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Increasing property tax compliance in Liberia

Evidence on the role of detection and enforcement capacity

In brief

- Many developing countries suffer from low tax collection rates. Broadening the tax base and effectively enforcing tax liabilities is crucial for economic and political development.
- Property tax compliance in Liberia is limited: an estimated 5% to 10% of properties are registered on the tax roll. Year-on-year compliance for registered properties is also weak.
- This study examines the results of two randomised experiments. These experiments involve interventions by the tax authority to manipulate property owners' perceptions of its capacity to detect and penalize non-compliance.
- Research finds that a tax notice that includes the name of the property owner and photograph of the property, as well as information on penalties, triples tax registration and payment relative to a plain notice.
- A tax notice that informs delinquent property owners of upcoming enforcement increases compliance compared to a standard reminder, but only in areas where the tax authority had previously carried out more enforcement.
- Investments in both detection and enforcement capacity are important for increasing tax compliance.

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FUNDED BY

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Background and motivation for research

An effective and equitable tax collection process is a key goal for many developing countries. To reduce their reliance on foreign aid and natural resources in funding public services and infrastructure development, states must build a tax system that ensures both a broad base and compliance.

There are at least two dimensions of capacity that tax authorities require to effectively administer taxes. First, they must be able to identify the tax base and determine the taxes due. This paper refers to this ability as "detection capacity." Second, the tax authority must be able to enforce the tax laws and ensure that taxpayers pay their tax liabilities, for example, through the use of delinquent notices, sanctions, and prosecution. This paper refers to this capability as "enforcement capacity."

This study examines the role of detection and enforcement capacity in the context of property taxes. While property taxes have the advantage of having an observable and immobile tax base, administering property taxes remains challenging across many developing countries due to capacity constraints. For example, in high income countries, property tax revenue represents about 2% of GDP, compared to about 1% for developing countries, and 0.4% in African countries (IMF Revenue database).

Property tax compliance in Liberia

Real estate tax compliance in Liberia is limited. Prolonged civil conflict in the 1990s and early 2000s led to the erosion of state capacity across several sectors, including tax administration. In 2018, in the Greater Monrovia area (the largest urban metropolis with over 1 million residents), the tax roll contained less than 7,000 properties, belonging to about 5,000 property owners. Even among properties on the tax roll, timely collection remains a challenge. After taxpayers enter the tax base in one year, over 60% of them do not pay taxes in the subsequent year.

The state's enforcement of tax liabilities is weak due to limitations in administrative processes (including incomplete databases and unstandardised billing practices) and legal, political, and logistical constraints on implementing penalties.

Compliance costs are also significant and discourage compliance. Complying with property taxes involves: (1) Obtaining a tax identification number (for first-time taxpayers); (2) Registering the property by completing a property declaration form that states the property's value and describes its features (Residential property owners can self-declare property value within a realistic range while commercial property owners must obtain a valuation from a list of approved providers); (3) Obtaining a bill for the current tax year and up to 4 prior years; and (4) Paying at a bank.

In Liberia, there are two primary classifications of properties: commercial and residential. Commercial properties are involved in income-generating activities and are taxed at 1.5% of property value. Residential properties, which are strictly used for housing and do not generate income, are taxed at 0.25% of property value. These taxes are paid once a year and payment plans are possible.

Experiment 1	
Research Questions	1. How do property owners respond to information that shows that the tax authority has located their property and detected their non-compliance with their tax obligation? 2. How do property owners respond to information on the penalties for non-compliance? 3. How do property owners respond to both types of information provided together?
Sample	Unregistered property owners in one of the tax zones in Monrovia
Experiment Design	Enumerated property owners were randomised into 4 groups: 1. Control Group: Received a generic notice of responsibility to pay real estate tax and instructions on how to comply. 2. Detection Group: Received a similar notice but it was personalised to them; it was addressed to them by name and included a photograph of the property. 3. Penalty Group: Received a notice similar to the control group but it included the legal penalties for noncompliance. 4. Detection and Penalty Group: Received a notice that had the features of both the detection and penalty group letters. The randomisation was stratified on property type (residential or commercial) and property value (above or below median value).
Data	1. Baseline enumeration survey 2. Administrative tax records

Results	This study finds that citizens are responsive to information that the state has identified their non-compliance and to information on penalties.
	The combined intervention triples property registration rates (9.9 percentage point increase from 5% average in control group) and tax payment rates (6.3 percentage point increase from 3% average in control group). The two other treatments – detection notice only, and penalty notice only – produced more modest effects relative to the combined intervention.

Experiment 2	
Research Questions	What is the impact of increasing the perceived probability of enforcement on tax compliance?
Sample	Delinquent property owners across different zones in Monrovia
Experiment Design	Property owners were randomised into two groups: 1. Control Group: Received tax notice requesting payment of delinquent tax liabilities. Notice included name of owner, photo of property, and information on non-compliance penalties (similar to combined treatment in Experiment 1). 2. Treatment Group: Received a similar notice to control but with an additional sentence informing the recipients that their properties are designated for intensive follow up if they do not comply. The randomisation was stratified on location (one of 3 districts) and payment history (delinquent for one year or more than one year).
Data	1. Property location verification data 2. Administrative tax records

Results	Overall, the enforcement message did not significantly affect outcomes (responding to tax notice, paying tax, or amount of tax collected). However, there was a positive impact in areas where the tax authority had previously carried out more enforcement, which suggests that credibility is important in enforcing tax liabilities.

Policy recommendations

- **Investment in detection capacity is necessary but not sufficient.** Given the growing consensus on the crucial role of information for tax administration, there is significant policy interest around investments in detection capacity, such as the use of electronic records and third-party reporting for monitoring. The first experiment shows that even among property owners that knew the tax authority was aware of their non-compliance and who knew the penalties, only 15% registered. This result implies that even the most sophisticated detection technology is insufficient for ensuring high compliance levels. Other factors such as compliance costs, liquidity constraints, tax morale and trust in government, and perceptions of the likelihood of enforcement may all play a role. Governments must therefore also pay careful attention to these factors.
- **Invest in enforcement capacity.** The second experiment finds that perceived likelihood of enforcement increased compliance only in areas that had previously experienced strong enforcement efforts. Empowered tax officials and effective legal systems improves the tax authority's credibility and facilitates future enforcement efforts. Interviews were conducted with more than a dozen high-ranking leaders of the ten signatory EAOs between February 2020 and March 2020. This qualitative data was combined with an original dataset of splits among active EAOs since 1939. The dataset was built using both primary and secondary sources, including in-person interviews, email correspondences, NGO reports, academic books, and newspaper articles.