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# Ten quick steps to unlocking tax-revenue collection in rapidly growing markets

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Fast-growing economies that don't strengthen their tax administrations miss a chance to create long-term fiscal stability. Some initiatives can deliver positive results within a year.

**Numerous challenges** can undo the benefits of rapid growth in emerging economies. One of the most often overlooked is making tax administration more effective. Successful reform can enable a country to tackle the challenges of rapid growth and ensure that the flow of revenue is stable and longer lasting.

In many emerging nations, tax administrations are, at best, only sound. While improving them isn't easy, it is critical, especially in emerging markets. Countries that fail to capitalize on the benefits of rapid economic growth are missing a tremendous opportunity to improve the quality of life for their citizens. In a rapidly developing economy, a 10 to 15 percent increase in tax revenues—which sounds ambitious but is quite achievable—often translates into an ability to double expenditures on, for example, health care or education.

## 'Quick wins'

Although large-scale structural reforms are an important part of a well-functioning tax administration, they are extremely challenging to implement, and they take time. We have therefore developed a set of quick-win initiatives that can achieve a significant revenue impact within a year of introduction. These recommendations are based on our experience supporting clients in over 20 countries through more than 120 public-finance projects over the past five years. We also drew on information from our proprietary global tax-benchmarking database, which contains the details of over 100 tax practices in more than a dozen countries. The quick-win approach is designed not only to make tax administrations more effective and to address their most pressing needs but also to provide a powerful "proof of concept" for broader efforts.

## Focus resources on improved auditing, processes, and tools

Fast-moving growth creates opportunities for tax evasion and may encourage a culture of noncompliance. Auditing can not only detect and penalize evasion attempts but also signal a tax

administration's intention to prioritize more aggressive enforcement. One such administration, for example, installed a group of some 50 auditors while at the same time training about 100 tax examiners. To automate parts of the process, the administration developed specific audit tools, which simplified procedures and improved the overall quality and consistency of audits. Within six months, the auditors' productivity rose more than tenfold and audit-related collections increased fiftyfold. Voluntary compliance increased substantially thanks to the perception of increased controls. As a result, revenue from the corporate income tax has risen by over 30 percent year on year.

#### [Use simple segmentation to identify larger collection opportunities](#)

Most rapidly developing economies lack the advanced analytic tools and databases necessary to flag and follow up on suspicious taxpayer behavior automatically. Nonetheless, simply segmenting taxpayers according to attributes such as size, sector, and past behavior can help tax authorities quickly perform a risk analysis identifying discrepancies between an individual taxpayer's behavior or payments and that of his or her cohort. By applying this technique to approximately 500 taxpayers, the tax administration in one African country, then in the early stages of its improvement journey, identified a small number of taxpayers who together owed 5 percent of the nation's total uncollected tax debt. The administration expects to recover over half of this amount.

#### [Target collections in the tax offices with the largest outstanding debts](#)

In many emerging markets, tax collection is neither automated nor centralized. Collection rates are often low, and there is little awareness of how much is truly owed. In response to this challenge, one customs authority identified the importing businesses that owed the most in back taxes and put in place a technical team to negotiate payment terms directly with debtors. The program helped minimize opportunities for importers to accumulate more debt and also served to publicize the customs authority's intention to act against evaders. Within three months of launch, the initiative helped collect approximately 15 percent of the customs department's outstanding debt—corresponding to some 2 percent of its yearly revenue—and reduced the rate of new-debt formation by more than half.

#### [Ensure regular updates to the taxpayer registry](#)

In many rapidly growing markets, it can be difficult to maintain an accurate central taxpayer registry, as much of the economy is made up of “informal” and small-scale businesses, and tax authorities lack the external controls necessary to ensure that such entities stay within the system. To counteract this, registration should be made more rigorous and feedback systems introduced to ensure that taxpayers regularly update their information. Additionally, quick and simple controls can be put in place to raise the alarm if taxpayers fail to comply with their obligations. One tax administration in Africa, for example, launched an aggressive two-week effort to improve its registry. During this period, the authority closed selected branches and sent their officials into the field to identify and register informal businesses in specific areas. Taxpayer registry entries increased by 20 to 30 percent in the targeted districts.

#### Introduce account managers to oversee large taxpayers

In most countries, a very small number of taxpayers account for the majority of tax revenue. Although tax administrations usually have large-taxpayer units, these LTUs often use the same processes, rules, and resources as general tax offices. LTU “account managers,” supported by a back office devoted to their needs, can provide large taxpayers with differentiated and improved services that will ensure increased revenues. One sub-Saharan country, for example, doubled the number of auditors in the audit teams of its large-taxpayer unit and implemented an ambitious training program to raise their technical skills and the quality of their work quickly. In parallel, the unit launched a focused effort to analyze and close a small number of high-value, complex cases in specific sectors by using specialized audit teams with sector-specific training and skills. The additional revenue the specialist teams identified equaled 2 to 3 percent of the tax authority’s total yearly revenue.

#### Use electronic channels for simple transactions

In many rapidly developing economies, mobile and Internet penetration are comparatively high. Tax administrations can therefore introduce electronic channels such as Internet portals, mobile-payment options, and ATMs. By using these channels for simple taxpayer transactions (such as declarations and payments), a tax administration can increase the level of voluntary payments while conveying a strong sense of its public purpose. Such approaches reduce the length of queues at tax offices while also removing a barrier to compliance.

#### Communicate the benefits of the quick wins widely

Communication about tax programs should address three areas: promoting the benefits of paying taxes, educating taxpayers about how to comply, and increasing the perception of risk for noncompliance. The communication plan should include both institutional and initiative-specific messages. It can incorporate appeals that have an emotional element—for example, linking the use of tax revenue to the funding of schools or highlighting sanctions for failure to comply. Other messages, such as explaining changes to tax laws or procedures, can be purely informative.

Effective communication promotes voluntary compliance. By communicating specific tax initiatives even to residents who weren’t necessarily affected by them, one country more than doubled their impact because the general population felt obliged to comply with broader tax rules.

#### Analyze opportunities to close tax loopholes

With input from senior tax officials, tax administrations can perform a top-down, granular analysis of each type of tax to establish whether there are opportunities to close sector-specific tax loopholes quickly. The analysis should establish whether there are any significant gaps between the expected and the effective tax rates.

Using this approach, a Latin American country identified two large economic sectors that had exploited loopholes (for example, legacy tax exemptions) to pay effective tax rates from a quarter to a sixth of the nominal corporate income-tax rate. With only limited legislative changes—and still keeping nominal tax rates for these two sectors lower than they were in neighboring countries—the administration increased total corporate income-tax revenues by more than 10 percent in one fiscal year.

#### Simplify the tax system to encourage formalization

The tax systems in most rapidly growing economies are highly informal and often unnecessarily complex. Simplifying the tax code encourages voluntary compliance, while at the same time sending the message that efforts to formalize the system are a priority. For example, in 2009 South Africa introduced a less complicated “turnover tax” as an alternative to the normal corporate income tax and value-added tax. The system attracted more than 7,000 new taxpayers in the first year alone. A large portion of them were converted from the informal economy.

#### Create external checks that enforce compliance

Often, informal businesses that don’t pay taxes nevertheless interact with government agencies as part of normal operations. Tax administrations can work with these agencies to verify the tax status of businesses. Such checks need not be overly intrusive but can still effectively encourage formalization. One rapidly developing country, for instance, passed a law requiring government workers to check the tax administration’s registry when residents attempted to import goods, send funds abroad, sponsor applications for work visas, or apply for public contracts. The law was then broadly publicized in the media, showcasing the government’s commitment to formalizing the tax system and ultimately increasing voluntary compliance.

#### How to do it

We have identified four broad success factors that help tax-administration reform programs achieve the desired level of impact. While these factors are important in all such programs, they are especially critical in rapidly growing markets, where implementation is particularly challenging.

First, the program must be coordinated across all the relevant government functions, including communications, human resources, IT, and legislation. Second, governments must secure a sufficient long-term commitment of financial and organizational resources at the outset. Such a commitment will minimize the possibility that a program will be abandoned as a result of a change in political actors.

Third, the program must deliver some early successes, as these will provide legitimacy and finance longer-term initiatives. Finally, a technical team focusing solely on this work (and

operating separately from any political structure) should collaborate closely with the tax-administration staff responsible for day-to-day business. The team must design and implement the initiatives, establish clear metrics, and closely monitor the results.

For more on this research, download the full report, *Unlocking tax-revenue collection in rapidly growing markets*, on [mckinsey.com](http://mckinsey.com). [□](#)

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