HARVARD MINISTERIAL LEADERSHIP PROGRAM

Revenue Systems Case Study Exercise: Building a Strategy to Strengthen Taxation of the Wealthy

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The Reform Challenge

In the wake of the covid-19 pandemic your country is facing national debt totaling 50% of annual GPD – which the IMF judges to be almost unsustainable – and persistent deficits, which reached 8% of GDP in 2020, and remained at 3% of GDP in 2023. Those deficits have reflected increased spending – owing to the pandemic and high global fuel and food prices – as well as reduced revenues. Your country does not have access to significant resource revenues, with the economy reliant on agricultural production, a nascent but small industrial sector, a large but relatively simple services sector and a recently growing construction and real estate sector.

Prior to the pandemic non-resource tax collection was 14% of GDP – somewhat above average for LICs – but revenue fell to 12.5% of GDP during the pandemic, and has only recently returned to 13% of GDP. Revenue collection in the country is heavily dependent on the VAT and excise taxes (7% of GDP), with the remainder made up of trade taxes (1.5%), corporate income taxes (2.5%) and personal income taxes (2%). Prior to the pandemic revenue collection had increased from 11% of GDP to 14% of GDP over a decade, which included the creation of a semi-autonomous revenue authority, significant improvements in pay for senior tax officials and progress with digitalization, with the government having introduced several core modules of the international SIGTAS IT system.

You are facing major pressure to expand revenue collection, which was an important priority in recent elections, held six months ago. The newly elected President emphasized three possible areas for strengthening tax collection. First, strengthening the taxation of the informal sector and broadening the tax net. Second, curbing corporate tax abuse by multinational companies. Third, strengthening the taxation of the wealthy. She has not focused on raising or strengthening value added taxes, owing to a concern that they may unpopular with her political base in the aftermath of the pandemic.

In each area she emphasized that these reforms were about improving fairness, so that everyone pays their fair share. She promised that new revenues would be translated not only into reduced debt, but expanded spending on health and education. Backed by those promises, her push for stronger tax collection appeared to enjoy significant public support.

Setting Priorities

The President has asked you to build a strategy for strengthening revenue collection. You have asked your advisors to assess the revenue potential of the alternative approaches, and to offer advice on potential strategies.

With respect to revenue potential they have advised that:

- *Taxing the Informal Sector*: While there is a large informal sector which could be taxed more, there is a need to target the small subset of larger firms and wealthier individuals in the informal sector with significant revenue potential. Otherwise, you risk devoting scarce administrative resources to very small taxpayers with limited revenue potential.[1]

- *Corporate Tax Abuse*: There is a clear need to strengthen taxation of multinational corporations. However, because of the small number of such firms the achievable revenue potential is likely not more than about 0.75% of GDP at best, while success may be challenging owing to the complexity of administering international tax rules.[2] There is also some evidence that tax exemptions and incentives have been granted to influential businesses with little justification, which could offer immediate revenue potential and be publicly popular. That said, the overall revenue potential is unlikely to exceed about 0.25%, or at very best 0.5%, of GDP.

- *Taxing the Wealthy*: More effectively taxing the wealthy holds the greatest revenue potential. Personal income tax collection is dramatically below levels in higher income countries (about 9% of GDP) and also well below other high-performing LICs and LMICs (4-5% of GDP). In turn, almost all personal income tax revenue (94%) is collected through withholding on salaries, with negligible collection from capital gains, self-employment income, rental income or inheritance taxes. Property taxes are also extremely weak (0.05% of GDP vs 2% of GPD or more in high performing OECD countries), despite high levels of investment in the real estate sector.

They have recommended a primary focus on strengthening taxation of large and wealthy taxpayers, noting both revenue potential and the potential to increase equity – an important priority for the President. To do so, they have recommended (a) renewed efforts to identify large taxpayers in the informal sector, to expand the tax net, (b) strengthening collection of existing taxes on the wealthy – especially personal income taxes and property taxes – for which there is evidence of major gaps in collection, and (c) a specific effort to investigate existing tax incentives and exemptions to large firms to identify unjustified revenue losses.

Existing Challenges

Following that initial advice, you asked your advisors to conduct an assessment of the drivers of weak existing taxation of the wealthy. Their assessment highlighted the following:

1) *Policy*: Policy around personal income taxes – including capital gains taxation and rental income taxation – underwent a significant update in 2019 and is consistent with what is considered international best practice and with regional norms. The policy framework for property taxes is similarly aligned with international practice, and could support reform modelled on that pursued successfully by neighboring countries.

2) *Gaps in registration and compliance*: Collaborative research between the national revenue authority and an external think tank that was conducted in 2018 highlighted major gaps in registration and compliance by wealthy individuals in the country, even

[1] https://www.ictd.ac/publication/why-mass-tax-registration-campaigns-do-not-work/
[2] Moore, Prichard and Fjelstad (2018). *Taxing Africa*. Zed Books. Chapters 3 and 4.

where those individuals were well known or easily identified. Illustratively, they found that[3]:

- Only 5% of company directors in the country remitted any personal income tax.
- Of 16 individuals who paid more than $150,000 in customs duties in the prior year, only 2 remitted any personal income tax.
- Among the 60 top lawyers in the country, as identified by the industry association, only 17 remitted any personal income tax.
- Among 71 top government officials who were known to own significant commercial assets, only a single person paid any personal income tax.

3) *Limited data sharing*: Many countries rely on data sharing both with other government bodies (e.g. public procurement, land ownership, construction) and private actors (e.g. banks, digital financial services, stock exchanges) to identify wealth and income for tax purposes. However, existing legislation in your country sets very high standards of evidence to be able to access data. Meanwhile, other government institutions have often not prioritized, or been resistant to, sharing data. This has made data sharing very limited in practice.

4) *Weak property taxation and knowledge of property assets*: Heavy investment in real estate by elites is believed to be a major driver of rising real estate prices, and a major source of untaxed rental income. However, government knowledge of land ownership and values is limited by an incomplete and out of date national cadaster, highly ineffective property valuation and extremely weak property tax administration. As a result, property tax revenue are extremely low even by regional standards, while limited knowledge of property ownership and values has affected the ability of the government to identify wealthy taxpayers and to collect rental income taxes.

5) *Challenges accessing overseas wealth*: Cross-country data suggests that a significant share of the wealth of national elites is held offshore, as the average for similar countries is estimated at 30-40% of wealth.[4] Recent leaks from tax havens have, in fact, highlighted the names of several wealthy individuals from your country. However, as of now no action has been taken against those named in recent leaks, while the country does not have systems in place to participate in automatic exchange of information (AEOI) for tax purposes in order to access data about wealth held overseas by citizens.

6) Limited audit capacity: Tax authorities struggle to bring cases against wealthy individuals given limited internal audit capacity, and the ability of those wealth individuals to rely on complex avoidance schemes. This is exacerbated by significant challenges with staff retention, as auditors are often targeted for recruitment by accountancy and legal firms.

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[3] Data derived from an actual study conducted in Uganda in 2015 (Kangave et al. 2016 - https://www.ictd.ac/publication/boosting-revenue-collection-through-taxing-high-net-worth-individuals-the-case-of-uganda/

[4] https://www.sciencedirect.com/science/article/abs/pii/S0047272718300082

7) *Collusion and corruption*: Some senior officials report concerns that large taxpayers may often be engaged in collusion with tax collectors to avoid being registered or to reduce their tax owing. Some suggested that this is not only about collusion with front line tax officers, but that those payments are sometimes shared with more senior officials as well.[5]

8) *Political interference*: Some staff of the revenue authority reported facing political threats when investigating the affairs of well-connected individuals, or that those individuals simply refused to respond to outreach from the tax authority.

9) *Popular support*: A survey conducted in 2021, during the covid-19 pandemic, asked taxpayers whether funds for recovery should come from (a) broad based taxes, (b) taxes on the rich, (c) taxes on large businesses or (d) taxes on property. Taxes on the rich and large businesses were by far most popular.[6] That said, experience of recent reform episodes suggests that the public may nonetheless withhold support for reform if they are not convinced that revenue will be used effectively.

Reform Options

In light of that analysis your advisors have highlighted several potential priority actions, highlighting some of the opportunities and costs of alternative approaches.

1) *Creating a High Net Worth Individuals (HNWI) Unit*: In recent years a number of countries have created specialized units for taxing wealthy individuals, alongside existing Large Taxpayer Units that focus primarily on large businesses. They have aimed to provide more personalized engagement with wealthy taxpayers, while also strengthening audit capacity and data collection/sharing. International experience suggests significant immediate success in identifying wealthy taxpayers, but that increasing compliance also requires new technical capacity, improved data sharing and political support.[7]

2) *Building an international tax unit to participate in international tax data exchange*: Recent reforms to international tax rules call on all countries to voluntarily share information with home countries about accounts held overseas by their residents. However, significant investments are needed in order to participate. Countries need to be able to receive, ensure the security of and use international information. And they need to be able and willing to share data reciprocally. A small number of lower-income countries

[5] https://www.tandfonline.com/doi/full/10.1080/00220388.2016.1153072

[6] Data derived from an actual survey conducted with taxpayers in Sierra Leone in 2020 and 2021 (van den Boogaard, Orgeira and Prichard 2023). The share of respondents who indicated that revenue for recovery should come from more taxes on the richest was 55% prior to the pandemic, and 83% at the end of the pandemic. By contrast, support for broad based taxes rose from 24% to 35%, while for large businesses support rose from 41% to 72%. When taxpayers were limited to selecting one revenue source to prioritize 27% selected taxes on the rich, 33% selected taxes on large businesses and only 10% selected broad based taxes.

[7] https://www.ictd.ac/publication/what-can-we-learn-from-the-uganda-revenue-authoritys-approach-to-taxing-high-net-worth-individuals/; https://www.ictd.ac/publication/small-nets-for-big-fish-tax-enforcement-on-the-richest-evidence-from-uganda/

have begun putting in place that infrastructure. However, progress has been slower than hoped and actual revenue gains so far very limited amidst challenges in meeting minimum standards for participation and difficulties in successfully using new information and enforcing compliance.[8]

3) *Strengthening audit and enforcement capacity*: Special investment may be made in recruiting and retaining audit and enforcement capacity through expanded staffing, higher recruitment or other retention strategies.

4) *Investing in digitalization of tax administration*: Digitalization can play a key role in improving data sharing, identification of under reporting and audit selection. The government could focus, in particular, on strengthening data sharing with key public and private actors and on improving identification of high-risk cases for audit. This would build upon initial digitalization undertaken in recent years.

5) *Strengthening property mapping, identification and valuation*: New investments in property mapping, identification and valuation could contribute to (a) improved collection of property taxes, (b) improved identification and collection of rental income taxes and (c) improved ability to identify high net worth taxpayers via improved information about property wealth. This would only target one category of wealth, and related income, but recent reform success in other low-income countries points toward the potential for significant improvements in outcomes.[9]

6) *Reviewing existing tax incentives and exemptions*: Many countries in the region have recently reviewed their incentive regimes and made efforts to (a) ensure that the Ministry of Finance approves all incentives, (b) ensure that all incentives are documented in legislation, and (c) introduce annual published assessments of the revenue impact of incentives, by firm. In many countries this has led to greater coherence and monitoring, and the elimination of poorly designed of monitored incentives.

7) *Study the potential for a new wealth tax*: In response to growing international interest, the country could launch a study of the potential of introducing a wealth tax. In favor of a new tax, your advisors note that your country faces very high levels of inequality, with a number of large intergenerational families controlling significant parts of the economy. However, they note that (a) collecting a wealth tax in practice could be difficult given limited data about assets, and concerns about wealth being moved offshore, and (b) that there may be other more immediate and simpler opportunities for improving collection from wealthy individuals.

8) *Building popular support*: Given the likelihood of resistance from elite taxpayers, and their supporters, the government could seek to build a popular base of support for reform. One question surrounds framing: should these efforts be presented as a progressive effort to tax the rich, as an effort to ensure that everyone pays their fair share under the law, or

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[8] https://www.oecd.org/tax/transparency/documents/new-african-voices-help-amplify-international-efforts-for-tax-transparency.htm

[9] https://www.ictd.ac/blog/freetown-new-property-tax-system-quintuple-revenue/

something else? A second question is what measures the government can take to build public confidence that new revenues will be used effectively, including options like increased budgetary transparency, explicit new spending initiatives or earmarking of new revenues.

9) *Addressing collusion and political interference*: Alongside these specific recommendations your advisors note that because existing weaknesses have been significantly driven by collusion/corruption and political interference the success of any strategy is likely to depend on developing a strategy to address those broader challenges.

Guiding Questions

You have decided to establish two working groups, each of which you will lead, to discuss next steps in reform planning. Their mandates are as follows:

1) *Broad Strategy*: Given limited capacity, which options among those proposed by your advisors should be prioritized first – and what should be key elements of the strategy for making those initiatives successful?

2) *Digitalization Strategy*: The government has already committed to – and has international support for – further investing in digitalization in order to improve data sharing, identification of underreporting and audit selection. Given that the technology itself is already in place, what will be the key elements of your strategy to ensure that those key functions are improved in practice?