

STRENGTHENING ADMINISTRATION OF ROAD USER CHARGES

(Prepared by Roy Bahl, 1992)

This note focuses on the problems of administering road user charges and ways of overcoming such problems. The terms taxes and charges are used inter-changeably to simplify exposition.

1. General Principles

The taxation of road users is affected by the following characteristics of the taxation system:

- structure of the tax
- nature of the tax base
- accuracy of record-keeping
- procedures for assessing liability
- methods of tax collection
- monitoring and enforcement
- penalty systems

A tax will be ineffective if the characteristics of the tax system encourage *evasion* (illegally failing to pay), or *avoidance* (using legal loopholes to avoid payment).

The rate of *evasion* generally increases with the tax rate (particularly marginal tax rates, since they increase the rewards for both *evasion* and *avoidance*) and reduces with greater probability of detection and more severe penalties. *Avoidance*, on the other hand, is essentially caused by loopholes which enable taxpayers to reduce liability by adjusting their consumption, the composition of received income, or by making different investment and production decisions.

The problems of *evasion* and *avoidance* need to be approached simultaneously, since reduced evasion may simply increase *avoidance* and *vice versa*. Strategies to improve tax administration generally concentrate on: (i) lowering marginal tax rates; (ii) broadening the tax base by eliminating exemptions and preferential treatment of certain items; (iii) increasing the costs of using legal loopholes; (iv) tightening control by the tax authorities and monitoring questionable cases; (v) discouraging under-reporting by using presumptive assessments and regular audits; (vi) preparing a full tax roll and monitoring compliance; and (vii) increasing penalty rates, discouraging negotiated settlements and tax amnesties, and enforcing penalties.

2. Road User Charges

Road user charges are collected using four main sets of charging instruments: (i) fuel taxes; (ii) import duties, excise and sales taxes; (iii) vehicle license fees; and (iv) tolls. Their main administrative characteristics are as follows:

Fuel taxes. The main attraction of fuel taxes is the ease and low costs of administration, provided the tax is collected at the point of origin (when it leaves bonded storage) or at the wholesale level. There are relatively few distributors (bonded storage areas and wholesalers) and few points of distribution. The taxpayer is easily identified, compliance easily monitored

and levels of *evasion* and *avoidance* are therefore low. Differential fuel prices between contiguous countries and alternative transport fuels will, however, encourage *evasion* and *avoidance*. Users *avoid* paying high taxes on gasoline by switching to diesel-engined vehicles, or adulterating fuel with a cheaper substitute (e.g., by adding kerosene) and they *evade* taxes by illegally misclassifying their use under an exempt category (e.g., agriculture), or smuggling fuel to/from other countries.

Import duties, excise and sales taxes. Import duties are difficult to administer. The rate structure is usually complex, rates are high (particularly on large cars), there is considerable scope for under-valuation and mis-classification (into lower rate categories) and contact between customs officers and tax payers encourages corruption and "negotiated" settlements. Excise and manufacturers sales taxes are easier to administer. There are fewer tax payers, less ambiguity (excise tax is due when goods are moved) and monitoring and enforcement are easier. General sales taxes are amongst the most difficult to administer. There are many taxpayers, many fail to register, they may submit exaggerated refund claims, make unrecorded cash sales, claim ineligible credits and under-report sales. The size of the tax base makes sales taxes difficult to administer.

Vehicle license fees. These are also difficult to administer. The structure is normally complex, record-keeping is poor, enforcement lax and penalties low. An added disincentive is that compliance costs are often high; indeed, in some countries the tax payer must first prove compliance with numerous other regulations before license fees can be paid.

Tolls. These charges are easy to administer. However, when collected manually they are costly to collect and impose high compliance costs on tax payers.

3. Reform Options

Reform options tend to focus on the following four inter-related strategies:

Rate levels. Rate levels should be kept as low as possible to reduce incentives for evasion/avoidance, corruption, under-declaration and changes in consumption patterns.

Base Broadening. Tax reform should concentrate on broadening the tax base by limiting exemptions, reducing rate variations, and avoiding large differences in tax rates or similar items.

Simplification. Tax reform should emphasize simplification of the tax structure to reduce administrative costs, simplify tax administration, minimize ambiguities and reduce the costs of compliance.

Enforcement and Penalties. This is the key to better tax administration; tax payers will not respond to lower rates and a simpler rate structure unless they are supported by effective enforcement. Reform should concentrate on increasing the probability of detection (by improving identification of the tax base), improving record-keeping, monitoring compliance, reducing negotiated payments, and speeding up and enforcing the penalty system.

4. Reform of Transport Taxes/Charges

Improved administration of road user taxes requires action under all four of the above headings. Rate levels need to be lowered, the tax base broadened and exemptions reduced, rate structures simplified, and enforcement strengthened. In particular, the prices of transport fuels need

to be better coordinated and rate structures — particularly for import duties and excise and sales taxes — need to be lowered and made more uniform. In some countries, there is scope for raising fuel taxes and license fees, provided it is accompanied by better enforcement. In the case of tolls, there is considerable scope for reducing costs of administration by introducing electronic toll collection systems.

Based on: Roy Bahl, *The Administration of Road User Taxes in Developing Countries*, World Bank, Washington, 1991.