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ANZSOG Case Program

A new direction for Inland Revenue in Solomon Islands (A)

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In 2010, Deputy Commissioner George Tapo and other senior staff of the Solomon Islands Inland Revenue Division gathered for their annual strategic planning day. They had cause for some satisfaction: that year, Inland Revenue would collect a record SI$1 billion[1] in revenue (approximately A$143 million). It was a milestone for the Division, for the Ministry of Finance and Treasury (MoFT), and for a country still struggling to rebuild from the civil conflict that engulfed it from 1998 to 2003.

During 'the tensions', revenue collection – along with the entire machinery of government and most public services – effectively came to a halt. It reached its lowest point in 2002, when just $136.5 million was collected.[2] With the government effectively bankrupt, schools closed, infrastructure deteriorated and civil servants went unpaid.[3]

Hitting the $1 billion revenue mark in 2010 was, therefore, a remarkable turnaround. But there was still much to be done to build an adequate revenue base. Solomon Islands remained one of the poorest countries in the Pacific, ranked 142 of 187 countries in the United Nations Development Programme's 2011 Human Development Index. More than 20% of the population lived below the

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[1] All figures unless otherwise specified are in Solomon Islands Dollars (SI$). As at July 2008 one Solomon Islands dollar was equivalent to 15 Australian cents.
[2] Regional Assistance Mission to Solomon Islands (RAMSI) (4 March 2011). 'Ministry of Finance achieves $1 billion revenue'. Retrieved from http://www.ramsi.org/media/news/ramsi-congratulates-ministry-of-finance-on-1billion-revenue.html on 27/10/2012.
[3] See also Public management challenges in Solomon Islands: Background Notes (2013-728.3).

national poverty line.[4] Essential services – schooling, health, policing – and infrastructure were only slowly recovering from years of conflict, neglect and under-investment. Many government services remained beyond the reach of the predominantly rural population. Managers attending the Inland Revenue Division's strategic planning day knew that maximising the tax take was critical to the country's recovery and future. But they were also aware of the challenges. The rate of tax compliance was estimated at only about 30%. Some well-established and successful businesses were known to have evaded tax for years, but auditing was haphazard and prosecutions were unknown. Public understanding of the tax system was poor.

'We decided that we wanted to take the organisation in a new direction,' recalled George Tapo, who had worked for Inland Revenue for two decades. A new divisional statement of purpose was adopted – 'Improving the life of Solomon Islanders'– and a new vision statement: 'We will be a highly skilled and professional division with strong leadership. Our taxpayer base will understand and meet their obligations.' It was hoped these aspirational statements would help increase revenue and allow government to better deliver the services the nation needed.

But George Tapo knew that the division also needed to motivate its own staff to 'want to collect more revenue to help fellow Solomon Islanders'. This would require 'a huge shift from our traditional ways of thinking and doing things, which was more ad hoc than strategic'. Like most of the country's government agencies, Inland Revenue had a significant shortfall of resources, skills, experience and capacity. Asked to develop an internal communication training programme that would help the organisation pursue its new vision, he wondered how best to proceed.

Repairing a broken taxation system

Solomon Islands revenue collection problems predated the tensions of 1998-2003. After independence from Britain in 1978, the country's economy depended heavily on the large-scale exploitation of natural resources (including palm oil, copra, fisheries and especially logging) by foreign companies. Yet government's limited capacity to collect taxes meant considerable potential revenue was lost. Between 1995 and 1997 alone, an estimated $109 million in potential government revenue was foregone through tax remissions on log exports.[5] The tax base was also limited by the small size of the private sector and the low employment rate, with most Solomon Islanders leading subsistence lives outside the market economy.[6]

The $1.2 billion national debt recorded in 1997 – more than double the government's budget for the next financial year – was attributed to a combination of 'poor management practices such as uncontrolled spending and non-collection of revenue'.[7]

The economic and civil chaos created by the tensions exacerbated this situation. As law and order declined, foreign investors pulled out. Many local businesses became reluctant to pay tax when they saw it could end up in the hands of warring militias and factions. The Inland Revenue Division itself was targeted by militants: the treasury was raided and armed gunmen wandered the corridors. 'They would force someone to write a government cheque, then to release the payment,' recalled George

[4] Asian Development Bank (2011). *Solomon Islands Fact Sheet*, p2. Retrieved from http://www.adb.org/publications/solomon-islands-fact-sheet?ref=countries/solomon-islands/publications on 20/10/2012.
[5] Kabutaulaka, Tarcisius Tara (2001). *Beyond Ethnicity: The Political Economy of the Guadalcanal Crisis in Solomon Islands* (Kabutaulaka 2001). State, Society and Governance in Melanesia Project Working Paper 01/1, pp13-15. Retrieved from http://ips.cap.anu.edu.au/ssgm/papers/working_papers/tarcisiusworkingpaper.htm on 19/10/2012.
[6] Clements, Kevin and Foley, Wendy (2007). *Towards Effective and Legitimate Governance: States Emerging from Hybrid Political Orders – Solomon Islands Report*. Brisbane: University of Queensland, p4.
[7] Kabutaulaka 2001.

Tapo. 'At one point we were collecting just $15-20 a day. We had to skip two, three, four paydays ourselves because the government couldn't afford it.'[8]

When the Regional Assistance Mission to the Solomon Islands (RAMSI) arrived in 2003 to help the Solomon Islands Government rebuild, economic governance reform – including growing the country's revenue base – was a priority. RAMSI advisors and Ministry of Finance and Treasury staff adopted a two-pronged strategy: building the capacity and professionalism of the Ministry, and introducing tax reforms to improve revenue collection. There was a push to develop policies and strategies that would make it easier for businesses to pay tax, and to improve compliance through taxpayer education and more stringent enforcement.

At an organisational level, the focus was on strengthening the technical, auditing and legal capacity of the Inland Revenue Division, which collected more than 60% of the government's revenue. The Customs and Excise Division (also part of the Ministry of Finance and Treasury) collected another 30% in the form of duties and taxes: the remainder was collected by other government departments in various forms.

A decade after RAMSI's arrival, these efforts were bearing fruit. Between 2003 and 2010, the government's tax revenues more than quadrupled. The amount of revenue collected continued to increase steadily by around 10-15% a year, even during the Global Financial Crisis. In 2012-2013, revenue collection reached SI$1.6 billion. Although this partly reflected an increase in business activity as the country stabilised, it also showed improving compliance with the taxation regime. In the three years leading up to 2010, Inland Revenue added 1,000 businesses to its books. Compliance continued to grow and by 2013, an estimated 50-60% of businesses were meeting their tax obligations.

George Tapo said that the country's revenue growth reflected the Inland Revenue Division's work in three areas: educating taxpayers about their obligations, improving services to taxpayers, and a tougher approach to compliance.

'We don't know what tax is or what the government does with it'

The 2011 People's Survey conducted by RAMSI provided an insight into public understanding of the taxation system. Among Solomon Islanders living in rural areas (some 80% of the population), many were confused about what constituted government taxes, who was obliged to pay, and how revenue was used. 'We don't know what tax is or what the government does with [it]' was the response of one group of villagers. Some thought that colonial-era taxes were still in force, others that fees payable by market stall-holders and even mobile phone top-ups were government taxes.[9] Many thought paying tax was optional. People were particularly unsure about the point at which individuals and small businesses became liable to pay tax. In 2012, the threshold was set at $15,080 (raised from $7,800 in an effort to help low-income earners and encourage saving).

Even within the business community, where awareness was higher, taxation was not necessarily seen as a public good. George Tapo commented that 'When I say to people that the government uses taxes to improve the lives of citizens, they sometimes reply "well, my life hasn't improved, so why should I pay?"'

In reality, all Solomon Islanders received the benefits of taxation whenever they travelled on a formed road, visited their local health clinic or sent their children to school. Likewise, all who participated in the cash economy paid tax in at least one form. The three major sources of taxation revenue were the goods tax imposed on sales, PAYE deductions and company tax. Some of the latter derived from the

[8] Callick, Rowan (2010). 'Wisdom rules in the Solomons'. *Solomon Star*, 23 April 2010.
[9] RAMSI (February 2012). 'People's Survey 2011'. Canberra, p71.

foreign companies that had gradually returned to Solomon Islands since the end of the tensions, but the majority came from small-scale businesses based in Honiara and the major provincial centres – mini-bus operators, taxi drivers, small retailers. They were required to complete and submit annual returns.

George Tapo said to improve understanding of taxation and its purposes among this group, the Inland Revenue Division had established a five-person taxpayer education team. The team ran workshops for small businesses and offered advice on completing tax returns, which some business owners found difficult. In 2010, the Inland Revenue Division launched a new website enabling businesses (especially small ones) to access information and forms quickly and easily. The division also published printed tax bulletins, distributing them through government offices in remote areas where internet connections were scarce. Division staff took part in regular RAMSI community seminars, which aimed to raise public understanding of government services. 'The message conveyed at these seminars is consistent with the Division's: the government collects revenue for the betterment of the community.'

The Division also sought to provide higher levels of service, supported by a new computer system and more business-friendly work practices. Taxpayers were increasingly regarded as customers. According to George Tapo: 'We are always asking ourselves: "how can we improve the way we work so it's easier for taxpayers to comply with their obligations?"' He said as well as increasing revenue, this approach benefited business owners: 'By getting involved and understanding how the Solomon Islands' tax system works, many businesses are actually also improving the way they run their finances.'[10]

At the same time, Inland Revenue's approach to those who avoided or evaded tax hardened. The division encouraged any business or individual who had not met their obligations to make a voluntary disclosure, and promised they would not be prosecuted if they did so. It established a specialised debt team to work alongside debtors, providing advice and implementing repayment schedules. But Inland Revenue also warned there was now a much greater likelihood of tax evasion being detected, thanks to better auditing and investigations between 2008 and 2012, the revenue it collected from audit activity increased five-fold.[11]

And for the first time, tax evaders faced prosecution and stiff penalties. In 2011, the first successful prosecution was brought against a Honiara business owner. He was jailed and required to repay the $6 million in taxes he had evaded over a three-year period. The Inland Revenue Division used the prosecution as an opportunity to send a stern message to potential tax evaders – and for some civic education: 'It needs to be understood that tax evasion is a deliberate act that reduces the tax that should be payable … Taxes are used by Government to provide the Solomon Islands community with services like schools, roads and hospitals,' said the then Commissioner of Inland Revenue, New Zealander Andrew Minto. He added that not only did tax evaders cheat the community of those services, but 'also obtain an unfair advantage over other businesses that pay the correct amount of tax'.[12]

In September 2011, the Inland Revenue Division's tax reforms earned the inaugural International Monetary Fund – Pacific Financial Technical Assistance Centre Award for achievement in tax administration.

[10] Perry, Tom (2010). *Bringing Back the Dollars* (Perry 2010). *Islands Business*, Jan 2010, p18. Retrieved from http://www.ramsi.org/Media/docs/Ramsi-IB-Jan-2010-1b11005e-28b8-43a2-a321-10dfea4fd768-0.pdf on 16/06/2013.
[11] 'Bell is new IRD commissioner'. Island Sun, 2 May 2012. Retrieved from http://www.islandsun.com.sb/index.php/index.php?option=com_content&view=article&id=4799:bell-is-new-ird-commissioner&catid=36:latest-news&Itemid=79 on 16/06/2013.
[12] Buchanan, Assumpta (2011), 'Business man jailed.' Solomon Star, 4 August 2011. Retrieved from http://www.solomonstarnews.com/news/national/11633-business-man-jailed on 16/06/2013.

Initiating cultural change

As George Tapo began designing a new training programme for Inland Revenue staff in 2010, he was aware that for all the improvements in revenue collection, something was still missing within the division.

Partly, it was insufficient capacity and resources. Recruiting suitably qualified and experienced staff, especially to senior positions, was difficult across the whole Ministry of Finance and Treasury. Not only was there a scarcity of people with advanced financial training, but public service salaries were so low that it was hard to attract the best and brightest. While the ministry had introduced a graduate recruitment programme, significant vacancies at all levels of the ministry forced continuing reliance on expatriate advisers. 'There are pockets of high performance within the ministry, but … substantial gaps in middle and upper management. While the graduate program is working, in the absence of workforce planning, succession planning and agency-wide performance management is a particular risk. Advisers can lead on reform, but implementation is lacking as a result of underlying capacity limitations,' said RAMSI's Annual Program Performance Report for 2011.[13]

Capacity-building within the Inland Revenue Division itself had progressed significantly under the RAMSI partnership. In 2009, the New Zealand Government committed NZ$13.5 million (then equivalent to SI$58.5 million) to strengthening the Division's capacity over the next five years. New Zealand Inland Revenue would provide ongoing operational support, and help to develop leadership and management skills. A year later, the Commissioner of Inland Revenue said the results were visible already, especially in the area of training and skill development. Some 30% of Inland Revenue staff were now studying part-time for qualifications in areas such as business and management.[14]

However, limited capacity continued to hamper the division's ability to collect revenue. In 2010, its establishment level was cut by 20%, which 'had the effect of immediately constraining the collection of revenue as there were less people collecting revenue and so too less people conducting audits for irregularities in collections'.[15] Even by 2013, Inland Revenue had only 86 staff, well below the targeted 160.

But as he mulled over his options, George Tapo concluded that the shortage of skilled staff was not the only factor hampering the division: its culture also needed to change. Many staff 'did not understand the new way of journeying because they had got used to the old ways of doing things'. There was a reluctance to ask questions, seek feedback or contribute ideas. He said a mid-term review of New Zealand Aid Programme (NZAID) assistance to the division had confirmed that staff did not really understand the organisation's direction and were confused about how they were expected to contribute.

It seemed that managers were not successfully communicating Inland Revenue's new purpose, vision or goals to their staff, nor significant decisions, and if the division's own staff were unclear about why revenue collection mattered to national development, how could they hope to convey that message to taxpayers and increase public support for the taxation system? George Tapo knew his training programme needed to address that challenge.

[13] RAMSI (June 2012), p9.
[14] Perry 2010.
[15] Independent experts team (March 2011). *Annual Performance Report 2010: a report on the performance of the Regional Assistance Mission to Solomon Islands*. Canberra, p13.