² It has also been found that in the case of taxpayers with low moral reasoning, appealing to their sense of morality is unlikely to be effective.²³ However, research has found that carefully tailored persuasive communication strategies can impact on taxpayer reporting, at least in the short-term.²⁴

Based on studies in Switzerland, Belgium and Spain, trust in the legal system, government, or parliament; national pride; and pro-democratic attitudes all have a positive effect on tax morale and support the finding that higher legitimacy for political institutions leads to higher tax morale.²⁵ Further, there is evidence, based on a study of 30 developed and developing countries, that tax compliance is highest in

¹⁹ Adams, J., 1965, 'Inequity in Social Exchange', *Advances in Experimental Social Psychology*, Vol. 2, pp. 267-299; Thibaut, J., Friedland, N. and L. Walker, 1974, 'Compliance With Rules: Some Social Determinants', *Journal of Personality and Social Psychology*, Vol. 30 No. 6, pp. 792-801; Spicer, M. and L. Becker, 1980, 'Fiscal Inequity and Tax Evasion: An Experimental Approach', *National Tax Journal*, June, pp. 171-175.

²⁰ Schmolders, G., 1970, 'Survey Research in Public Finance - A Behavioural Approach to Fiscal Theory', *Public Finance*, Vol. 25 No. 2, pp. 300-306; Hasseldine, J. and K. Bebbington, 1991, 'Blending Economic Deterrence and Fiscal Psychology Models in the Design of Responses to Tax Evasion: The New Zealand Experience', *Journal of Economic Psychology*, Vol. 12, pp. 299-423.

²¹ Lewis, A., 1979, 'An Empirical Assessment of Tax Mentality', *Public Finance*, Vol. 2, pp. 245-257.

²² Schwartz, R. and S. Orleans, 1967, 'On Legal Sanctions', *University of Chicago Law Review*, Vol. 25, pp. 274-300.

²³ Kaplan, S., Newberry, K. and P. Reckers, 1997, 'The Effect of Moral Reasoning and Educational Communications on Tax Evasion Intentions', *JATA*, Vol. 19 No. 2, pp. 38-54.

²⁴ Hasseldine, J., Hite, P., James, S. and M. Toumi, 2007, 'Persuasive Communications: Tax Compliance Enforcement Strategies for Sole Proprietors', *Contemporary Accounting Research*, Vol. 24 No. 1, pp. 171-194.

²⁵ Torgler, B. and F. Schneider, 2007, 'What Shapes Attitudes Toward Paying Taxes? Evidence from Multicultural European Countries', *Social Science Quarterly*, Vol. 88 No. 2, pp. 443-467.

the countries characterised by high control of corruption and low size of bureaucracy.²⁶

In a study by Song and Yarborough²⁷ it was assumed that a high level of tax ethics (on the part of taxpayers) was a prerequisite for a fair and successful tax administration, particularly one that was based largely on voluntary compliance. They argued that voluntary compliance was determined by three major factors: the overall legal environment, the citizen's tax ethics, and other situational factors operating at a particular time and place. It was found that people with higher income levels and high levels of education had higher ethics. However, the extent to which ethics (which could be aligned with intention under the theory of reasoned action) determines actual behaviour is unclear.

A study into the extent to which unfairness was the basic cause of dissatisfaction with the tax system in the State of Oregon found that fear of informal sanctions (from peers, from community and from the stress of getting caught) was one of the most powerful predictors of conformity with tax laws.²⁸ A study into income tax evasion in Australia found that 86 per cent of evaders surveyed considered that the level of income tax in relation to the level of government services was excessive. Further, the burden of tax was regarded as not shared fairly and the rates of tax were perceived to be too high.²⁹

In a US study into income tax compliance,³⁰ the effects of audit rates, penalties, other tax administration policies and socio-demographic factors on tax compliance were examined. It was concluded that an increased probability of audit, increased use of first and second notices of taxes due and increases in criminal penalties all generally led to increased level of compliance. Further, education of taxpayers appeared to increase compliance.³¹ Results in respect of enforcement were mixed, but they did indicate that increased levels of activity in these areas were associated with decreased rather than increased compliance. Dubin³² studied the impact of criminal investigations (in the case of money laundering) on taxpayer compliance and found that they have a positive effect on general deterrence. For those taxpayers engaged in illegal activities, the threat of imprisonment was found to be a more effective deterrent than were monetary penalties. Further, Dubin argues that the media can play an important role in disseminating information to the public and thereby improving

²⁶ Picur, R. and A. Riahi-Belkaoui, 2006, "The Impact of Bureaucracy, Corruption and Tax Compliance", *Review of Accounting and Finance*, Vol. 5 No. 2, pp.174-180.

²⁷ Song, Y. and T. Yarbrough, 1978, 'Tax Ethics and Taxpayer Attitudes: A Survey', *Public Administration Review*, (September/October), pp. 442-452.

²⁸ Mason, R. and L. Calvin, 1984, 'Public Confidence and Admitted Tax Evasion', *National Tax Journal*, 37(December), pp. 489-496.

²⁹ Wallschutzky, I., 1985, *Taxpayer Attitudes to Tax Avoidance and Tax Evasion*, Australian Tax Research Foundation, Sydney.

³⁰ Witte, A. and D. Woodbury, 1985, 'The Effect of Tax Laws and Tax Administration on Tax Compliance: The Case of the US Individual Income Tax', *National Tax Journal*, Vol. 38, pp. 1-15.

³¹ For evidence of the importance of education in improving voluntary compliance in Malaysia at the time of introducing self assessment see Loo, E.C. and J.K. Ho, 2005, 'Competency of Malaysian Salaried Individuals in Relation to Tax Compliance Under Self Assessment', *eJournal of Tax Research*, Vol. 3 No. 1, pp. 47-64.

³² Dubin, J., 2004, "Criminal Investigation Enforcement Activities and Taxpayer Noncompliance", paper presented at 2004 IRS Research Conference, Washington D.C., June.

voluntary compliance. This concept is referred to by Alm *et al*³³ as the indirect deterrent effect of audit. Alm *et al* found that ‘unofficial’ communications have a strong indirect effect that increases compliance, but that “official” communications may not encourage voluntary compliance.

Smith and Kinsey developed a useful conceptual framework of tax compliance that incorporated three key points: in a complex tax system, compliance was as problematic as non-compliance; individuals have different opportunities for performing particular acts; and that tax behaviour did not necessarily involve conscious decisions.³⁴ It was argued that the assumption that had dominated earlier models, that non-compliance was a result of considered choices and conscious decisions by taxpayers, was neither appropriate nor needed. Some compliance may be unintentional, simply the result of indifference or habit. It was recognised that the strategies utilised to reduce intentional non-compliance may not be the most effective strategies to reduce unintentional non-compliance. This argument, viz. that compliance and non-compliance could not be understood as unitary phenomena, and therefore policy and enforcement strategies would be more effective if directed to address specific compliance behaviour, has continued to be reinforced in the literature.³⁵

Clearly, understanding taxpayer compliance remains a challenging and unresolved problem. A large part of the problem appears to have been the search for one overarching model of taxpayer compliance that allowed predictions to be made about the taxpaying population as a whole. Realistically, the later typology-type fiscal psychology models offer more guidance for revenue authorities seeking to improve voluntary compliance in a dynamic environment. That is, different strategies are more appropriate for different types of taxpayers, but that an understanding of the various types of taxpayers underpins the choice of strategies. Again, this approach is consistent with the tax risk management approach advocated by the OECD and is practised today by many leading tax administrations.³⁶ However, as noted by Kornhauser in the context of the United States, further behavioural research is still needed and together with educational efforts aimed at all segments of the population to improve taxpayer knowledge, attitudes and behaviour, holds much promise for improving voluntary compliance.³⁷ These needs are not unique to the United States and could be said to be equally applicable to any tax administration, and particularly those that rely on self assessment.

³³ Alm, J., Jackson, B. and M. McKee, 2004, ‘Audit Information Dissemination, Taxpayer Communication and Compliance: An Experimental Approach’, paper presented at 2004 IRS Research Conference, Washington D.C., June.

³⁴ Smith, K. and K. Kinsey, 1987, ‘Understanding Taxpaying Behaviour: A Conceptual Framework with Implications for Research’, *Law and Society Review*, 21(4), pp.639-663.

³⁵ See Kidder R. and C. McEwen, 1989, ‘Taxpayer Behaviour in Social Context: A Tentative Typology of Tax Compliance and Noncompliance’, in J. Roth and J. Scholz (Eds) *Taxpayer Compliance Volume 2: Social Science Perspectives*, University of Pennsylvania Press, Philadelphia, pp.47-75; and Kirchler, E., Hoelzl, E. and I. Wahl, 2008, ‘Enforced Versus Voluntary Tax Compliance: The “Slippery Slope” Framework’, *Journal of Economic Psychology*, Vol. 29, pp. 210-225.

³⁶ OECD, note 8.

³⁷ Kornhauser, M., 2007, ‘A Tax Morale Approach to Compliance: Recommendations for the IRS’, *Florida Tax Review*, Vol. 8 No. 6, pp. 599-640.

2.3 Challenges for policymakers

What emerges from the literature is that there are no quick fixes to improving taxpayer compliance. Instead, what is required is a concerted, long-term coordinated and comprehensive plan that uses a complimentary range of policy instruments underpinned by a solid legal base.³⁸ This highlights the importance of tax policy and other aspects of tax systems design that provide the framework within which the revenue authority has to perform its responsibilities. In reality it makes sense for policymakers to identify and address the underlying and systemic challenges of their tax systems before the respective revenue authorities considers how to manage their resources and discharge their responsibilities.

Simple policy (or at least as simple as possible) needs to have clearly articulated objectives and be integrated with other aspects of the tax system. In developing policy, the application of the policy must be considered and this will require consultation with its intended users and drafters. Policymakers need to consider the volume of legislation and the rate of change as complicating factors and seek to minimise them (for example, by moving away from 'black letter' law). Simple policy must then be translated into legislation, the purpose of which must be transparent and clearly communicated to the drafters. The drafters must then produce legislation that users (including taxpayers, tax administrators and the judiciary) can apply efficiently, consistently and with certainty. In doing so, both compliance and administrative costs can be minimised and simplicity best achieved.

In terms of practice, Arnold³⁹ described the integrated policy of the formulation of tax policy as having three major components – policy development, technical analysis and statutory drafting – and argued that the three functions are so closely interrelated that the entire process would suffer if performed by different parts of the government bureaucracy. However, the tax policy function should be separated from the tax administration and enforcement function (but there needs to be effective communication). Separation of policymakers and tax collectors results in a system of checks and balances which protects the interests of taxpayers and the government. There is a danger that policymakers are often so taken with the theoretical purity of their proposals that they do not pay sufficient attention to the compliance and administrative aspects of the proposals. Approaches to simplify tax law that have failed in developed economies (such as Australia, the United States and the United Kingdom) have done so because they did not adequately develop tax policy in the context of wider economic reforms.⁴⁰

In the case of developing economies undertaking tax reform, Bird and Casanegra de Jantscher argue the need to have a strategy or comprehensive plan that assigns clear priorities to the tasks that must be performed, tailored to the available resources. The scarcity of resources is a common constraint and reform strategies that require

³⁸ Brooks, note 11.

³⁹ B. Arnold, 1990, 'The Process of Tax Policy Formulation in Australia, Canada and New Zealand', *Australian Tax Forum*, Vol. 7, pp. 379-394.

⁴⁰ McKerchar, M., Meyer, K. and S. Karlinsky, 2006, 'Making Progress in Tax Simplification: A Comparison of the United States, Australia, New Zealand and the United Kingdom' in McKerchar, M. and M. Walpole (Eds), *Further Global Challenges in Tax Administration*, Fiscal Publications, Birmingham, UK, pp. 367-383.

substantial additional administrative resources are doomed to failure simply because the resources are unlikely to materialise fully or in a timely fashion. Instead, more efficient alternatives (such as eliminating unproductive tasks or simplifying procedures) need to be pursued.⁴¹ Further, Bird and Casanegra highlight the importance of a robust management information system together with the streamlining of systems and procedures in reforming tax administration.⁴²

This part of the article has identified broadly and generally many of the tax compliance issues affecting taxpayers, revenue authorities and tax policymakers today. This now leads to the identification of the full range of compliance challenges that developing economies are currently facing and underpin the development of suggestions to deal with those compliance challenges.

3 STRATEGIES TO IMPROVE TAXPAYER COMPLIANCE

3.1 Underlying propositions

What can be done to improve tax compliance in the context of developing economies? In the first place, there are a series of key high level and strategic propositions that must underpin the development of appropriate compliance strategies at the operational level. These propositions are summarised for convenience here.

Proposition 1: *the legitimacy and credibility of the revenue authorities need to be established and enhanced as part of a broader consensual revenue-bargaining arrangement between government and its citizens.*

This goes to the heart of good governance. Bird et al⁴³ conclude that a more legitimate and responsive state is likely to be an essential precondition for a more adequate level of tax effort in both developing and high income economies. This is also the key message from a number of other commentators, including Brautigam et al⁴⁴, who note that "...authority, effectiveness, accountability and responsiveness [are] closely related to the ways in which governments are financed. It matters that governments tax their citizens rather than live from oil revenues and foreign aid, and it matters how they tax them. Taxation stimulates demand for representation, and an effective revenue authority is the central pillar of state capacity."

The consensual relationship between the state and society is critical in a number of ways. "The attentions and political energies of a substantial fraction of citizens in taxation issues [are engaged] by raising taxes from them. The felt experience of paying taxes should not be confined to small numbers of companies and very rich

⁴¹ Bird and de Jantscher, note 5, p. 6.

⁴² Bird and de Jantscher, note 5, p. 9. It is noted that in developing countries tax administration is tax policy (Casanegra de Jantscher (1990, p. 179) cited at p. 1).

⁴³ Bird, R., Martinez-Vazquez, J. and B. Torgler, 2008, "Tax Effort in Developing Countries and High Income Countries" *Economic Analysis and Policy*, pp. 55-68.

⁴⁴ Brautigam, D., Fjeldstad, O-H and M. Moore (Eds), 2008, *Taxation and State-Building in Developing Countries: Capacity and Consent*, Cambridge University Press, Cambridge, at p. i.

people”.⁴⁵ And those taxes need to be raised as consensually and as transparently as possible.

Proposition 2: *the goals and objectives of tax reform need to be clearly articulated and the tax policy settings need to match those goals.*

It may be obvious that “good tax policy influences economic development”⁴⁶, but that does not detract from the importance of the statement. Having a clear vision of where the tax reform is supposed to lead and then getting the tax policy settings right is absolutely critical to the success of tax reform, and a precondition for enhanced compliance activity.

Mainstream thinking on the point suggests that tax reform in developing economies usually involves a broad simplification of the tax system incorporating simpler taxes, policies and processes. In short: fewer taxes; the use of broad based taxes with lower rates; a shift in emphasis from direct taxes to indirect taxes; a reduction in the number of tax incentives and tax expenditures; the elimination of multiple taxation by various tiers of government; and consolidation and centralisation of political and administrative responsibility for taxes and the administration of the tax system.

Proposition 3: *A risk management approach to taxpayer compliance is vital and should in turn underpin resource allocation decisions.*

Resources are not infinite and therefore risks to the revenue need to be prioritised and continually reassessed. Adopting a risk management approach means that the revenue authorities need to understand their taxpayers and create appropriate typologies. Different strategies are needed to address different types of compliance behaviour, and a variety of audit strategies will need to be developed according to risk assessment and resource availability. There is a need for on-going research to understand taxpayer morale and to monitor the impact of the various strategies that are employed. All of this has implications for the introduction of appropriate management information systems and infrastructure within the revenue authorities.

3.2 Compliance strategies

Based on these three propositions, the following, more specific, compliance strategies can begin to address the needs of revenue authorities in developing countries at the operational level and allow them to move away from their current sub-optimal performance levels. The strategies are grouped into four broad categories: creating a more effective tax administration; fostering voluntary compliance and enhancing taxpayer morale; strengthening and enforcing compliance; and tackling the shadow economy. Note that in practice the categories and strategies are not as discrete or

⁴⁵ Fjeldstad, O-H and M. Moore, 2008, ‘Tax Reform and State-Building in a Globalised World’, in Brautigam, D., Fjeldstad, O-H and M. Moore (Eds) *Taxation and State-Building in Developing Countries: Capacity and Consent*, Cambridge University Press, Cambridge, pp. 235-260, p. 255. The authors note that figures provided by the Tanzanian Revenue Authority relating to June 2005 show that in that country, with a total population of more than 35 million people, almost 70% of domestic taxes were raised from just 286 large taxpayers (p. 256).

⁴⁶ Bahl and Bird, note 3 at p. 288.

compartmentalised as suggested in the article – they are of necessity interdependent, with all feeding into each other and off each other.

3.2.1 Creating a more effective tax administration

An effective tax administration is obviously critical to enhanced compliance outcomes in the four key areas of service, education, verification and enforcement. Without this vital ingredient the major compliance risks relating to taxpayer notification and registration, return filing, correct reporting and accurate and timely tax payment cannot be overcome. There are a number of possible strategies that can help to achieve a more effective tax administration, including strategies related to: organisational and institutional reform; management strengthening; nuts and bolts reform; and building integrity and tackling corruption.

Organisational and institutional reforms

Autonomous revenue authorities

In recent years many developing countries have established their tax departments into autonomous or semi-autonomous revenue authorities (“ARAs”). It has been a noticeable world-wide trend, with some suggestions that the World Bank has, upon occasions, “been a persuasive salesman”.⁴⁷ As of March 2006 Fjeldstad and Moore note that there were about 30 ARAs in the developing world, largely in Africa and South America and including Uganda (1991), Kenya (1995), South Africa (1997), Ethiopia (2002) and Gambia (2005).

The defining feature of an ARA is some degree of autonomy whereby the revenue collection function is removed, either partly or wholly, from the Ministry of Finance. The management of the ARA therefore has significant independence in financial, personnel and operational matters, but is accountable for delivering agreed results, with continuation of appointment and renewal of contract for top management dependent upon revenue administration performance.⁴⁸ These independent revenue agencies, it is argued, are thus more able to provide better pay and other incentives to their staff while also imposing greater accountability for performance.⁴⁹ Taliercio argues that if one compares the pre- and post- reform state of affairs in countries where ARAs have been introduced, there is improvement in most cases along most dimensions of performance. Moreover, he suggests, the relatively more autonomous revenue authorities (such as Peru, Kenya and South Africa) have been more adept at increasing performance than the less autonomous ones (such as Uganda, Mexico and Venezuela).⁵⁰

Others are more circumspect. Gallagher notes that the jury is still out,⁵¹ while Fjeldstad and Moore suggest that many of the perceived advantages may have been

⁴⁷ Fjeldstad and Moore, note 45 at p. 249.

⁴⁸ Gill, J., 2003, “The Nuts and Bolts of Revenue Administration Reform”, World Bank, available at <<http://siteresources.worldbank.org/INTTPA/Resources/NutsBolts.pdf>> accessed 21 July 2008.

⁴⁹ Gallagher, M., 2005, “Benchmarking Tax Systems”, *Public Admin. Dev.* 25, pp. 125-144 at p. 130.

⁵⁰ Taliercio, R., 2004, “Designing Performance: The Semi-Autonomous Revenue Authority Model in Africa and Latin America”, Policy Research Working Paper 3423, World Bank, October.

⁵¹ Gallagher, note 49 p. 133.

short term and identify a number of conceptual and practical problems with ARAs that suggest they are not always the panacea that the World Bank may have suggested.⁵²

Organisational options

Regardless of whether the revenue authority is constituted as an autonomous or semi-autonomous body, the way in which it is internally organised can have a significant impact upon the effectiveness of the tax administration. “A well-designed organizational structure can provide a foundation for effective tax administration, which minimizes tax evasion opportunities and fosters voluntary compliance”.⁵³

Traditionally three separate models for the organisation of revenue authorities have been suggested both in the broader organisational theory literature⁵⁴ and in more specific literature relating to tax administration:⁵⁵

- product-based, relating to the type of tax (income tax, VAT etc) administered by the revenue authority;
- functional, relating to the different administrative functions performed by revenue authorities such as processing tax returns, or auditing, or collecting taxes; and
- client-based, relating to the different types of taxpayer according to criteria such as scale of operation (large, small etc), form of ownership or industrial/economic sector.

Sometimes, revenue agencies adopt a fourth approach, involving some combination of these three models, often referred to as a matrix approach. There are obvious advantages and disadvantages of each of the three principal approaches, as summarised in Table 1.

Developing countries have tended to move away from product-based structures built upon different types of tax to those which are based upon function, although often with elements of a client-based market segmentation approach also in evidence (for example, the introduction of large taxpayers units focusing upon the large companies which are often responsible for a disproportionate amount of revenue collections; or the introduction of industry-based organisational structures).⁵⁶ In this way they have been able to secure the advantages of improved accountability and control, enhanced compliance, better administrative efficiency, reduced corruption and more customised taxpayer service.

⁵² Fjeldstad and Moore, note 45 at pp. 249-255.

⁵³ Vehorn, C. and J. Brondolo, 1999, ‘Organizational Options for Tax Administration’, paper presented at 1999 Institute of Public Finance Conference, Zagreb, June.

⁵⁴ For example, Hodge, B., Anthony, W and L. Gales, 1996, *Organization Theory: A Strategic Approach*, Prentice Hall, New Jersey, 5th edition.

⁵⁵ Vehorn and Brondolo, note 53.

⁵⁶ Vehorn and Brondolo, note 53 at p. 21; Gallagher, note 49, at p. 133; and Fjeldstad and Moore, note 45, at p. 248.

TABLE 1 SUMMARY OF ADVANTAGES OF DIFFERENT ORGANISATIONAL MODELS

Criterion (Advantage)	Organisational model		
	Product-based/ type of tax	Functional	Client-based/ Type of taxpayer
Establishes clear accountability within organisation and control for each tax	Yes	Yes	Yes
Improves opportunity for compliance by taxpayers	Neutral	Yes	Neutral
Enhances quality of taxpayer service	Yes	No	Yes
Permits different administrative procedures for different taxes	Yes	No	No
Produces lower administrative costs and high staff productivity (less duplication)	No	Yes	No
Imposes lower compliance costs on taxpayers	No	No	Yes
Reduces opportunities for collusion and corruption	No	Yes	No

Based upon Vehorn, C. and J. Brondolo, 1999, 'Organizational Options for Tax Administration', a presented at 1999 Institute of Public Finance Conference, Zagreb, June.

Management strengthening:

Gill has noted that “[t]he quality and continuity of leadership of the [revenue administration] reform effort is a major determinant of success. Senior managers should be selected carefully.... Efforts should be made to minimize changes as these have a disruptive effort on the reform process”.⁵⁷ Those senior managers carry the main burden of “setting strategic goals; formulating operational policy; managing financial, human, information and physical resources effectively; supervising, monitoring and evaluating performance; improving coordination, anticipating and resolving operational problems; enforcing internal control systems; preventing corruption; improving mechanisms to redress taxpayer grievances; and interacting with external stake-holders”.⁵⁸

Unfortunately the importance of a strong and continuing management team – often necessarily supported by political champions and mentors – has been under-

⁵⁷ Gill, note 48 at p. 21.

⁵⁸ Gill, note 48 at p. 12.

emphasised in many countries, with the result that weak management teams and perverse management practices have been allowed to continue to the detriment of the development of a changed culture.

Nuts and bolts reform

In addition to the need for organisational change and management strengthening, there are many other more mundane, but nevertheless vital, changes that can help to create a more effective and efficient tax administration, thereby enhancing the revenue authority's capacity to enhance voluntary compliance and strengthening its ability to enforce compliance. These "nuts and bolts" reforms include strategies relating to areas such as taxpayer registration and verification.

Registration

A clean and up to date automated taxpayer registration system, involving a directory of all taxpayers in the country, along with unique identifiers (TINs), addresses and contacts details, legal residence, economic activities and links to other asset ownership such as land, vehicles and bank accounts, is an essential foundation for any compliance strategy. "The taxpayer registry is the backbone of all tax administrations",⁵⁹ and should have easy and automatic links to the rest of the tax administration's systems. It is the basis upon which the tax administration communicates with the taxpayer and advisers, maintains tax filing and tax payment records, and it also feeds naturally into the verification and risk profiling processes discussed later.

An efficient registration system also allows automated default systems to leverage off the central system. This may involve the automatic detection of "stop filers", non-filers and taxpayers who have not paid the full taxes shown as due in their tax returns.⁶⁰ For example, Gallagher notes that in many developing economies, seemingly unexplainable drops in fiscal revenues have resulted solely due to the fact that taxpayers have found that they can simply stop filing their VAT declarations with impunity. He therefore suggests that tax administrations should have automated notification and follow-up systems that immediately remind taxpayers of their responsibility to file and pay their tax obligations.⁶¹

Many developing economies (and most developed) have introduced unique Taxpayer Identification Numbers ("TINs") as a means of ensuring registration by taxpaying units (whether individuals or corporates). This is a strategy facilitated by the development and spread of digitalisation and communication technologies.⁶² The existence of a TIN "forms the basic building block for revenue administration IT systems, as it allows connecting taxpayers to their returns, payments and major taxable transactions with third parties".⁶³ Field surveys to detect unregistered taxpayers, as well as extensive publicity campaigns, have often accompanied the introduction of TINs.

⁵⁹ Gallagher, note 49, p. 139.

⁶⁰ Gill, note 48, p. 16.

⁶¹ Gallagher, note 49, p. 137.

⁶² Fjeldstad and Moore, note 45, pp. 247-248.

Verification

The verification process involves data gathering, analysis and matching, together with appropriate risk analysis and profiling, in order to establish which taxpayers are likely to be the greatest compliance risks, and where scarce resources should therefore be concentrated in the audit and investigation phase.

Verification activities need to vary according to the type of taxpayer and level of risk involved. Data collection, or intelligence gathering, should be from as wide a range of relevant sources as possible, including internal sources (central registry, tax returns, information about other taxes etc) and external or third party sources (such as financial institutions, government agencies, trade associations, other businesses and information from other taxpayers). Data analysis needs to be undertaken on an ongoing basis to inform and refine the understanding of the taxpayer base and the types of compliance behaviour exhibited.

One of the key aspects in ensuring compliance is the need to build and analyse risk profiles based upon the characteristics of the taxpayer concerned (past compliance behaviour, transaction patterns) and external factors such as data matching of third party information, understanding of industry norms, and even such factors as past behaviour of tax advisers used. Where inconsistencies and other risks are identified, audit or other appropriate action can be instigated.

Building integrity and tackling corruption

The integrity of its staff and systems is a vital component of any effective revenue administration, and yet – as Bahl and Bird point out – corruption and taxation have always been associated in history – and not just in developing countries.⁶⁴ It would be naïve to believe that corruption is not a serious issue in most developing economies – indeed Uche and Ugwoke noted in 2003 in relation to Nigeria that “[t]he major threat to the effective administration of VAT in Nigeria...is the widespread corruption and indiscipline which are deeply entrenched in all aspects of the country’s social and economic life”.⁶⁵

Corruption may be systematic – involving groups of employees acting together in a corrupt fashion and often led by senior staff – or individual; and may or may not involve external “clients”. Examples are not difficult to cite: charging for services that should be free; diverting cash; making false repayment claims; losing files; and receiving payments to complete tax returns or bribes to favorably settle audits. And corruption is not limited simply to tax activities – it can also include abuses of power such as theft or private use of goods like office equipment; fraudulent subsistence and travel allowance claims; and stealing time to pursue outside interests and/or employment.⁶⁶

⁶³ Gill, note 48 at p. 14.

⁶⁴ Bahl and Bird, note 3, p. 291, citing Webber, C. and A. Wildavsky, 1986, *A History of Taxation and Expenditure in the Western World*, Simon and Schuster, New York.

⁶⁵ Uche, C. and O. Ugwoke, 2003, “The Law and Practice of Value Added Tax in Nigeria”, *IBFD Bulletin*, June, pp. 265-272, p. 272.

⁶⁶ Child, D., 2008, ‘Key Steps to Address Corruption in Tax and Customs’, *U4 Brief No. 15*, Chr. Michelsen Institute, May, available at www.u4.no/themes/pfm accessed 18 August 2008.

The consequences of corruption are obvious. It is a cancer that destroys the organisation itself and undermines all other aspects of society. It erodes confidence in the tax system and encourages evasion. It increases the costs of doing business and distorts the level playing field that should be available. And to the extent that there is a political limit as to the amount of tax that people will bear in a developing countries (and that there is therefore a substitution effect between taxation and corruption), it reduces the amount of formal tax that can be collected.⁶⁷

A number of strategies to combat or address the issues of corruption in a revenue authority have been identified in the literature.⁶⁸ These include:

Corruption risk mapping

The preparation of “Corruption Risk Maps”, designed to guide procedural changes to reduce opportunities of corruption, is a useful starting point for any revenue agency determined to tackle problems of corruption. In Columbia this strategy was successfully employed, based upon an initial systematic study of important business processes, to address the vulnerable points in the systems and identify optimal strategies for dealing with each.⁶⁹

Recruitment policies and practices

Staff need to be carefully recruited on merit based selection principles, and remunerated at levels which are at least comparable to equivalent positions in banking and the accounting profession, have access to carefully developed in-house and external training possibilities and have realistic opportunities for career and income progression.

Ethical policies and practices

Staff must be aware of the importance of integrity at both the personal and organisational levels, and policy and practice must reflect this. It is not sufficient merely to introduce ethical “Codes of Conduct”, sets of internal disciplinary rules and instruments such as “Taxpayers’ Charters”; they also need to be shown to be “living” documents that inform everyday activity and decision-making. Other practical measures include asset declarations for all staff, and the availability of avenues for whistle blowing (including protection from disclosure after the event). Collier et al, in an Indonesian context, identified that the establishment of peer learning groups in the workplace considerably enhanced and reinforced ethical behavior and reduced corruption in a revenue authority when allied to internal training on the topic. The groups comprised a small number of trainees who maintained contact and reinforced communities of ethical practice in a variety of ways, including face to face meetings, and SMS and email groups, during and after the delivery of the training.⁷⁰

⁶⁷ Bahl and Bird, note 3, p. 291.

⁶⁸ See, for example, Bahl and Bird, note 3, p. 291, and Child, note 66.

⁶⁹ Gill, note 48, p. 13.

⁷⁰ Collier, K., Rokhman, A., Ayuandini, S. and P. Kurniawan, 2007, ‘Using ‘Workplace Learning Groups’ — A Peer-Learning Approach — in the Indonesian Tax Office to Encourage Workplace Learning and Support Cultural Change within the Organisation’. Paper presented at the *Researching Work and Learning Conference 5*, Cape Town, South Africa, December.

Internal controls and deterrence

Strong internal controls are an essential part of any strategy designed to address corruption in a revenue authority. Child notes that managers must be proactive and conduct desk and office inspections, and design procedures and systems that deter integrity lapses and make them easier to spot.⁷¹ Other examples include restricting access by taxpayers to designated taxpayer service areas so that they cannot access other revenue authority work spaces; restricting access by employees to scanned copies of original records to prevent tampering; creating audit trails of administrative decisions and changes made to taxpayer current accounts; and separating the functions of assessing and collection in order to reduce opportunities for corruption and collusion.⁷²

In addition, an effective internal investigation force, combined with severe penalties (including dismissal and prosecution) for malfeasance and a strong likelihood of detection, will inevitably reduce the incidence of corruption. “To the extent corruption follows an economic calculus, the expected value of the outcome of taking a bribe may be heavily influenced by the chances of getting caught and being heavily penalized”.⁷³

Statutory changes

Statutory changes to increase transparency, remove discretion and simplify the law can make a significant contribution to the enhancement of the integrity of the operation of the revenue authority. Where the structure of a particular tax is as transparent as possible, and obligations and liabilities are clearly stated, taxpayers will be less likely to be cheated. Bahl and Bird note that “[n]othing good can come of a situation in which tax administrators and tax payers negotiate over how large the tax liability should be. One problem in the practice of income taxation in developing countries is that, apart from withheld taxes, tax liabilities are, in fact, often negotiated”.⁷⁴

Minimise taxpayer/revenue agency interaction

The higher the level of contact and interaction between tax officials and taxpayers, the greater the scope for corruption and collusion. Therefore minimising that contact through the use of self-assessment, withholding taxes and the like can be an effective strategy. Gill identifies examples from Latvia and Russia where work processes were modified to reduce interaction between tax officials and taxpayers⁷⁵, and Bahl and Bird note that VAT and payroll taxes tend to score relatively high in this respect.⁷⁶

⁷¹ Child, note 66.

⁷² Gill, note 48, p. 13.

⁷³ Bahl and Bird, note 3, p. 291.

⁷⁴ Bahl and Bird, note 3, p. 291.

⁷⁵ Gill, note 48, p. 13.

⁷⁶ Bahl and Bird, note 3, p. 291.

Reduce compliance costs

Compliance costs for taxpayers in developing countries are four to five times higher than those in developed countries.⁷⁷ This therefore suggests that reducing compliance costs “lowers the amount of bribe a (rational) taxpayer might be willing to pay to avoid the declaration and payment process”.⁷⁸

One strategy that does not appear to have been successful in combating corruption is the privatisation or outsourcing of the tax collection function. Tax farming (the process where the right to collect tax is auctioned off to a private agent in exchange for a fixed sum payable in advance) and tax sharing (whereby private agents collect taxes, with the right to keep a share of the total collection) have often been introduced with the objective of reducing administrative costs and increasing the level and reliability of collections.⁷⁹ The examples of outsourcing of some local authority tax collection in Tanzania and Uganda suggest that they may sometimes have succeeded in increasing revenue collections, but that the levels of corruption have also increased.⁸⁰

3.2.2 Fostering voluntary compliance

In 2004 the OECD suggested that “[c]ompliance is most likely to be optimised when a revenue authority pursues a citizen-inclusive approach to compliance through policies that encourage dialogue and persuasion, combined with an effective mix of incentives and sanctions”.⁸¹ This section of the article focuses upon the voluntary aspects of this broad compliance strategy, while Section 3.2.3 turns to the sanction-based enforced elements.

Gill notes that voluntary tax compliance does not have a long history in many developing economies.⁸² Nonetheless, this has been an area where significant developments have taken place in recent years. There has been a “very substantial shift in the attitudes of tax administrations towards taxpayers”.⁸³ Based in large part on the literature on compliance explored in Section 2 of this article, tax administrations have come to recognise that that a cooperative and positive engagement with taxpayers and their advisers in a customer-service focused and user-friendly environment will be more productive and efficient than more traditional adversarial and antagonistic approaches.

⁷⁷ Evans, C., 2003, “Studying the Studies: An Overview of Recent Research into Taxation Operating Costs”, *eJournal of Tax Research*, Vol. 1 No. 1, pp. 64-92.

⁷⁸ Bahl and Bird, note 3, p. 291.

⁷⁹ Joshi, A and J. Ayee, 2008, ‘Associational Taxation: A Pathway into the Informal Sector’, in Brautigam, D., Fjeldstad, O-H and M. Moore (Eds) *Taxation and State-Building in Developing Countries: Capacity and Consent*, Cambridge University Press, Cambridge, pp. 183-211, p. 190.

⁸⁰ Bahigwa, G., Ellis, F., Fjeldstad, O-H. and V. Iversen, 2004, ‘Uganda Rural Taxation Study’, Report commissioned by DFID Uganda, Economic Policy Research Centre, Kampala; and Kobb, D. 2001, ‘Corruption in Tanzania: An Application of Tax Farming’ Mimeo, Tanga Tanzania and KKonsult USA.

⁸¹ OECD, 2004, note 8, p. 48.

⁸² Gill, note 48, p. 13.

⁸³ Fjeldstad and Moore, note 45, p. 248.

As a result, the strategies designed to foster voluntary compliance have taken two broad and mutually supportive directions: building positive taxpayer and tax community morale; and making compliance easier and cheaper for taxpayers.

Building positive taxpayer and tax community morale

Enhanced compliance, the literature tells us, is likely to occur where fiscal ignorance is tackled and reduced, where taxpayers feel that they are getting a fair deal from the exchange relationship with the state, where the environment is cooperative and where positive attitudes towards taxation are nourished. Taxpayers, and potential taxpayers, need to be aware of the general concept of taxation and why they should pay taxes.

Based upon this analysis, revenue authorities in many countries have undertaken community awareness campaigns. Some revenue authorities have been very creative in raising awareness of the value of the social exchange and contract between taxpayer and state, using TV skits; radio programs; competitions to create advertisements displayed on buses; school plays on tax issues; fairy tales spun around tax compliance; and the incorporation of tax themes in school curricula, in collaboration with Ministries of Education.⁸⁴ The South African Revenue Service widely advertises that “your taxes paid for this road/school/hospital”⁸⁵ while the Australian Taxation Office (“ATO”) used, for a long time, the slogan “Building a Better Australia”.

The focus is not just on the relationship between the tax authority and the taxpayer. The relationship between the tax authority and tax practitioners, industry associations, trade unions and other community groups can be just as important. The OECD recognises, correctly, the importance of building community partnerships, and that “[a]lliances with trusted intermediaries may be crucial to challenging community or industry attitudes and influencing taxpayer behaviour. Network alliances allow for the development of an integrated approach to addressing compliance issues and mutual support which greatly increase the chances of success of any given strategy”.⁸⁶

Making it easier and cheaper to comply

On the assumption that many, if not most, taxpayers wish to comply with their tax obligations (within cultural and social norms), efforts are being made in many revenue authorities to make it easier and cheaper for taxpayers to comply. The strategies that can help to achieve this can be broken down into three main groups.

Consultation/collaboration and co-design

This is a current mantra of the ATO, but it also adequately summarises the importance of any revenue authority ensuring that it adopts an “empathetic, user-based approach [that] ensures administrative solutions are designed around what works for the community”.⁸⁷ In order to make it easier and cheaper to comply, it is important that registration, reporting, filing, record-keeping and payment processes work, so far as possible, in harmony with the ways in which taxpayers and their advisers operate.

⁸⁴ Gill, note 48, p. 14.

⁸⁵ Fjeldstad and Moore, note 45, p. 248.

⁸⁶ OECD, 2004, note 8, p. 56.

⁸⁷ Australian Taxation Office, note 10, p. 6.

Research consistently shows that the burden of tax compliance is significant and that it falls more heavily on small businesses than on large businesses (compliance costs are regressive).⁸⁸ This has prompted authorities to increase efforts to simplify compliance requirements, including exploring ways of more closely aligning tax reporting to the natural systems businesses use for their own banking, accounting and financial reporting. Such initiatives have the potential to save businesses time and cost and improve the reliability of information received by the authority.⁸⁹

Thus, for example, where possible it makes sense to leverage monthly, quarterly and annual payments of tax by business taxpayers off naturally occurring internal business processes rather than imposing upon business an additional burden that is forced to exist independent of business need. But where that is not possible, it also makes sense to engage with business taxpayers and their professional advisers and associations to establish whether, with suitable business process re-engineering, outcomes that work to the benefit of both business and the revenue authority can be developed.

Many revenue authorities, including the ATO and the New Zealand Inland Revenue, seriously and positively engage with the tax community to identify and implement policies, systems and processes that can assist taxpayers in complying with their obligations in as easy and simple and inexpensive a manner as possible. The benefits of consultation, collaboration and co-design will always far outweigh the costs involved.

Making taxpayer obligations clear

The OECD has pointed out that “[i]f taxpayers do not understand what their obligations are, any intervention to enforce compliance will be perceived as unfair”.⁹⁰ It is therefore vital to make taxpayers’ obligations clear – in the sense of being transparent, easy to understand, simple and non-confusing. The OECD goes on to suggest that the following issues need to be considered:

- is the law clear? If not, is an amendment or additional legislation required?
- are the authority’s administrative requirements clear?
- are clear interpretative products, such as interpretive rulings, readily accessible?
- are there clear information products available, at relevant levels of detail, in the language of the taxpayer? Are these products accessible in the taxpayers’ channels of choice (e.g. web-based, paper-based, CD-Rom)?
- has there been adequate communication and marketing of the information available? Has this included publication in relevant industry or community vehicles?
- are effective support services available to meet taxpayers’ needs? (e.g. telephone enquiry services, web services, educational field visits etc)

⁸⁸ Evans, note 77.

⁸⁹ OECD, 2004, note 8, p. 49.

⁹⁰ OECD, 2004, note 8, p. 48.

- have opportunities been taken to remind those potentially at risk of what their obligations are?

These considerations point to the importance of the educational products and related customer service facilities provided by the revenue authority. The ATO notes that it aims to provide taxpayers and their advisers with the information they need to understand their rights and responsibilities. Information products (for example, pamphlets, web pages, seminars and workshops) are tailored to the needs of different taxpayer segments and industries, and taxpayers and their advisers are encouraged to approach the ATO for personalised advice through a variety of help lines and other formal and informal advice channels.⁹¹

In some jurisdictions, for example, particular attention is paid by the revenue authority to start up businesses, on the basis that making the tax obligations clear and “getting it right” for these businesses from the outset will repay huge dividends later.

Smoothing transactions and interactions

The third group of strategies designed to make it easier and cheaper for taxpayers to comply with their tax obligations relates to the capacity of the revenue authority to provide convenient and inexpensive ways for taxpayers to interact with, or undertake transactions with, the revenue authority. Making it easy and inexpensive to comply can, potentially, include all the initiatives an authority might take to improve service delivery. For example, in recent years, many authorities have sought to expand the range of electronic services (e-services) provided (particularly for filing and for payment of taxes) and have seen a rapid increase in the number of taxpayers and tax advisers taking advantage of the ease and convenience they provide.⁹²

Other service delivery initiatives designed to remove the “grit” from the system and ease interactions and transactions between revenue authorities and taxpayers have included:

- providing assistance (including assistance in minority ethnic languages) to taxpayers in completing and filing tax returns;
- opening customer friendly “one stop shops” for taxpayers;⁹³
- setting up telephone hotlines and help lines to answer questions and clarify doubts on legal and procedural matters; appointing floor walkers to assist taxpayers waiting in queues; improving waiting areas; keeping tax offices open for longer and more convenient hours on days when there are filing deadlines;⁹⁴

⁹¹ Australian Taxation Office, note 10, p. 6.

⁹² OECD, 2004, note 8, p. 49.

⁹³ Fjeldstad and Moore, note 45, p. 248.

⁹⁴ Gill, note 48, p. 14.

- providing the opportunity for reduced annual filing for those taxpayers where the revenue authority is already aware of all income and has already received all relevant tax through withholding or related measures;⁹⁵
- using pre-population and pre-filing techniques with returns and other forms to avoid the necessity for taxpayers to provide information that the revenue authority already possesses;⁹⁶

3.2.3 Strengthening and enforcing compliance

The overall strategy of a revenue authority should always be to encourage voluntary compliance wherever possible, and to facilitate such compliance by whatever means it can make available. But not all taxpayers are compliant, and many who are compliant some of the time are not compliant at other times. Taxpayers move up and down the compliance pyramid, or adopt different position on the compliance — non-compliance continuum, for a variety of reasons. The revenue authority must therefore also have a range of tools, graduated in severity, to deal with non-compliance. These must be applied — and be seen to be applied — as appropriate, in relation to the level of risk. The OECD has identified a number of strategies that progressively escalate the level of sanctions including:⁹⁷

- customised letters alerting taxpayers to the fact that information they have reported is unusual for their industry or appears not to include income of which the authority is aware from third parties. The taxpayer is encouraged to send more or more accurate information;
- walk-in (unannounced) visits to businesses. Such visits may provide the opportunity for a quick check of basic registration, record-keeping and reporting requirements;
- income/sales reviews. These focus on the income of a business, recording processes, business procedures, matching of purchases and sales and sales being made in cash or off the books;
- comprehensive audits. These are in-depth investigations seeking to identify the omission of income or overstatement of expenses, usually across more than one reporting period;
- serious evasion audits. Such audits may involve a range of compliance checks and lead to relatively higher penalties; and
- prosecution for cases of non-compliance involving large sums, persistent evasion or criminal activity. (Some commentators suggest that a dedicated tax fraud unit should be established to tackle such cases, as it requires special skills – including knowledge of the tax fraud legislation, knowledge of the

⁹⁵ Evans, C., 2004, 'Diminishing Returns: The Case for Reduced Annual Filing for Personal Income Taxpayers in Australia', *Australian Tax Review*, Vol 33 No 3, pp. 168-181.

⁹⁶ Highfield, R., 2006, 'Pre-Populated Income Tax Returns: The Next Big Thing in Reform of Australia's Personal Income Tax System', in McKerchar, M. and M. Walpole (Eds) *Further Global Challenges in Tax Administration*, Fiscal Publications, Birmingham, pp. 331-357.

⁹⁷ OECD, 2004, note 8, p. 57.

courts and appeals systems, and law enforcement expertise and ability to liaise with other governmental offices.⁹⁸ This appears to be a better idea than the introduction of a separate “Tax Police” – introduced in some Eastern European and South American regimes – which has a sub-optimal effect as it artificially splits tax law enforcement between two organisations.⁹⁹)

The essential point of these escalating levels of sanctions is “to heighten the risk perception and demonstrate the revenue administration’s capacity to detect and punish evasion”.¹⁰⁰ Gill goes on to note that this “is perhaps still the weakest area in revenue administrations in most developing countries”.¹⁰¹ It is therefore an area that deserves closer attention, by reference to specific further strategies that can ensure revenue authorities enforce compliance in the most efficient and cost-effective fashion.

Investigation

Audit and investigation can take many different forms, ranging from low profile queries resulting in no further action through to full scale investigation resulting in prosecution for fraud. Too much auditing implies inefficiency and harassment, whereas too little calls into question the enforcement efforts of the tax administration.¹⁰² Gallagher suggests that in developed economies about 1% of taxpayers are subject to audit of some kind in any year, although the figure is likely to be higher in developing economies. Gill considers that it is usually between 1% and 10%,¹⁰³ although Bird shows audit rates as high as 45% in Kyrgyzstan and 50% in Moldova and Turkmenistan.¹⁰⁴

The critical point is that cases for audit (which may involve up to 30% of the revenue authority’s professional and administrative staff) should not be selected on a random basis. Rather, audit selection should be based on unbiased risk assessment using automation and statistically determined parameters.¹⁰⁵ Gill notes that the development of “sophisticated systems for risk analysis and selection of cases for audit and investigation is another tool to improve the enforcement capacity of the revenue administration”.¹⁰⁶ He goes on to cite three main advantages:

- a systematic risk-based approach where suspicious characteristics are evident is more likely to find actual tax evasion compared to the situation where a random audit selection basis is used. It is therefore likely to be cost effective and the productivity of enforcement activities (measured in terms of tax and penalties) will increase;

⁹⁸ Gallagher, note 49, p. 135.

⁹⁹ Gill, note 48, p. 17.

¹⁰⁰ Gill, note 48, p. 15.

¹⁰¹ Gill, note 48, p. 16.

¹⁰² Gallagher, note 49, p. 140.

¹⁰³ Gill, note 48, p. 16.

¹⁰⁴ Bird, R., 1999, ‘Some Reflections on the Conference’ in Shapleigh, A., Andic, F. and S. Banta (Eds) *Transition Economies and Fiscal Reforms: Proceedings of the Conference on Central and Eastern Europe and the New Independent States*, June.

¹⁰⁵ Gallagher, note 49, p. 137.

¹⁰⁶ Gill, note 48, p. 16.

- secondly, an approach based upon risk analysis allows the revenue administration to be more selective in scrutinising cases, resulting in more intense scrutiny and better use of scarce audit and investigation resources; and
- finally, the fact that most cases are not investigated means less interaction between tax officials and the taxpayers – resulting in lower compliance costs and less opportunity for corruption.

Sanctions

Any revenue authority needs to have appropriate powers to enforce compliance, including a full range of penalties (monetary and imprisonment) that can be applied where taxpayers have not properly complied. Often the threat of punishment can be as effective a sanction as the punishment itself. In its 2004 study, the OECD notes that while the revenue authority's preferred strategy will be one of self-regulation or voluntary compliance (at the base of the pyramid), the greatest leverage the authority can exert towards that outcome comes from taxpayers knowing that the authority has the power and will use it (at the top of the pyramid) to punish those who do not comply.¹⁰⁷

According to Ayres and Braithwaite,¹⁰⁸ the threat of severe punishment is most effective when it is used in conjunction with a hierarchy of lesser sanctions. "That is, regulators will be able to speak softly when they carry big sticks (and crucially a hierarchy of lesser sanctions). Paradoxically, the bigger and more various are the sticks, the greater the success regulators will achieve by speaking softly." Sanctions are important, not so much as a deterrent, but as a mechanism to convince people that others are complying.

The OECD also notes that a "revenue authority must not only have powers of credible enforcement, but must also communicate effectively its use of these powers. This 'aura' of power helps give the authority as an institution its credibility and allows individual officers more freedom to be co-operative with individual taxpayers".¹⁰⁹

Strategies noted by the OECD that may help to achieve this outcome of making powers and activity highly visible include:

- encouraging media reports of successful prosecutions;
- publishing information that provides taxpayers with early warning of behaviour that may be regarded by the authority as non-compliant. This kind of 'alert' may, for example, provide reports of court or tribunal decisions or interpretive rulings by the authority on matters of law or administrative practice;
- sending 'leverage' letters advising taxpayers that the authority is aware of a specific risk and inviting a specific response. Such letters have dual utility: they prompt compliant behaviour from the potentially non-compliant

¹⁰⁷ OECD, 2004, note 8, p. 50.

¹⁰⁸ Cited in OECD, 2004, note 8, p. 50.

¹⁰⁹ OECD, 2004, note 8, p. 50.

(*deterrence*) and they support the perception among the compliant that their compliance is not in vain: wrongdoers are being pursued (*reinforcement*); and

- exercising vigilance in follow-through of known defaults in relation to basic obligations of registration, filing, reporting and payment. At some point, leniency in extending time to pay becomes counterproductive in promoting voluntary compliance.¹¹⁰

3.2.4 Tackling the shadow economy

The assumption thus far is that the taxpayers are within the tax system or are otherwise known to the tax authorities. This section considers the case of those not in the system – members of the shadow or cash or informal economy, often referred to as part of the “hard to tax”.

It has already been noted that the informal sector is likely to be large in most developing countries. It is also “complex and heterogeneous. It comprises large and small enterprises, urban and rural firms, owners as well as workers, and local activities as well as those that cross jurisdictional boundaries”.¹¹¹

Revenue authorities, in both developed and developing economies, are often tempted to give the informal sector low priority – it is, by definition hard to tax and, in terms of productivity, returns on effort may not be spectacular. Moreover, employees of revenue authorities in developing economies will tend to want to avoid the sector because it is likely to be “unrewarding in terms of income supplementation” and because working in that sector is likely to be “unpleasant, difficult or even dangerous”.¹¹² There is simply no incentive for employees to get involved.¹¹³ Even tax consultants and scholars, advising those in developing economies, have often considered seeking to tax the informal sector as too difficult, requiring considerable effort with few returns.¹¹⁴ It is not surprising that they have tended to concentrate on the easier pickings from the “low hanging fruit”, by focusing on the introduction of VATs, tax system simplification and reform of tax administration.

Nonetheless there are good public policy and other reasons for tackling the informal sector. Businesses that fail to meet their tax obligations pose a threat to those that do in the form of unfair price competition.¹¹⁵ The playing field is therefore not level, and such unfairness causes legitimate businesses to consider exiting the system in order to counter the threat. A thriving cash economy reduces revenue collections and undermines the community’s confidence in the tax system. Moreover, it is in the interests of the governments of developing economies to have as broad a tax base as

¹¹⁰ OECD, 2004, note 8, pp. 50-51.

¹¹¹ Joshi, A and J. Ayee, 2008, ‘Associational Taxation: A Pathway into the Informal Sector’, in Brautigam, D., Fjeldstad, O-H and M. Moore (Eds) *Taxation and State-Building in Developing Countries: Capacity and Consent*, Cambridge University Press, Cambridge, pp. 183-211, p. 184.

¹¹² Fjeldstad and Moore, note 45, p. 244.

¹¹³ Joshi and Ayee, note 111, p. 190.

¹¹⁴ Joshi and Ayee, note 111, p. 185.

¹¹⁵ OECD, 2004, note 8, p. 55.

possible, and to protect that revenue base. And spreading the tax net also contributes to the state-building capacity and the legitimacy of developing economies.¹¹⁶

Successful strategies to tackle the informal sector are therefore more difficult to find, but are typically built around the same essential risk analysis framework that more conventional voluntary and enforced compliance strategies follow. Thus revenue authorities focus on particular sectors or groups that are perceived to constitute more serious risks to revenue. For example, tax authorities in developed economies consider, as high risk, sectors where cash transactions are commonly used for payment. They are also mindful of emerging new risks such as internet trading which provides new opportunities for businesses to operate in the hidden economy without detection.¹¹⁷ The former is more likely to be of greater significance in the context of developing economies, but the latter cannot be ignored as the internet spreads.

The key components of prevention, detection and deterrence, evident in earlier sections on voluntary and enforced compliance, also underpin strategies designed to tackle the informal sector. These components are now examined, based in large part upon the RAND report to the UK's National Audit Office in April 2008, which is the latest detailed research on this topic.

Prevention

The RAND report notes that tax authorities are focusing more on encouraging people into the formal economy as a way of improving voluntary compliance in addition to the traditional detection and deterrence approaches. Thus, for example, the following examples of good practice are identified by RAND:¹¹⁸

- tracking the motivations of those in the hidden economy through surveys to feed into the overall risk assessment for compliance activities;
- targeted educational campaigns at specific sectors (e.g. home repair and maintenance or small businesses) and cooperating with trade associations to tackle industries with a high incidence of non-compliance;
- offering voluntary disclosure schemes;
- surveys tracking the attitudes of those in the hidden economy to assess the impact of media campaigns;
- community visits, workshops, and specific internet sites to encourage individuals into the formal economy; and
- schemes to displace the hidden economy such as the use of work 'vouchers'.

In addition, one strategy that has proved to be highly effective in the context of developing economies is the use of specific taxes and tax collection mechanisms which by their nature and design make evasion difficult. Obvious examples are the

¹¹⁶ Joshi and Aye, note 111, pp. 186-188; Fjeldstad and Moore, note 45, pp. 244-245.

¹¹⁷ RAND Europe, 2008, 'Comparing How Some Tax Authorities Tackle the Hidden Economy', a Report prepared for the UK National Audit Office, April.

¹¹⁸ RAND Europe, note 117, p. 9.

VAT, withholding taxes such as PAYE and PAYG, and presumptive taxes, which can be introduced broadly (for example the VAT) or with specific industries or population sectors in mind. For example, Indonesia has recently introduced a tax payable by residents traveling abroad by air or ship which acts as a final tax for those who do not declare any income in Indonesia or are otherwise not known to the Indonesian revenue authorities, but which is entirely creditable against the tax liability of those traveling residents who are already in the tax net. This is effectively a presumptive income tax (with international travel a proxy for high income), though with the added incentive that it is removed for those who are already paying income taxes in Indonesia.

One compliance strategy related to presumptive taxes that may be particularly useful in the context of developing economies is the associational taxation pathway into the informal economy proposed by Joshi and Ayee.¹¹⁹ Their research, based upon the experience of the Ghana Private Road Transport Union and its agreements with the Ghanaian government in the 1990s, suggests that a negotiated social contract between the state and trade associations, whereby the associations effectively act as taxation collectors from its members in the informal sector in exchange for access to legitimacy and power, can help to tackle the issue of the taxation of the informal sector. They note that “[t]he Ghana experience suggests that the collection of presumptive taxes might be an important step in the long path towards more standardised tax collection through public sector revenue agencies”.¹²⁰

Detection and deterrence

Key strategies relating to detection and deterrence, in addition to the risk assessment approaches already detailed in the section on strengthening and enforcing compliance above, include:

- using telephone hotlines and other information channels to enable the public to report their suspicions of people working in the hidden economy;
- the regular use of data matching to target specific sectors and activities in the hidden economy particularly where there is a high incidence of non-compliance;
- the wider use of external data in data matching to increase the rate of detection;
- the systematic use of sanctions and adjusting penalties for inflation to increase deterrence; and
- tracking the perceptions of people on sanctions to assess the deterrent effect.¹²¹

3.3 Compliance monitoring

Strategies designed to enhance voluntary and enforced compliance need to be carefully monitored to determine their effectiveness. Revenue authorities are

¹¹⁹ Joshi and Ayee, note 111.

¹²⁰ Joshi and Ayee, note 111, p. 197.

¹²¹ RAND Europe, note 117, pp. 9-10.

therefore increasingly concerned with developing appropriate compliance monitoring frameworks. As the OECD notes¹²², revenue bodies “require a comprehensive and robust set of outcome-related measures and indicators reflecting the results of their programs and strategies to achieve improved compliance with the tax laws”. A compliance monitoring framework is broadly defined as “an agency-wide strategy for monitoring compliance and evaluating the impacts of specific compliance improvement activities. To achieve its objectives, it embraces a comprehensive range of compliance measures and indicators and accompanying measurement methodologies for the key compliance obligations of the major taxes administered by the revenue body”.¹²³

Such monitoring frameworks, the OECD suggests, should therefore:

- encompass the major taxes administered at the aggregate level;
- explicitly report on the main compliance risk types;
- report on compliance impacts at the program and targeted risk level; and
- include a comprehensive set of measures and indicators, all of which have a multi-year focus (three to five years).

4. CONCLUSIONS

Effective tax reform designed to enhance tax compliance outcomes requires commitment by government and time. It is not a process to be rushed and caution is counseled, particularly in respect of getting the right balance of policy objectives.¹²⁴ Legitimacy and credible commitment has to be established by government and the revenue authority if taxpayers are to comply voluntarily and this political capacity can in turn impact on the extractive capacity (i.e. revenue collections) of government.¹²⁵ This commitment needs to be at all levels of government and public offices including the judiciary.¹²⁶ There is a need to ensure that commitment at all levels of government continues to build and this could be helped by co-ordination and the promotion of fiscal responsibility at sub-national levels and the implementation of a stable and transparent system of transfers.¹²⁷

¹²² National Audit Office, 2008, “Comparing How Some Tax Authorities Tackle the Hidden Economy”, NAO, London, April; OECD, 2008, *Monitoring Taxpayers’ Compliance: A Practical Guide Based on Revenue Body Experience*, OECD, Paris available at <http://www.oecd.org/dataoecd/51/13/40947920.pdf> accessed 18 August 2008 at p. 27.

¹²³ OECD, 2008, note 122 at p.22.

¹²⁴ Bird (1983) cited in Fjeldstad, O. and L. Rakner, 2003, “Taxation and Tax Reforms in Developing Countries: Illustrations from Sub-Saharan Africa”, Chr Michelsen Institute *Development Studies and Human Rights* R2003:6 at p.28.

¹²⁵ Fauvelle-Aymar, C., 1999, “The Political and Tax Capacity of Government in Developing Countries”, *Kyklos*, Vol. 52 No. 3, pp. 391-413; and Tyler, 2006, “Psychological Perspectives on Legitimacy and Legitimation”, *Annual Review of Psychology*, Vol. 57, pp.375-400.

¹²⁶ An effective judicial system is important when it comes to making tax policies work in developing countries. See Ebel, R. and R. Taliencio, 2005, ‘Subnational Tax Policy and Administration in Developing Economies’, *Tax Notes International*, March 7, pp. 919-936.

¹²⁷ Arowolo, O., 2007, “Moving Toward Responsible Tax Administration in Nigeria”, *Tax Notes international*, December 17, at p. vii.

The key lesson that this article has attempted to convey is that there is no single appropriate tax compliance strategy for any developing or transitional country that can be plucked off the shelf and implemented. Each country is unique. But there is a vast body of research and practical experience, culled from both developed and developing economies, which can help to inform and shape the compliance program that can work for developing countries. In order to manage and improve tax compliance, revenue authorities need to adopt an approach that encourages voluntary compliance within a co-operative and participative regulatory environment. Moreover, in choosing and applying appropriate risk-based treatment strategies, such countries would do well to heed the advice of the OECD that:¹²⁸

- compliance programmes need to provide a graduated response to compliance behaviour — making it easy for those who want to comply and applying credible enforcement to those who do not;
- treatment needs to address the underlying drivers of compliance behaviour;
- the most effective strategies are likely to be multi-faceted and systemic;
- the first step is often to ensure that taxpayers understand their taxation obligations and find it easy to comply;
- acting at all times with integrity and in a manner perceived to be fair and reasonable will encourage voluntary compliance;
- enhanced capacity to influence taxpayer compliance behaviour often comes through strategic alliances and partnerships with other agencies, industry bodies and tax advisers;
- strategies need to be applied in a way that demonstrates effective and efficient use of resources;
- sustainable improvement in compliance can only be achieved by influencing and changing social and personal norms.

¹²⁸ OECD, 2004, note 8, pp. 71-72.