

ADMINISTERING THE TAX SYSTEM

This paper highlights potential issues with the administration of the tax system, covering both administrative issues faced by revenue authorities and compliance issues faced by taxpayers.

Executive Summary

The arrangements for administering the tax system are critically important, both to raise revenue and to promote public confidence in the overall system. Confidence in turn leads to better compliance and this reduces the costs for both taxpayers and the revenue authorities. The key aim of a tax administration system should be to maximise the collection (within the law) while keeping the costs of administration and compliance as low as possible.

The current tax legislative framework is outdated and causes problems for tax administrators and taxpayer compliance. Much of the primary tax law is outdated and this causes problems in administering the tax system. For example, the law does not support the use of electronic systems, self-assessment or provide adequately for rulings to guide taxpayers in complying with the tax laws.

There is significant evidence to suggest that there is considerable room for improvement when it comes to taxpayer compliance. When it comes to the lodgement of tax returns, there is very poor compliance across all of types of taxes. Further, the current stock of tax debt is also very high and increasing (uncollected debt currently stands at \$1.9 billion dollars), with much of the debt characterised as long-standing and may not be recoverable.

There is a strong need to improve the interface between IRD and taxpayers to improve taxpayer compliance. Lack of formal rulings and guidance contribute to poor compliance. Further, the current administration of the tax laws requires the lodgement of paper forms and the payment of tax via cash, cheque or other physical instruments – which is costly for business and IRD in the current digital age.

When it comes to administering the tax system, the two revenue authorities (IRD and CED) act as independent agencies even though they are jointly responsible for things such as the collection of Goods Tax. The information they collect can be a useful aid to compliance for both Divisions but currently they are operating separate computer systems which are not linked. This means information exchange is difficult and largely non-existent.

The development of the administrative arrangements will be critical to providing a solid foundation of which to implement other tax policy reforms. Many of the issues to improve the administration of the tax system can be resolved through an updated overarching tax administration act, where all administrative provisions are in one stand-alone Act.

The organisational issues identified may require an organisational review of the revenue authorities to consider whether the current organisational arrangements are appropriate and conducive to the efficient administration of the tax system. The review may encompass the organisational split between IRD and CED (both within the Ministry of Finance), cooperation and system alignment between the two authorities and also consider other organisational issues such as resourcing.

Introduction

The arrangements for administering the tax system are critically important, both to raise revenue and to promote public confidence in the overall system. Confidence in turn leads to better compliance and this reduces the costs for both taxpayers and the revenue authorities.

There are two sides to administering a tax system. First, is the work of the revenue authorities and this is tax administration. However, the taxpayer's role is also important and this paper will examine both aspects.

There are two major concerns in tax administration:

1. the need to collect revenue - tax administrations should aim to collect the right amount of revenue as specified in the law from all persons liable to pay and
2. the costs involved in the tax system. Administration costs are the costs of the revenue authorities and compliance costs are those that taxpayers incur in complying with the tax law.

The key aim of a tax administration system should be to maximise the collection (within the law) while keeping the costs of administration and compliance as low as possible.

Outdated legal framework

Tax Legislation is outdated and causes problems for tax administrators and taxpayer compliance

Much of the primary tax law is outdated and this causes problems in administering the tax system. For example, the law does not support the use of electronic systems, self-assessment or provide adequately for rulings to guide taxpayers in complying with their obligations. These are common matters across various tax types which need to be considered as part of the development of a single tax administration legislation.

The various Acts have operative provisions (imposing the tax) and administrative provisions (imposing penalties etc.) They are similar between the Acts but are not consistent between the various Acts.

There are also other issues which relate to specific taxes. For example, the Goods Tax is not consistent with the consumption taxes applying in other countries and this creates problems for international businesses seeking to invest in Solomon Islands and for exporters. These sorts of specific problems will be best dealt with in the consideration of the individual taxes and will not be covered in this paper.

The penalties regime is inconsistent across different taxes

The penalties regime is currently provided in individual legislation for each specific tax. This includes both civil and administrative penalties such as interest charges and also formal penalties for conviction for offences. There are inconsistencies between the various acts in the nature of offences and the penalties provided. The various penalty regimes should be examined with a view to developing a single set of provisions to apply to all tax offences.

Taxpayer Compliance

It is not possible to work out with any certainty the current level of compliance. However, there is significant evidence to suggest that there is considerable room for improvement.

General poor compliance leads to:

- lower collections of tax and reduces the resources available for government to provide the services necessary to support and develop the community;
- unfairness as those taxpayers who do not comply may get a significant advantage over those that do;
- worse compliance as the incentive to comply is challenged;
- higher rates of tax on compliant taxpayers and restricted capacity to reduce rates of tax.

Poor lodgement of returns. A recent IMF report examined debt management strategies of IRD as well as the filing of returns for income tax, PAYE and sales tax. So far as lodgement of returns is concerned, the report found very poor compliance across all of types of taxes. The **best** result was for sales tax in 2017, where only 56.8 per cent of returns have been lodged. The worst result was for income tax in 2016 with a lodgement rate of only 4.6 per cent.

Lodgement is a key part of ensuring compliance with the system and such poor performance needs to be addressed.

Current stock of tax debt is high and increasing. The same report noted that the current stock of debt is very high and increasing. Uncollected debt currently stands at \$1.9 billion dollars, i.e. 115 per cent of the annual IRD collection. Much of the debt is long-standing and may not be recoverable.

While the writer of the report believes the existing legislation appears to be “very sound”, he concluded that it should be brought together into a central administration act and be consistent across all tax products.

Since the report, IRD has commenced implementing some of the recommendations including the forming of separate debt and lodgement teams and this is already starting to produce results.

Lack of rulings and guidance contribute to poor compliance. It is difficult for taxpayers to comply with requirements if they are unsure of how the law applies to their own situation. A system of binding public and private rulings should be established so that taxpayers know what is required and have certainty that if they follow a ruling they will not be penalised. Establishing such a system is vital to the successful implementation of self-assessment but requires proper resourcing (particularly legal skills) within the revenue authorities and specific legislation to provide protection for both taxpayers and the revenue authorities.

Improving the interface between taxpayers and the tax system

Self-assessment

Self-assessment systems are designed so that taxpayers can accurately assess their own tax and make appropriate payments (or receive refunds) from the revenue authorities.

A successful self-assessment approach requires:

- The development of a formal rulings system to provide accurate and reliable advice to taxpayers on their obligations;
- Development of computer based records systems in order to support an active compliance strategy based on risk analysis to direct case selection for audit;
- An active approach to managing compliance including the use of penalties and prosecution as necessary.

The lack of a formal rulings system and an active approach to managing compliance limits the benefits of a self-assessment system.

On the other hand, if self-assessment is not adopted, significant resources will be required in the assessing areas although historically assessments have not been made on a timely basis. Formal assessment of returns by IRD can also discourage a strong penalty system if taxpayers can argue their returns have already been examined by the tax office and no errors were detected.

Self-assessment is based on voluntary compliance and allows the tax office to be more effective in allocation of its scarce resources based on the risks presented.

Electronic payment and lodgement

The current administration of the tax laws requires the lodgement of paper forms and the payment of tax via cash, cheque or other physical instruments. Customs has implemented electronic lodgement of entries with its new computer system but has not yet implemented electronic payment systems.

IRD is introducing electronic lodgement and payment of Goods tax, Sales tax and PAYE as from September this year. Rules are needed to be put in place to provide for this to take place.

Electronic systems have many benefits for both taxpayers and revenue authorities. Businesses can significantly reduce their compliance costs, improve their record keeping and benefit from avoiding the delays that are common with face-to-face manual systems.

Revenue authorities would gain similar benefits as well as the potential for much better targeting of compliance action through the implementation of computerised risk management processes and the development of much better data systems for managing the overall tax system.

Implementing full electronic systems may be a challenge for current IT systems but will improve significantly as the international data cable comes on line in early 2019 and the National Payment System legislation is implemented.

Tax agents

Tax agents are an important part of the administration system and should play a key role in encouraging compliance with the rules. Agents should be considered as holding positions of trust and may have specific privileges, for example taxpayers using agents may have different lodgement requirements.

However, there is a need to better define their roles and controls on their operations. This could include matters such as licensing, qualifications, professional standards and conduct and particular offences actions as an agent.

Administration of the Tax System by Revenue Authorities

Organisational Arrangements

Internal Revenue Division (IRD) and Customs and Excise Division (CED) are part of the Ministry of Finance and Treasury (MOFT). However, under the relevant laws the Commissioner (IRD) and Comptroller (CED) are legally responsible for the collection of relevant taxes and thus IRD and CED have a significant degree of autonomy within MOFT.

Further, they act as independent agencies even though they are jointly responsible for things such as the collection of Goods Tax. The information they collect can be a useful aid to compliance for both Divisions but currently they are operating separate computer systems which are not linked. This means information exchange is difficult and largely non-existent.

Some countries, such as UK, Fiji and Vanuatu, have merged their revenue authorities into one agency. In Australia, some revenue functions have been removed from the customs service which now operates as part of the immigration agency.

The relationships between MOFT, IRD and CED should be examined to ensure that appropriate lines of accountability are in place and to seek operational improvements through improving systems and seeking efficiencies through economies of scale.

Information Exchange

IRD and CED operate separate computer systems which do not automatically exchange information. This is a significant issue for the goods tax in particular where administration is split between the two divisions. However, customs information is also relevant for the administration of other taxes such as company income tax where claims for deductions have sometimes been found to be significantly higher than declared values of imported goods. Conversely, tax information may be relevant to customs administration in assisting to identify cases of under-valuation of goods for both import duties and goods tax.

Development of an interface to link the IRD RMS and Customs Asycuda systems could help facilitate information exchange between the two revenue authorities, which could be further supported by legislative reforms to manage and facilitate the flow of information between the two systems.

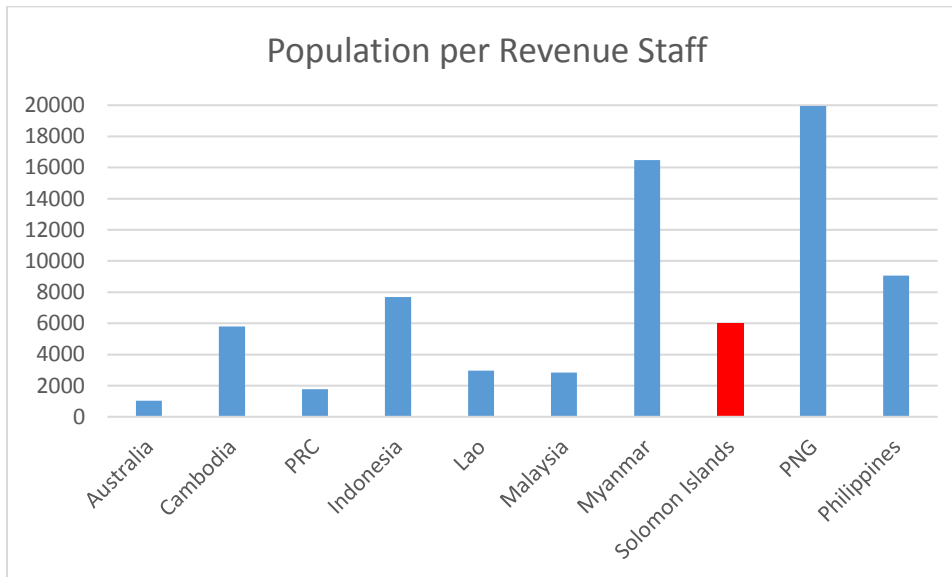
Resources in Internal Revenue Division

Solomon Islands has a relatively low number of staff in its Internal Revenue Division.

There are currently 100 staff members with 13 vacant positions. This gives a ratio of about 6,000 people for each IRD staff member. This is six times the number in Australia and about twice the number in Laos and Malaysia.

A ratio like this can only provide an indicative guide to capacity and numbers can also be skewed by the different range of functions undertaken by revenue authorities in different countries.

It is nevertheless the case that less resources will, all other things being equal, raise challenges for revenue authorities. This is likely to lead to reduced ability to provide adequate taxpayer support and lower levels of compliance. These problems are further exacerbated in smaller countries without the economies of scale which larger jurisdictions have.



A practical example of where under-resourcing directly impacts on the administration of the tax law is illustrated by the current Joint IRD-CED Exemption Committee process. A substantial redesign of the exemptions process led to the establishment of a combined Exemption Committee in 2014 to replace previous separate processes in IRD and CED. The combined Exemption Committee reviews applications for certain discretionary exemptions against criteria before making recommendations to the Minister. However, a lack of staff resources means that the existing criteria for assessing applications for exemptions cannot be practically applied in any meaningful way to the near 1000 applications received each year.

Possible way forward: Tax administration legislation

Many of the issues discussed above would best be dealt with in an overarching taxation administration act. The specific scope of such an act would be defined in the analysis of issues such those in this paper.

The basic approach though would be to have as many uniform administrative arrangements as possible in the one piece of legislation and specific matters relating to particular taxes would remain in the relevant legislation. So matters such as secrecy, information exchange, tax numbers, tax agents, record keeping, rulings, objections and appeals, penalties, discretionary exemptions, lodgement and debt management would be in the administration act, while specific elements such as registration requirements for particular taxes, customs warehouses, etc. would remain in the individual legislation for specific tax types.