

**The Challenges of Tax Administration in Somaliland Ministry of Finance: A Critical Analysis of  
Institutional Perspective**

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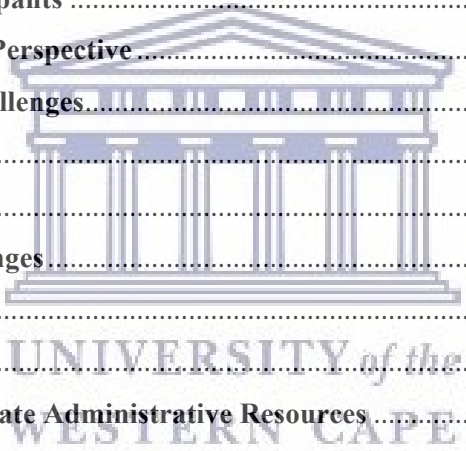
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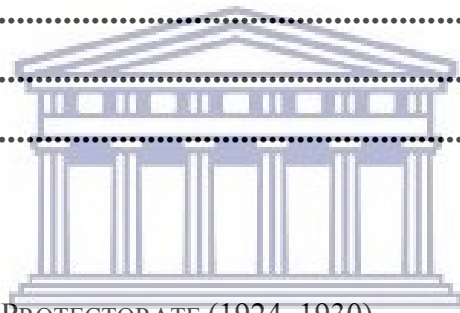
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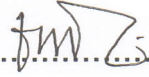


## Declaration

I declare that the mini-thesis entitled “The Challenges of Tax Administration in Somaliland Ministry of Finance: A Critical Analysis of Institutional Perspective” is my own work and has not been submitted for any degree or examination for this university or any other university. All the sources I have used or quoted have been indicated and acknowledged as complete references.

Faisal Haginour

December 2018

Signature: 



## Acknowledgements

I would like first to thank Allah for having given me the strength and the good health to be able to conduct my mini-thesis.

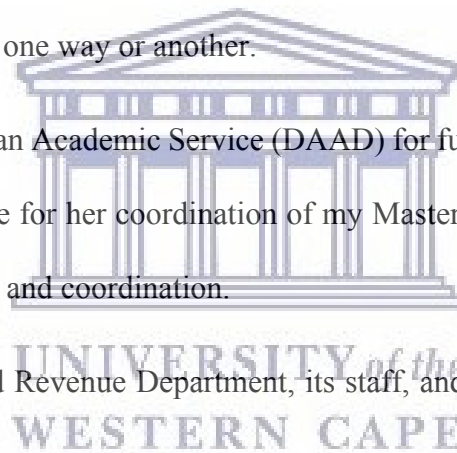
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## Abstract

This research focuses on the challenges of tax administration in Somaliland Ministry of Finance (MOF). The study analyses existing challenges in the MOF-Tax Administration, causes of these challenges, the impact of these challenges on domestic revenue collection as well as the country's economic growth and development. In order to obtain a desirable, comprehensive, and in-depth understanding of the research problem, the researcher applied a mixed method approach, thereby limiting the weaknesses of using the quantitative or qualitative research approach alone. The sample size consisted of 63 staff members. The research included 57 questionnaires for 57 employees and lower level managers as well as 6 interviews for top and middle-level managers in Somaliland Inland Revenue Department. The data was analyzed using Statistical Package for Social Science (SPSS), Ms. Excel, and conceptual analysis, where themes were developed and analyzed.

The key findings of the research were that Somaliland tax administration faces immense challenges that can be broadly grouped into three categories: institutional challenges, attitudinal challenges as well as political and economic challenges. These challenges are mainly due to the absence of professional staff, the lack of taxpayers' education, outdated tax laws, non-compliance behavior of taxpayers, rigidity of the tax system, and poor public trust amongst others. These challenges restrained tax revenue collection, public service provision, investments, and economic growth issues. Therefore, the recommendations, accordingly made in this thesis, include, amongst others, the need to establishing a professional training center for staff, automating tax procedure, implementing effective performance appraisal system, and the regular updating of tax policies to establish a transparent, accountable and equitable tax system in Somaliland.

**Keywords:** taxation, tax administration, tax challenges, taxation impacts, tax system

## **List of Abbreviations**

BRICS        Brazil Russia China South Africa

DAAD        German Academic Exchange Service

ERCA        Ethiopian Revenue Customs Authority

FDI         Foreign Direct Investment

IMF         International Monetary Fund

IT            Information Technology

KRA         Kenya Revenue Authority

MOF         Ministry of Finance

SARS        South African Revenue Service

SIR         Somaliland Inland Revenue

SNM        Somali National Movement



SPSS Statistical Package for Social Science

TJNA Tax Justice Network Africa

URA Uganda Revenue Authority

USC United Somali Congress

VAT Value Added Tax



## Chapter One

### The Challenges of Tax Administration in Somaliland: Introducing the Study

#### 1.0 Introduction

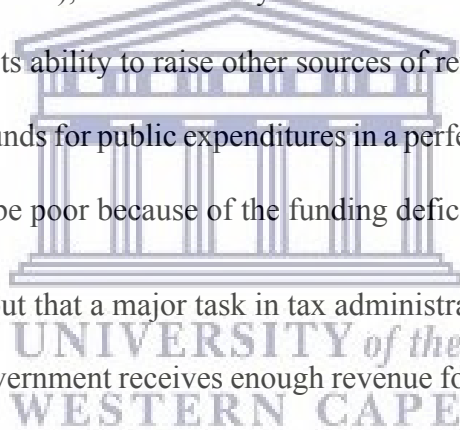
Tax administration, also referred to as tax authority or tax service, is a system that levies and collects taxes imposed by the tax proclamations and regulations of its respective country. Alink and Van Kommer (2011) define tax administration as a system that administers tax by implementing and enforcing tax laws. Similarly, Jimenez et al (2013) define tax administration as a department of a government that is in charge of enforcing tax policies and laws. Similarly, Abiola and Asiweh (2012, p. 103) state that tax administration is formed for two reasons; firstly, to create tax laws and secondly, to enforce tax laws in an attempt to realize goals of these tax laws. Summatively, a tax administration can be seen as an independent agency or an agency under a Ministry of Finance in a country that is responsible for tax obligations specified by tax laws. Thus, it is key for revenue generation in most of the world nations.

Tax administration plays a critical role in today's modern governments. According to Williams (2014), there are 10 countries with no personal income taxes. These countries are Saudi Arabia, United Arab Emirates, Brunei, Oman, Bahrain, Cayman Islands, Kuwait, Qatar, Bermuda, and the Bahamas. However, these countries still impose other forms of taxes as the revenue from natural resources like oil and gas as well as tourism could not be enough to cover these governments' expenditures. Tanzi and Zee (2001) argue that tax remains a core means of revenue generation for governments to provide necessary public services until someone comes up a

substitute solution. Therefore, well-functioning and proper tax administration structures are vital to any country. Alm (1996) states that a sound tax administration is efficient, fair, and simple. McDonald and Jumu (2008) also argue that an effective tax administration is central for generating revenue and redistributing of wealth and it is essential for building public trust in government. Thus, establishing a fair, efficient, and effective tax administration without discouraging investment activities or economic activities as a whole is vital.

In addition, the tax system of a country necessarily works in conjunction with the national objectives hence assists society in achieving various life goals. According to Bird (2008), the best tax system is a mirror that reflects the country's economic shape, the capacity to tax, provision of public services, and its ability to raise other sources of revenue. Similarly, Micah et al. (2012) argue that a sound tax administration can generate necessary funds for public expenditures in a perfect manner. These statements confirm that without a sound tax administration, public service would be poor because of the funding deficiency.

Furthermore, Jimenez et al. (2013) point out that a major task in tax administration is to make sure that sufficient amount of tax revenue is raised from taxpayers to ensure that government receives enough revenue for funding public goods and services. Thus, strong tax administration leads to adequate tax revenue generation and expands governments' capability to implement public projects that in turn, boosts different aspects of growth and development. Tax administration is the machine of raising the necessary fund for financing public service delivery as well as enhancing the socio-economic growth of respective societies. An efficient tax administration is very critical for the existence of a government. A government cannot exist without funds and tax administration as they play a vital role in generating required funds.



Taxation primarily aims to raise revenue hence enabling governments to cover their expenditures. It also aims to reduce wealth inequalities among citizens, promote economic growth, and change people's behavior. Therefore, it is indispensable for a tax system to explore and combat any challenges against its primary task of collecting adequate revenue in addition to stabilizing of economic policies and contributing to country's different development aspects amongst others. However, most tax administrations in developing countries face some formidable challenges in establishing an effective, efficient, and equitable tax system. The major challenges of tax administrations in the developing world are highlighted in Chapter Two, the literature review and include capacity constraints, the nature of the developing world's economies, policies, and poor government legitimacy to mention a few. According to Bird and Zolt (2008), some tax administration challenges in developing countries are smaller tax bases, informal economic structures, and traditional agriculture systems.

There are several causes of these challenges in the developing world, as indicated in the succeeding chapter. Some causes are outdated tax policies, lack of transparency in governments, poor norms of compliance as well as lack of taxpayers' education. Rai (2004) contends that tax exemptions for political reasons and agricultural income, as well as the high level of unemployment are the main causes of poor tax administration in developing countries. Likewise, Kayaga (2007) points out that taxation challenges in developing countries are due to unskilled and insufficient administrative staff, a significant level of illiteracy in both taxpayers and tax collectors, inadequate facilities as well as lack of taxpayers' information.

These challenges of tax administration in the developing world have affected these countries' revenue collection, government trustworthiness, and economic growth and development. Bird (2010) posits that poor tax administration reduces tax revenue, debilitates the legitimacy of government, and weakens governments capacity to fund its expenditures. This revenue gap in government delays public projects, economic growth of the country as well as provision public goods and services. As a result, without proper taxation, a country loses its capacity to finance these paramount public services. Therefore, proper enforcement of tax laws, efforts to bolster taxpayers' education, and setting up an appropriate tax administration could be immensely beneficial in establishing effective, efficient, and equitable tax systems and in turn tackle all other tax administration challenges.

This study specifically focuses on Somaliland tax administration challenges. Somaliland shares some common challenges as other developing countries. According to Hassan and Tellander (2016), Somaliland tax administration suffers from outdated tax laws, lack of transparency, lack of public trust in government, weak enforcement of tax laws, and poorly trained staff, which are common in all developing countries. In addition, lack of international recognition further negatively affects Somaliland tax administration. Mukhtar (2017, p. 83) argues that the lack of international recognition is an obstacle to Somaliland's eligibility to enter multilateral and bilateral agreements. Huliaras (2002, p. 165) agrees and states that Somaliland suffers from a lack of formal recognition as it limits foreign direct investment. Low foreign direct investment eventually decreases employment opportunity and in turn, reduces government's tax revenue collection as well as the country's growth rate. Therefore, Somaliland must have an adequate, efficient and effective tax administration system to fill the gap opened up by the lack of international recognition. To establish a sound tax administration, Somaliland should also address current challenges in tax administration and prevent future. The following section discusses Somaliland for the purposes of

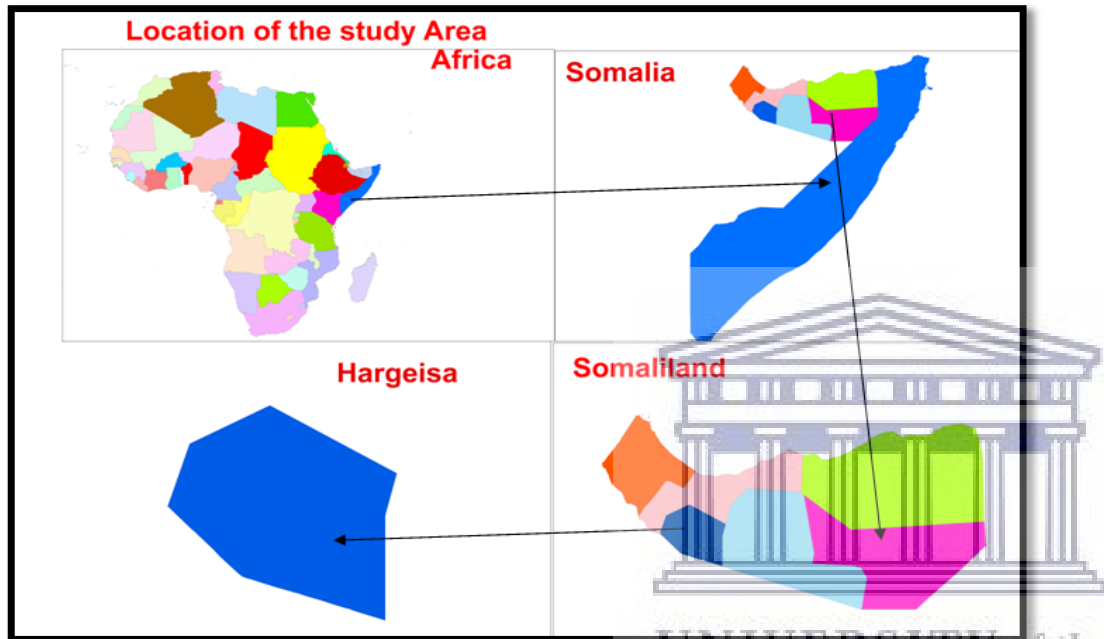
generating further understand and giving an overview of the current study. The succeeding section, entitled “study area”, provides details of the site for this research.

## 1.1 Study Area

Somaliland has been a self-declared, independent, and unrecognized state since 1991. Somaliland has established a stable and democratic system that has been fully functioning for the last 26 years. However, it still lacks the international community recognition to be an independent country. Somalilanders, both ordinary citizens and state officials, argue that Somaliland has fulfilled all the state features, including a functioning democratic government, national currency, passport, army forces, and others. Yet, not even a single nation in this world has recognized Somaliland as an independent country from the failed state of Somalia. Somaliland is an unrecognized country in the Horn of African. Known as Somaliland British Protectorate while it was under British colonial rule from 1887 until 1960. Somaliland gained its independence from Britain on June 26, 1960. However, it was only an independent state five days before its union with Italian Somalia. Somalia became independent on the day of the union, July 1, 1960, from Italy. Somaliland is an irredentist state/secessionist state in the northwestern part of the country, formerly known as The Democratic Republic of Somalia. Section 1, Article 2 of the constitution of the Republic of Somaliland (2000) states that Somaliland shares borders with Yemen to the north, Somalia to the east, Ethiopia to the south and west, and Djibouti to the north-west. Somaliland territory remains the same as in the time of the British Somaliland Protectorate (Constitution of the Republic of Somaliland, 2000).



*Figure 1.1.* Map of the study area.



**Source:** Author's own design

Somaliland has a population size of 3.5 million; a majority of Somaliland population live in rural areas (Kiruja et al., 2017). With regard to public services, these people need clean water, housing, health, education, electricity, and security among others. Therefore, because of the broad and varying nature of services the government should provide to its citizens, sufficient funds are necessary. Yes, provision of services to citizens is not the only function of governments. Musgrave (1959) believes that three roles were

assigned to governments. Firstly, governments should firstly stabilize the economy, distribute wealth equitably among their citizens secondly, and allocate resources appropriately thirdly. However, Somaliland always struggles to generate adequate revenue to fund its activities as many other developing countries in the world.

Somaliland government, as far as it is not internationally recognized and is not eligible to make international agreements of investments or aid, it relies heavily on tax revenue. Nevertheless, Somaliland tax administration able to generate the necessary revenue. Ali (2014) states that Somaliland tax administration faces two challenges, inadequate revenue generation and poor administration of taxes. Thus, proper administration of tax policy and the tax system at large are critical for the government to raise enough tax revenue. Gill (2003) poses that total revenue collected by a government hugely relies on how effective and efficient its tax administration is. Therefore, it is also applicable to Somaliland, as far as governments need to raise revenue that matches their demands of funds, and then governments should have a sound tax administration.

Inland Revenue Department under Somaliland Ministry of Finance (MOF) is the government body responsible for assessing, collecting, administering, and reporting tax revenue in Somaliland. This research will assess challenges faced by this institution; more will be discussed under “Research Problem Statement”.

## **1.2 Research Problem Statement**

Somaliland is among the poorest countries in the world with a population size of 3.5 million and a GDP per capita of \$444 (NDP II, 2017). Although there is good internal legitimacy, where many people are willing to pay taxes and lack of external legitimacy in

somehow creates the growth and development of Somaliland internal legitimacy (Pegg and Kolsto, 2015).<sup>1</sup> Yet, a well-functioning tax administration is critical for Somaliland's economic development as far as Somaliland is not a recognized nation. This is because, Somaliland tax administration has not been able to collect the required revenue or contribute to the betterment of other fiscal policies of the country. Some of the government projects were delayed because of lack of funds. Tax administration officials always worry about tax administration challenges and the potential for a poor tax revenue collection. I believed that corruption practices of tax officers, poor technological capability in the organization, outdated tax laws and hence tax avoidance,<sup>2</sup> tax evasion,<sup>3</sup> poorly educated and unskilled staff as well as lack of tax education for the taxpayers to mention a few, are factors that lead to the inefficacious tax revenue generation. Ahmed (2016) states that Somaliland collects less than 7% of its GDP's from tax revenue, i.e., less than half of the Sub-Saharan Africa average and below the minimum UN requirement for achieving sustainable development goals. Therefore, this research analyses existing challenges against adequate revenue collection, causes of these challenges, socio-economic impacts of these challenges as well as the possible solutions to these challenges.



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<sup>1</sup> Lack of external legitimacy limits collaboration of international community with Somaliland. Hence it limits Somaliland and its civil servant's access to technological development of other nations. On the other hand, lack of external legitimacy unites locals as they learn to use the little resources and experience they have wisely.

<sup>2</sup> Tax avoidance is a method of reducing tax by making use of loopholes in tax laws without breaking the laws.

<sup>3</sup> Tax evasion is an illegal act where taxpayer cheats tax administration and completely denies his/her tax liability.

### **1.3 General Objectives of the Study**

This research analyses existing challenges in Somaliland tax administration, causes of these challenges, and the effects of these challenges on revenue collection. It also assesses possible ways to improve Somaliland tax system to solve current challenges and prevent possible future problems.

#### **1.3.1 Specific Objectives of the Study**

1. To analyze the challenges of tax administration in Somaliland.
2. To evaluate the causes of these challenges in Somaliland tax administration
3. To assess the impact of these tax administration challenges on revenue collection; specifically, potential indirect impacts on the country's economic growth and development.
4. To analyze possible ways of solving the current tax administration challenges in Somaliland and preventing future threats

### **1.4 Rationale and Significance of the Study**

A tax administration can only successfully accomplish its tasks of revenue collection, stabilization of fiscal policy, promotion of economic growth, and others when it addresses its challenges. Likewise, discovering the existing challenges as well as how the tax administration can solve them would determine how efficient and effective it would perform in its tasks. This, in turn, would determine the amount of revenue it could generate and the contribution of the tax system to the prosperity of a nation. Nevertheless, Somaliland is a 26 years old de facto state. Its institution building has commenced from the scratch after the Somalia central government collapsed

due to the savage dictatorship of Siad Barre, the loss of the regime legitimacy after the defeat of Ethio-Somali war in 1977 as well as the Somali National Movement (SNM) and United Somali Congress (USC) liberation wars. Due to this, all the existing systems, institutions, and infrastructure were destroyed. Hitherto, there are no strong research institutions, which can produce reliable information for solving existing socio-economic problems in public institutions and in the country as a whole. Therefore, this research contributes to the Somaliland Ministry of Finance and tax administration, in particular in identifying current challenges in administering Somaliland taxation.

Moreover, tax administration can only ensure high compliance of taxpayers and lower administrative costs when it recognizes where the problems lie before confronting them. Hence, identification of current challenges is part of finding solutions. In addition, this research is perhaps one of the few projects investigating the tax revenue generation/revenue system in contemporary Somaliland. Furthermore, this research would be a resource of empirical literature for potential researchers who are interested in doing researches of the same or a related field. Lastly, this research provides recommendations to policymakers and the administration to make the Somaliland tax system more effective, efficient, and equitable.

## **1.5 Scope of the Research**

This research was delimited geographically to the Somaliland Inland Revenue (SIR) department under MOF. The research was conducted in Hargeisa, Somaliland's capital city, where SIR Head-Quarter is located. The research focused on this city because it is the main source of revenue for Somaliland Inland Revenue. It is also where the largest number of SIR staff work and where the most tax

revenue is collected. According to Adam Smith International Report (2014), over 80 percent of tax revenue is collected from Hargeisa and its nearby townships. Moreover, the scope of this research study was limited to this specific location to avoid resource and time constraints.

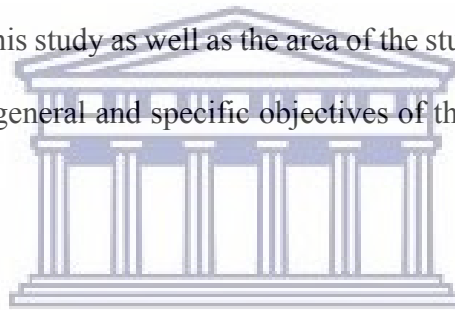
## **1.6 Chapter Outline**

### **1.6.1 Chapter 1: Introduction**

This provides introduction of the field of this study as well as the area of the study. The chapter also highlights other introductory parts of the research such as problem statement, general and specific objectives of this research, rationale and significance of the study as well as the scope of this research.

### **1.6.2 Chapter 2: Literature Review**

This chapter presents the results, arguments, and statements of other researchers who conducted research that is closely related to this study. This chapter outlines definition, history, and role of tax as well as tax administration challenges in the developing countries. It also demonstrates the effects of tax administration challenges in the developing countries and potential corresponding solutions. Moreover, this chapter familiarizes the reader with the ongoing dialogue of the related studies.



### **1.6.3 Chapter 3: Research Methodology**

This chapter provides the research approach to this study, the design of this research approach, sample design, sample size, data collection instruments as well as ethical considerations of the research.

### **1.6.4 Chapter 4: Data Analysis and Interpretation**

This chapter offers the presentation, analysis, and discussions of the research findings using both Statistical Package for the Social Science (SPSS) as well as Atlas ti8.

### **1.6.5 Chapter 5: Conclusions and Recommendations**

This chapter summarizes the outcomes of the research and it concludes the findings. The chapter also provides recommendations for where corrections and improvements are needed in the Somaliland tax administration.



## Chapter Two

### The Challenges of Tax Administration in Somaliland: Review of the Literature

#### 2.0 Introduction

This chapter highlights the ongoing discussions and studies surrounding this research problem statement. The chapter covers the historical trajectory of taxation in the first civilizations that introduced taxes as well as in Somaliland. It also contains the definitions of taxation, roles of taxes in governments, tax administration challenges in the developing world, causes of these tax administration challenges in the developing countries, effects of these challenges primarily on tax revenue collection as well as on economic growth, economic stabilization, and other development aspects of the developing countries. This chapter also discloses the views of scholars on how to improve tax administrations to counter the challenges faced by developing countries.

#### 2.1 Trajectory of History of Taxation

Taxes are as old as the existence of organized societies (governments) or human civilizations. Unlike other voluntary transfers of money from individuals to governments, from governments to governments, or from individuals to individuals, and so forth, a tax is a kind of compulsory payments imposed by the governments on different financial transactions and activities. Many scholars define taxes similarly. Jones and Rhoades (1998) define tax by stating that, unlike fines and penalties to penalize inappropriate individual behaviours, the tax is a payment to contribute to public expenditures. Without a source of revenue, governments could not even finance

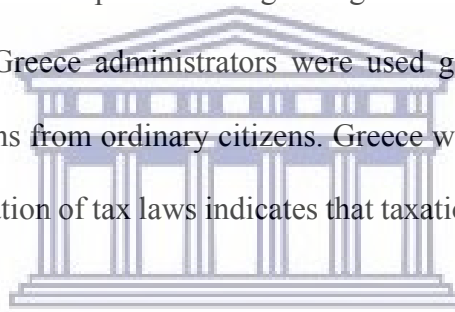


their current expenditures. Hence, the tax is an essential source of governments' revenue. This is particularly true when governments do not have alternative sources of revenue like natural oil, gas, etc., to finance public projects.

Tax is mandatory under a country's laws. McGee (2008) defines tax as a mandatory payment provided to the government that is nonrefundable and carries no equal benefits in return. Likewise, Lavrenchuk (2013) defines tax as an obligatory fiscal contribution to the costs of governments by an individual or group of individuals. These two definitions indicate that tax is obligatory, i.e., anybody who is obliged to pay tax by a tax law of a country must pay it. In addition, Kiprotich (2016) defines tax as a fee imposed by an authority on goods and services as well as financial activities to fulfill its financial demands. All these definitions of tax agreed that tax is compulsory under the law and it is unlawful to evade it. Furthermore, definitions of tax also indicate that there is no direct and equal return of taxes to taxpayers. According to Worlu and Nkoro (2012), governments generate tax revenue to deliver public services of health, education, roads, security as well as job creation, which are impossible without taxes. These public services are characterized as non-excludable; meaning that a taxpayer would enjoy the same services regardless of his/her percentile contributions to the public revenue pool.

As mentioned before, taxation started with the existence of public governance. This is because as soon as the government comes into existence; it is expected to provide public goods and service to its respective inhabitants. It is also expected to cover its operational and administrative costs. Therefore, tax is inevitable for governments in fulfilling its role to provide services, citizens' protection, and sustainability of social development. Therefore, taxation dates back to ancient civilizations like Iraq, Greece, Egypt, and the Roman

Empire. Carlson (2005) states that the first tax was imposed on clay tablets around 6000 B.C in the city of Lagash, where modern Iraq is today. The monetary system did not yet exist when civilization first began to tax those under their administration. Thus, these civilizations imposed the tax in the form of food. Specifically, they would ask farmers to contribute to the ruler a portion of their harvest. Ordinary people were also forced to work for the rulers or kings as they were considered the ruler's property. Sergidis (2012) notes that Ancient Greeks enacted grain (wheat and barley) tax law in 374/3 BC on the three islands of Lemnos, Imbros, and Skyros. Stroud (1998, p. 2) also states that Athenian rulers authorized "intricate provisions regulating a tax on this grain, which I will argue was a tax in kind." Similarly, Tedla (2008) contends that Ancient Greece administrators were used generating revenue from mining, taxes levied on conquered lands, customs duties, and contributions from ordinary citizens. Greece was one of the oldest civilizations, if it was not the first, to impose taxes. Therefore, their implementation of tax laws indicates that taxation was one of the first revenue-generating sources in government history.



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However, Ancient Egyptian rulers, who were also among the first human civilizations to impose taxes, levied different taxes. Egyptians taxed land, grains, cattle, beer, and oil (Carson, 2005, p. 3). He also remarks that Romans imposed property taxes on land, livestock, buildings, and other personal properties between 200 B.C to 300 A.D. These statements show that taxation has existed since the era of ancient civilizations.

In the Middle Ages, Europeans paid taxes to their administration in the forms of money or crops. Tedla (2008) highlight that Europeans were obliged to pay various forms of taxes, which included toll taxes, property taxes as well as fines and fees between the 5<sup>th</sup> century to the 20<sup>th</sup> century.

In Somaliland, taxes were introduced in the 20<sup>th</sup> century, during the British colonial era. However, the implementation of tax laws was not effective due to people’s antipathy toward the British colonialists. Soran (2015) highlights that when taxes were introduced in Somaliland by British colonialists at the beginning of the 20<sup>th</sup> century but Somaliland people opposed it because they considered it as an unjust payment. This resistance of Somaliland people against colonial taxation forced the British to stay in cities along the coast, keeping its interest in safeguarding its ships crossing Somaliland water. Kakwenzire (1986, p. 661) argues that Britain, having failed to discover any exploitable resources and tax the Somalis, Britain kept Somaliland Protectorate solely for the purpose of defending her strategic interests in the Red Sea, particularly in the busy trade route of Gulf of Aden. A small amount of revenue came from customs and duties. The tax revenue from the Inland Revenue Department was negligible or did not exist at all. **Table 2.1** below shows the financial position of British Somaliland Protectorate (currently The Republic of Somaliland) in the period between 1924 and 1930.

**Table 2.1.** The Budget of British Somaliland Protectorate (1924–1930)

Year	Revenue (£)	Expenditure (£)
1924–1925	82,806	150,569
1925–1926	89,057	167,955

1926–1927	90,569	149,125
1927–1928	159,478	198,628
1928–1929	101,541	207,067
1929–1930	105,304	199,027

**Source:** Resistance, Revenue and Development in Northern Somalia, 1905–1939, by Patrick Kakwenzire

The table illustrates that there was a huge budget deficit in the administration throughout those years. This is a clear indication of people’s resistance against taxation and poor compliance of taxpayers with the tax laws, which created the gap between the revenue collected and the expenditure. Kakwenzire (1986) highlights that in so far as the revenue did not match the expenditure, the colonial administration used imperial grants in aid to cover the difference.

After the union of the British Somaliland Protectorate and Somalia Italiana (Southern Somalia) to form The Somali Republic, the tax administration challenges remained the same. The united government faced difficulties in integrating the two tax systems, Somalia Italiana and British Somaliland, where the tax laws are completely different and the former had a higher tax rate than the latter. The new government tried to impose higher tax rates on Somaliland but the people rejected and protested against that tax system. Somaliland declared that it is an independent state from Somalia in 1991, but the challenges still exist in Somaliland tax administration to accomplish its tasks satisfactorily. Hassan and Tellander (2016) state that Somaliland does not have proper tax policies or a strong institution that is capable of collecting the required revenue.

In the earliest times, governments use taxes revenue to cover the administrative, defense, and personal costs of kings. Hence, there was not as much pressure on tax administrations. Nowadays, the purpose of taxation is beyond covering these basic costs. Taxes are now imposed largely to contribute to country's demanded funds to further various social and economic developments in society. Taxation has been changing throughout time, and in each era, taxation has been a key source of public funds. Taxes are so important because governments are required to deliver public services of national defense, firefighting, policing, education, health care, water provision, and others. Governments must spend money to cover the costs of these services and taxes are the most sustainable source of funds in nearly all circumstances. This is because tax, particularly domestic revenue tax, is a source of a fund that a country has a full control over.

In the earliest era, the main purpose of taxation was to cover kings' expenses and minimal public expenditure. It is now beyond that. Taxation is an instrument of fiscal policy, a source of fund for public expenditures, a tool to reduce inequalities, a tool to redistribute wealth among citizens of respective countries, and so forth.

Taxes are not only a source of funding for public expenditures but it also plays a critical role in economic stabilization (fiscal policy tool) as well as economic growth. Taxes affect ability and willingness to work, save, and invest. Wasylenko (1997) argues that 75% of a country's analysis of its economic growth in terms of investment and employment as well as firms' decisions on where to open new branches include tax issues. Stiglitz (2000) also describes tax as an automatic stabilization. This is because altering a tax policy creates a economically recoverable environment in a financial crisis. Tax, as far as it is a compulsory transfer of money from taxpayers

to the government, has an effect on consumption as it reduces the purchasing power of taxpayers. Moreover, Cobham (2005) in setting out the four roles of taxation discusses taxation as a source of revenue. He then points to its role of redistributing income to reduce inequalities among citizens of different economic status. Representation is the third role of taxation, which Cobham directly relates to the statement, “no taxation without representation”. Finally yet importantly, the fourth role of taxation is to re-price economic alternatives. Similarly, McDonald and Jumu (2008, p. 10) mention that there are four main goals for taxation: to generate revenue, to reduce inequality, to impose commodity control and to offer representation. In addition, Uzonwanne (n.d, p. 54) states that tax is a tool to address inflation. Specifically, taxes are raised to shrink consumption to lower investment and inflation. These statements emphasize the importance of tax as an instrument of economic stabilization and economic growth as well as a source of funding for public policies, programs, and projects. Thus, a sound administration of taxes is critical.

Somaliland has many lessons to learn from its own history of taxation as well as those in ancient times. This is because, the past and present are interdependent, if one wants to know where one is going, then must study the past. The same is true for organizations, governments, and the like. Hence, one will maintain successful actions in the past and avoid failed ones. The same is true for Somaliland. Somaliland needs to learn from others’ history of better tax administration. According to Waris (2008, p. 274), tax system constituents are the history and experiences of people in tax laws and politics. This indicates that known history could provide a hand in informing current decisions.

Somaliland is one of the poorest nations on the African continent and it is a developing country. Developing nations share some common taxation challenges, including informal economic structure, illegal trade (contraband), tax evasion or avoidance, poor capacity of tax systems, and political instability to mention a few. The following section further details the most common tax administration challenges in developing countries while Chapter Four in this research provides an analysis of specific tax administration challenges that the Somaliland tax system faces.

## **2.2 Tax Administration Challenges in Developing Countries**

There are different tax administration challenges for different nations in the world and these challenges are different in terms of the size, impact, and geographic location of their challenges, political stability and advancement of technology. Specifically, war-torn, fragile and post-conflict countries like Somaliland, Somalia, South Sudan, and emerging powers like Brazil, Russia, India, China, and South Africa (BRICS) would not have identical tax administration challenges.

However, the developing nations face tax administration challenges that are somewhat related or similar in nature. Tanzi and Zee (2000) posit that the developing countries face some daunting problems in setting up a sound tax system. They point out that informal economic structure, lack of proper tax data, political instability and capacity constraints are the four challenges of taxation in the developing world. The developing countries, particularly in Africa, small and informal businesses, as well as subsistence agriculture are the dominant economic activities in the market structure, which makes taxation difficult. These economic characteristics shrink the tax base and put pressure on tax revenue generation.

Similarly, the absence of proper tax data for taxpayers and their taxes dues hampers the amount of tax revenue that could be collected and the number of taxpayers in the tax net. Civil wars, military coups, dictatorship, and autocratic governments are also common in developing countries. This hugely disturbs countries' political stability and in turn diminishes the capacity of public institutions, including tax administrations. Therefore, these countries always experience poor performance in their domestic revenues mobilization, particularly in inland taxes. With regard to Di John (2006, p. 16), collecting taxes is very difficult in poor countries, particularly in countries recovering from civil wars. In addition, political instability disrupts both foreign direct investment (FDI) and domestic investments; this, in turn, reduces the amount of tax revenues to be collected.

These challenges deter socioeconomic development in developing countries. The same applies to Somaliland. Challenges of tax administration in developing countries may include resource constraints, structure of their economy, technological flaws, policy gaps, corruption, sociocultural, and others as mentioned above. Bird & de Jantscher (1992) assert that some administrative challenges that tax administration systems do not focus on include tax avoidance, evasion as well as administrative and compliance cost. Kangave (2005) also states that some tax administration challenges in developing countries include non-compliant behaviour in taxpayers, corruption in tax systems, and limited resource in public institutions. These challenges limit revenue mobilization as well negatively affecting the socioeconomic growth of respective nations. Magashula (2009), while highlighting the major tax administration challenges in African countries, asserts that narrowness of the tax base, large scale of the informal economic sector, lower tax rates, tax evasion, and loopholes in tax laws are the principal challenges. Likewise, Salami (2011) highlights that tax administration challenges include corruption, fraud



made by tax collectors, lack of information about taxpayers, compliance challenges, and administrative challenges (i.e., inadequate staff and institutional capacity constraints to administer taxes meritoriously).

Moreover, South Africa Revenue Service (SARS) (2014 cited in Lewis and Alton, 2015) states that in addition to informal economic structure and illegal businesses, rich people and transnational companies escape paying their taxes. This also means that informal economy and illicit financial flows plus other illegal transactions that are all common in developing countries also exist in South Africa.

Similarly, Micah, Ebere, and Umobong (2012) state that taxation problems in the Nigerian tax administration include lack of tax data, failure to deal with tax issues, improper administering of limited resources, duplication of tax, a regulatory problem as well as the structure of Nigeria economy. Moreover, Hussein (2017) contends that improper tax administration, poor hierarchy of the system that hinders communication, and lack of motivated staff are some of tax administration challenges in Somaliland. These findings of Hussein matches the current findings of this research. All these challenges in developing countries are similar in that they hamper collection of taxes revenue as well as the social and economic development of these nations.

In the next section, we shall individually discuss the challenges faced by the tax administration in the developing world, focusing on Africa. According to the scholars referred to above, the most common challenges are of the developing world are: informal economic structure, capacity constraints in tax administrations, corruption in tax administrations, non-compliance attitude of taxpayers as well as political instability.

## 2.2.1 Informal Economic Structure

Informal economic structure is a common taxation challenge in most developing countries and particularly in African, where small, informal enterprises and agricultural sectors dominates the economic structure. It is believed that the informal economy is more prominent in developing countries than in developed and transitional economies. There are a variety of factors that create an informal economy in the developing countries, including the increasing number of populations and limited formal job vacancies, high tax rates, low risk of detection as well as the high cost of formalizing business. As Kayaga (2007) noted in her study, “tax and social security rules place pressure on small enterprises to operate informally and outside the official reporting system.” Similarly, Kristofferson (2011) argues that increases of informal economic activities are mainly due to the huge burden of taxation, social security contributions, and rigid labour market regulations. Some of businesses and individuals prefer the informal sector of market structure due to the rigidity tax laws and poor tax administration capacity among other factors.

However, the question then is why is informal economy hard to tax. Joshi et al. (2012) as well as Udoh (2015) state that tax regimes find the informal sector difficult to tax due to the lack of accounting records or financial statements, lack of statistical database, lack of well-trained and skilled staff, instability of business operations, higher cost of tax collection, and large number of unregistered enterprises. The lack of database or poor registration of taxpayer allow many individuals and businesses to be outside of tax administrations’ control. Without a taxpayer database, it is difficult to bring those outliers into the tax net, resulting in low levels of tax revenue. Ndajiwo (2017 cited in Umar and Tsubira. 2017) confirms that tax administrations in developing countries are working with

poor databases, which hinder their efforts of generating adequate revenue from their immense informal sector. Similarly, the lack of bookkeeping and the lack of a consistent fiscal year in business operations makes taxation difficult.

While it is true that informal economic structure in the developing countries is one of the major challenges in tax administration in the developing world, it is not the only challenge. Capacity constraints is also one of the main if not the most daunting challenge in developing countries' tax administrations.

### **2.2.2 Capacity Constraints**

In the developing countries and in particular, in Sub-Saharan Africa, where Somaliland is located, various capacity constraints in tax administrations both in principle and in practice exist. Tax administrations in these countries lacks skilled and well-trained staff that can administer effectively and efficiently on their public institutions like tax offices. In developing countries, highly skilled officials in tax administrations drain towards private companies and international organizations because of their higher salaries. Mascagni et al. (2014) contend that a bigger constrain in tax administrations than funds is the human resource. Specifically, tax administrations find it difficult to retain experienced staff who are draining to international institutions, companies, banks, and other firms. Capacity constraints in developing countries' tax administrations are not only limited to human resources. There is also a shortage of financial resources, infrastructure, and technological innovations. The combination of these capacity constraints, among other challenges, create opportunities for non-compliance in tax evasion and tax avoidance, which in turn creates under development in these countries. Capacity constraints in tax administrations also reduce tax revenue, create under performance, and hold back the standard of living for the

country's citizens as well as the country's abilities to finance sustainable development. Ndikumana (2010, p. 4) highlights that capacity constraints in Africa tax administrations are generally recognized as major challenges to enhancing tax policy in order to create policy options and to increase tax revenue collection. There is no doubt that while tax policy and tax laws are important, their implementation, enforcement, and administration are also vital. Therefore, tax administrations must work smarter in performing their tasks to limit the consequences of these capacity constraints.

### **2.2.3 Corruption**

Corruption, whether it is petty or grand corruption, has always been existing as a challenge in the tax administration of developing country. It is common in tax administrations of the developing countries that tax officers take bribes from taxpayers. Tax collectors and taxpayers collude so that taxpayers could avoid the payment of their tax liabilities or undermine their taxes due. Fjeldstad (2006) states that tax revenue frauds of different forms, including undervaluation and under-declaration of taxable items as well as contraband are common in the developing world's tax administrations.

Corruption is a big challenge to tax administrations as it hampers the amount of tax revenue that could be collected. Ajaz and Ahmed (2010, p. 405) argue that “developing countries are typically unable to generate sufficient amount of revenue from taxation because these countries face a number of institutional problems in the process of revenue generation and one of the main problems is corruption.” Similarly, a former commissioner of Uganda Revenue Authority (URA), Aslund (2003 cited Fjeldstad, 2006), stated that corruption is the first challenge in Uganda revenue authority and the same applies to many other tax administrations in Africa or

developing countries in general. These statements confirm that corruption is one of the main challenges in the developing world. Corruption in tax administrations undermines trustworthiness between governments and their citizens, which in turn erodes revenue collection capacity of these institutions. Martini (2014) affirms, “corruption in tax administrations in Africa remains fundamental barrier to effective and fair taxation and to building trust between government and citizens.” Loss of trust between government and citizens results in the loss of tax revenue due to non-compliance with tax laws, as taxpayers perceive their governments as corrupt.

Moreover, Transparency International (2013b cited in Martini, 2014) states that the percentage of African citizens who are paying bribes to tax officials are above the global average. Specifically, Transparency International indicates that the global average is 15%; in 2013 however, Global Corruption Barometer states that for instance, in Liberia, 62% of its citizens reported that they pay bribes to access tax services, in Sierra Leone 61%, Senegal 59%, Uganda 46%, Cameroon 46%, and Ethiopia 41%. This report indicates that some of these countries, more than 50% of taxpayers pay bribe to tax officials, which would have severe and widespread consequences for tax revenue collection, economic health, and the development of these nations.

#### **2.2.4 Political Instability**

Political instability is another challenge in the developing countries’ tax administrations. Chawdhury (2016) asserts that political instability is a major concern in each country and is always a part of any investment decision analysis. Similarly, Nkurunziza (2005 cited in Estrada, Mutascu, & Tiwari, 2011) notes that high tax rates and political instability are the main factors that push taxpayers to the informal economy as well as escape from the tax net. Political instability always lead to volatility of tax administrations through

conflicts, civil wars, or frequent revamp of tax policies and replacement of tax administrators or Finance Ministers. Van den Boogaard et al. (2018) highlight that conflicts restrict revenue mobilization likely due to their effects on tax base, tax collection efforts in conflict-affected places, and investment in public institutions. This means that if a country is politically stable and has a good governance structure, then it is the most likely to have a better tax administration.

Bird (2008) highlights that a tax system of a country is highly reliant on its governance system. As such, developed countries can improve the performance of their tax administrations through improving their governance systems. Political instability is not a big issue in Somaliland as the country is peaceful and stable in general. However, the better the governance structure and political stability, the better that the tax administration. In addition, political instability can indirectly affect tax administrations in impacting investment decisions both domestically and internationally. No investor is willing to invest in a politically volatile environment. This in turn reduces the amount of tax revenue to be collected and become detrimental to the provision of public services.

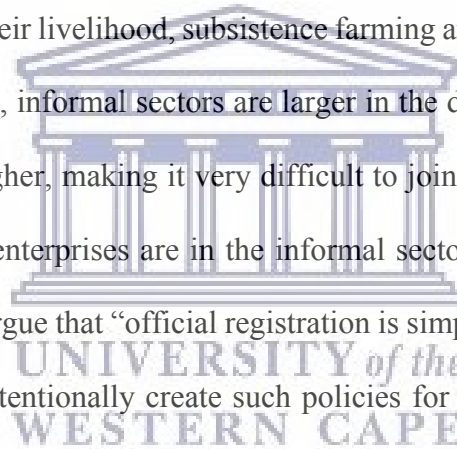
There are many similar factors causing challenges for tax administration in developing countries. These include corruption in tax offices, lack of public trust in public institutions, unskilled staff of public institutions amongst others. The following section provides overview of the factors that researchers believe are the main causes of tax administration challenges in the developing world.

### **2.3 Causes of Tax Administration Challenges in Developing Countries**

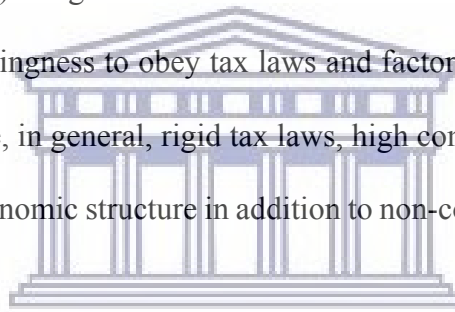
There are many possible reasons for why poor countries, particularly African countries' tax administrations, face huge challenges in accomplishing their tasks. Lack of government internal legitimacy, corruption of the tax officials, inadequacy of resources, lack of

taxpayers' education/awareness, rigidity of tax systems as well as poor tax audit are always among the major causes of poor tax administrations in these countries. The next few paragraphs highlight the causes of the tax administration challenges in developing countries with a dominant informal sector as mentioned above: poor capacity of tax administrations, corruption, and political instability.

To start, as we touched on in the previous sections, there are various reasons why the informal sector exists in the developing countries. Majority of citizens in these countries are poor and they could not afford required initial capital to establish big, incorporated companies. Rather, these people depend on, for their livelihood, subsistence farming and small, informal, and unincorporated enterprises that are mainly outside of the tax net. In addition, informal sectors are larger in the developing countries because business license and tax laws compliance costs, among others, are higher, making it very difficult to join the formal market structure. Auriol and Warlters (2005, p. 627) assert that the main reason why enterprises are in the informal sector in developing countries is the large fixed costs involved in entering into the formal sector. They argue that “official registration is simply beyond the reach of poor entrepreneurs.” They also state that governments in these countries intentionally create such policies for the sake of raising more tax revenues. However, contrary to the intention, these policies distort countries' economic growth and reduce tax revenues that should have been collected. Similarly, Tanzi and Zee (2000) emphasize that because of the informal economy in which developing countries are characterized by, the possibility of relying on contemporary taxes, including personal income taxes and value added tax (VAT), as well as achieving high tax revenue would be significantly reduced.



Moreover, low tax moral and poor capacity of tax administrations as well as poor fiscal courts to enforce tax laws and tax obligations are contributors to the existence of informal market structure in the developing world. Ng'eni (2016, p. 91) argues that, in Tanzania, the government loses revenue because of unproductive and incompetent tax administration as well as poor administrating of tax morale and voluntary tax compliance. These factors are not merely present in the Tanzania tax administration, but also in most developing countries since their independence. In addition, taxpayers conceal their tax liabilities because of the low quality of public services in return for taxes they pay. Prague (2010) categorizes factors that cause tax avoidance and evasion in developing countries into two: factors that negatively affect taxpayers' willingness to obey tax laws and factors that are brought about by the poor capacities of tax administrations to enforce tax laws. Therefore, in general, rigid tax laws, high compliance costs, and poor enforcement of tax laws, among others, are the main causes of informal economic structure in addition to non-compliance attitudes of taxpayers in the developing countries.



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Capacity constraints is one of the biggest challenges of tax administrations in the developing countries as mentioned before. Mascagni et al. (2014) argues that in developing countries, the lack of educated and well-trained staff in tax administrations significant reduces the capacity to collect sufficient taxes. Skilled employees are always attracted by private companies' incentives and good salaries. Poor incentives and lower salaries that public institutions offer as well as absence of career growth discourage well-trained individuals to join in the public sector. Therefore, lack of sufficient number of trained and skilled personnel is always among the biggest causes of capacity constraints in the developing countries' tax administrations. Similarly, in the developing countries, primary tax laws are outdated, which likely causes problems in administering tax systems. In addition, work environments in tax administrations and



public institutions in the developing countries in general are not staff friendly. Fjeldstad (2005, p. 6) argues that the working conditions in these countries' public institutions are attributed by absence of technical equipment and low quality office facilities. This undermines the ability of staff and provokes inefficiency in these institutions.

Corruption is another devastating challenge in tax administrations in developing countries as an aspect of informal economy and capacity constraints. Corruption in tax administrations is a challenge that is mainly created by the interaction between tax officials and taxpayers. Rahman (2009) notes that there are two main drivers of corruption in tax administrations: demand drivers and supply drivers. In the demand drivers, taxpayers are willing to pay bribes to reduce their tax liabilities and save time for tax audits. He adds that weak tax law enforcement that reduces the risk of detection and punishment. Higher tax rates and higher compliance costs contribute to corrupt behaviour as well. On the supply driver of tax corruption, Rahman highlights that paying bribes is the only option to escape harassments from tax officials. He states that the causes of tax corruption among tax officials include “complex and unclear tax laws and procedures, non-transparent hiring and reward mechanism; a low-level skills, a lack of professional ethics and integrity, a low pay and lack of incentives” as well as “insufficient checks and balances within the tax administration.” Moreover, face-to-face contact of taxpayers and tax officials encourages corruption. “The higher the level of contact and interaction between tax officials and taxpayers, the greater the scope for corruption and collusion” (Evans & Tjen, 2017).

Additionally and as mentioned before, political instability is another obstacle of establishing a sound tax administration in developing countries. Political instability is mainly due to fragile democratic institutions as well as poor leadership and governance. Tax

administrations are often under Finance Ministries, which restrict tax administrations' operations or put them under restrict supervision, depriving tax administrations of their autonomy and making them politically unstable. Another reason for politically fragile environment in tax administrations is that finance ministers and their top-level managers are frequently axed. Umar and Tusubira (2017) highlight politically volatile environment in tax administrations is sometimes due to actions of “omission” and “commission” of political leaders. This broadens political instability of tax administrations and creates confusion in taxpayers as well as a lack of trust for political leadership and a lack of confidence in tax officials.

These tax administration challenges in developing countries severely affect the level of domestic revenue collection, economic growth, political stability, investment, innovation as well as trust and respect between governments and their respective citizens among many other developmental aspects. The impact of poor tax administrations in developing countries on their tax revenues collection as well as socioeconomic wellbeing are enormous. The succeeding section details the effects of these tax administration challenges on revenue collection, public trust, growth rate, and various development potentials in the developing countries.

#### **2.4 Impact of Tax Administration Challenges in Developing Countries**

Poor tax administration can create insufficient revenue collection, fiscal imbalance, economic distortions, and many other unwanted elements in a country's development aspects. The following few sections focus on negative effects of tax administration challenges in the developing countries on their taxes revenue collection, public trust in government, economic growth, and stabilization as well as both domestic investments and foreign direct investments (FDI).

### 2.4.1 Effects of Tax Administration Challenges on Public Trust

“Taxes can be seen as a price paid for government’s positive actions” (Torgler et al., 2008). People would pay their tax liabilities if they trust that their governments to provide public services and goods they need in return. Bird and de Jantscher (1992) argue that a tax system is an important bridge between any government and its citizens. As such, how taxes are administered will have both short and long-term consequences on the trustworthiness of that government. Similarly, according to Boly et al. (2017) as well as Torgler and Schneider, (2009) if taxpayers believe that public institutions represent their interests and work in their favours, voluntary tax compliance will increase. Thus, poor tax administration adversely affects relationship between a government and its citizens, particularly when citizens lose trust in their governments, resulting in poor voluntary tax compliance.

Among the different factors that affect citizens trust in public, corruption most adversely affects the trust between taxpayers and government. Evans and Tjen (2017) assert that corruption weakens country’s capacity to tax, lead to lower level of tax revenues, and discourages taxpayers to pay their tax liabilities, which in turn reduces fund for public expenditures. “It is a cancer that destroys the organization itself and undermines all other aspects of society”, (Evans and Tjen, 2017). They note that the IMF estimated that the annual cost of bribery in developing countries alone is USD 1.5 trillion (roughly, 2% of their GDPs). This indicates the severe effects of corruption is a challenge amongst others in tax administrations of the developing countries.

In addition, Bridi (2010) summarizes the effects of corruption on tax administrations in five parts; first, corruption reduces tax revenue and in turn has a lasting effect on quality of public services due to postponing and discontinuation of many economic growth

and reform projects and second, corruption diminishes taxpayer's voluntary compliance with tax laws, regulations, and directives. Bridi (2010) adds that third, corruption increases inequality as it weakens country's financial capacity to deal with such problem; fourth, corruption increases resistance against any reform as all stakeholders of corrupt tax administrations are benefactors of status quo; and fifthly, corruption harms the relationship between state and its citizens. However, corruption is not the only challenge that affects the various functions of tax administrations. Other challenges mentioned under Section 2.2, among many others, entail their own consequences for revenue collection, economic growth, and other aspects of social wellbeing in developing countries.

#### **2.4.2 Effects of Tax Administration Challenges on Revenue Collection and Economy**

Tax administration greatly influences a country's revenue collection, particularly in developing economies where tax revenues are vital. Unfortunately, these countries predominantly have ineffective tax administrations, which negatively affects taxes revenue collection. Kipilimba (2017) opines that small government revenue in the developing countries is due to corruption and the inability of tax administrations to perform their tasks. Challenges of tax administrations in these countries weaken their tax systems, limiting revenue collection. Thus, this results in budget deficit and debt to name a few. Mansfield (1988, p. 181) states that the actions of tax system will either increase or decrease tax revenue, which in turn determines fiscal position of a country. When a country is a member of international community like the UN and other global bodies, it can borrow money to subsidize its budget even while it is in debt. However, as Somaliland is not internationally recognized, it is worse off when it experiences a budget deficit. It has no alternative but to improve its tax administration so that it can generate the required revenue in order to fund its public expenditures.

An efficient tax administration has positive effects on a country's economy. For instance, the informal sector, a common cause of challenges in the developing countries, shrinks the tax base and reduces tax revenues. Farrell (2004) states that informal enterprises evade financial and regulatory obligations such as VAT, income taxes, labour market obligations as well as product market obligations. This means the loss of both tax and non-tax revenues. Gill (2000 cited in Kipilimba, 2017) states that the ineffectiveness of tax administrations lead to poor tax collection, thus shrinking budget and limit countries' capacity to finance policies and programs as well as to provide necessary public services. Therefore, a small tax base would negatively affect developing countries' economic growth and productivity as informal sector discourages formal economy and reduces public revenue pool to finance state building projects and programmes.

Moreover, Kesner-Škreb (2002) argues that countries that widen their tax bases and efficiently manage their tax administrations will likely have a faster growth rate than countries with smaller tax bases and poor tax administrations. Ahmad et al. (2016) also argue that a tax system with desirable characteristics such as efficiency, effectiveness, and stability is essential condition for economic growth. Hence, tax administration is a key to reducing inequality through the redistribution of resources between the private and the public and among ordinary citizens. Tax administration also adds value to society's health, education, water, public infrastructure, and public transport among others, which are all fundamental to economic growth and social wellbeing. A country like Somaliland, whose tax revenue is critical to its development, cannot step up on the economic growth ladder without a sound tax administration.

Tax administration also has an influence on the ability of individuals or companies to save and invest. Therefore, Tax policy makers should pay close attention to tax rules to ensure attractive inbound in new investments. Capital flow and the basic model of taxation indicate that increasing tax rates in an open economy creates net capital outflow, which in turn lowers overall capital stock (Devereux & Maffini, 2007). Although some economic scholars argue that tax policies and tax administrations are not the main determinants of foreign direct investment, some policymakers and investors gives great consideration to avoid improper tax administration and policies that could have severe investment consequences.

Moreover, tax administration also has an influence on the stabilization of economy because it is used as a component of macro-economic policy (fiscal and monetary policies), particularly in fiscal policy. Therefore, poor tax administration would have no power to stabilize inflation, unemployment as well as income distribution. Tareq et al. (2009) state that the scale of automatic stabilizer in Sub-Saharan Africa countries is weak due to their lower revenue to GDP ratios, poor structure of their tax systems as well as public expenditures that are not giving much consideration to the economic cycle.

All in all, the tax administration challenges mentioned above impose significant adverse effects on tax revenue collection, economic growth, stabilization of economy, individuals' capability of saving and investing as well as public trust in government to name a few. Therefore, establishing efficient, effective, and equitable tax administration is indispensable for any country and particularly for countries that have little or no alternative in tax revenues like Somaliland. Fjeldstad (2014, p. 186) posits that a well-functioning tax administration is a primary factor for sustainable development and the end of dependence on aid and natural resources. Since we have

seen the importance of tax administration and its effects for revenue collection as well as socioeconomic development, the succeeding section focuses on how a country could establish a stable, simple, equitable, effective, and efficient tax system such that challenges in tax administration would be eliminated or kept to a minimum.

## **2.5 Improving Tax Administration**

Improving tax administration is paramount for any country's tax system, specifically in countries where tax is the main source of funding for its expenditures. Improving tax administrations in developing countries requires resources, time, commitment, and cooperation among various stakeholders including tax officials, lawmakers, and taxpayers. As such, a country must keep its tax system updated in terms of tax laws, technology, and capacity of the staff as well as other necessary tools for administering taxes. This way, tax evasion, tax avoidance, corruption of tax administration, compliance costs, administrative costs, and all other flaws would be eliminated or reduced to a minimum. For a tax administration to achieve its goals, revenue collection is critical, as is improving structure, tax laws, tax procedures, and accounting standards of the tax administrations (de Jantscher & Bird, 1992). Bird et al. (1992) also assert that for improving tax administration, the willingness of tax officials to implement tax policies, simple means to achieve policies' goals, and sufficient resources to implement tax policies are the three key components for desirable tax administration of any country.

One of the most important steps to achieve effectiveness of a tax administration is the development of its capacity against the backdrop of its capacity constraints. One of the best ways to increase taxes revenue is through voluntary compliance. This could happen if tax administrations are computerized, tax policies are updated and implemented, and tax audit systems are enhanced to mention a few.

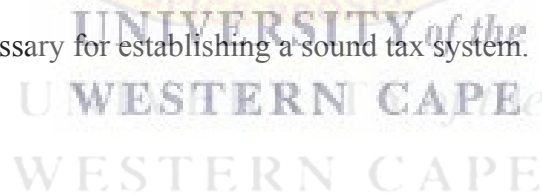
Automation of tax administration also plays a key role as it simplifies tax procedures such as tax assessment and reporting. Simplifying the procedures of the tax system is one of the key characteristics of a sound system. Nnadozie et al. (2017) assert that effective utilization of technology in tax administrations improve taxpayers' identification, data collection and processing, surveiling and tracking of taxpayers, transparency of tax revenue collected, and observation of illicit financial flows. They also believe that the key capacity development interventions that have created a change and could be a lesson for African countries. They include effective policy management process, evidence-based policymaking, and efficient use of technology in revenue administrations. Similarly, having adequate, well-educated, skillful staff, as well as other necessary resources for operations, are essential. Thus, a tax system should focus on key tools and techniques that enhance its operations as well as encourage compliant behaviour in taxpayers.

In spite of the fact that there are no perfect attributes of a sound tax administration, some characteristics are believed to be useful in creating a sound tax administration. In 1776, Adam Smith, who is known as the father of modern political economy, laid down four principles of taxation. These principles, known as Adam's canons of taxation, include equality of tax, certainty of tax, convenience of tax payment, and economic collection of taxes. These principles are still believed as among the most useful principles in creating a good tax administration. Alley and Bentley (2005, p. 586) highlight that Adam's canons are still essential for tax policy as they support tax systems to effectively enforce tax laws. In addition, Stiglitz (2000) argues that the crucial attributes of a tax system are efficiency, elasticity, transparency, and equity. Moreover, Guru (2018) argues that some of the essential principles of a sound tax system are effectiveness, efficiency, flexibility, equality, and stability. Therefore, if a tax system has the above characteristics, then it can be categorized as a sound.



Administering taxation is a complex issue in nature and is more complicated in developing countries where corruption, informal economic structure, political instability, non-compliance nature of taxpayers and capacity constraints in terms of human capital, infrastructure, technology and funds among others are common. In addition, administering taxation is the worst in fragile, war-torn and post conflict countries like Somaliland where all above mentioned challenges and more others are existing. These challenges are mainly due to the lack of strong internal legitimacy in government, inadequacy of resources, rigidity of tax systems and outdated laws to mention a few. The tax administration challenges in the developing world have adversely affected tax revenue collection, eroded tax bases, lost public trust in government resulting in non-compliance behavior of taxpayers and contributed to the economic fluctuations in the developing world as well as hindered economic growth and development in general.

As previously mentioned, compulsory taxation creates huge challenges for the tax administration and there is no tax perfect tax system. However, consistent improvement of tax administration in terms of personnel capacity, tax laws, infrastructure, and other operational and administrative tasks are necessary for establishing a sound tax system.



## Chapter Three

### The Challenges of Tax Administration in Somaliland: Research Methodology and Data Collection

#### Instruments

#### 3.0 Introduction

The research methodology is the general framework of methods as well as the broad worldviews or philosophical assumptions in which researchers choose to conduct research studies. Kothari (2004, p. 8) points out that the research methodology is a procedure to solve problem statement systematically. Therefore, in the methodology, we shall discuss the research approach, research design, sample design, sample size and data collection instruments as well research ethical considerations of this research.

#### 3.1 Research Approach

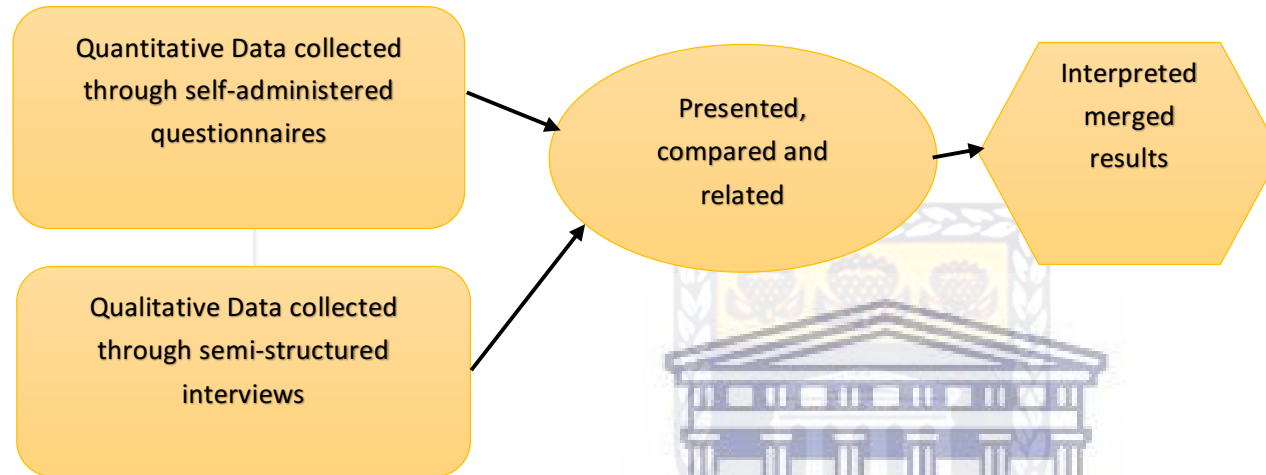
Creswell (2014, p. 1) states that research approaches are plans for conducting research that discusses topics from broad worldviews to specific methods of data collection, data analysis, and interpretation. Therefore, to accomplish the aim of the research and to find the expected results from the research question. This is done in order to collect reliable data and to prevent limitations. There are three types of research approaches: qualitative, quantitative, and a mix of both. Qualitative approach uses language instead of numbers; quantitative is more numeric rather than language-based; and the mixed method lies in between and the triangulation of the two former approaches. Based on the nature of my research problem statement, my experience as well as the audience of the research,

this research study applied the mixed method approach. Above all, I selected this approach because it provides a more comprehensive understanding of the research problem than when using either the qualitative or the quantitative approaches alone. Moreover, I trust that collecting both qualitative and quantitative data increases my confidence as well as that of my audiences about the findings of this research.

### 3.1.1 Research Approach Design

In the preceding section, “Research Approach”, I mentioned that the research deployed a mixed method approach where both quantitative and qualitative data were collected and analyzed. As mentioned before, mixed method involves combining these two types of data, i.e., qualitative and quantitative. While there are many designs of the mixed method, the three primary methods include convergent parallel mixed method, explanatory sequential mixed method, and exploratory sequential mixed methods (Creswell, 2014). This research employed convergent parallel mixed method as **Figure 3.1** indicates below. To comply with the selected design in this research, quantitative data was collected using self-administered questionnaires and qualitative data was collected through semi-structured interviews roughly at the same time. The two data sets were presented separately but in a related manner with the approach known as the “side by side comparison” (Creswell, 2014). The quantitative data was analyzed using descriptive statistics through Statistical Package for Social Science (SPSS) and presented using frequency and percentage tables as well as graphs. The qualitative data was presented through normal text. The results of the two data sets were merged in the discussion section.

**Figure 3.1.** Research approach design.



**Source:** Author's own design

### **3.2 Sample Design**

It is always difficult to cover the whole population when the study population is large due to its mandated cost, time, and energy. Hence, sampling is critical in any research study. A sample is a plan of getting a sample from a target population (Kothari, 2004). There are two types of sampling: probability sampling and non-probability sampling or non-random sampling. This research applies systematic sampling of probability sampling and purposive or judgmental sampling of non-probability sampling. Babbie (2017) defines systematic sampling as a type of probability sampling in which for instance, every 10<sup>th</sup> element in the sample frame is selected. He also defines purposive sampling as a non-probability sampling method in which researchers purposively include specific units in their samples.

### 3.2.1 Sample Size Determination

My sample size includes a target population of 408 staff in Somaliland Inland Revenue, Hargeisa. To determine the sample size, the following formula was used.

$n = z^2 pq \div d^2$ , when the target population is greater than ten thousand ( $N > 10,000$ ), (Kothari, 2004). Where,  $n$  = desired sample size,  $N$  = population size,  $Z$  = Standard normal deviate, at the required confidence level of (90%),  $z = 1.65$   $P$  = Estimated characteristics of target population,  $p = 0.5$ ,  $q = 1-p$  = non-estimated characteristics of target population,  $d$  = margin of error (10%). Therefore,

$$n = (1.65)^2 * 0.5 * 0.5 \div (0.1)^2 = 0.680625 \div 0.01 = 68$$

However, the target population is less than ten thousand ( $N < 10,000$ ), thus,

$fn = n \div 1 + (n \div N)$ , where,  $fn$  is the desired sample size when  $N < 10,000$

$$fn = 68 \div 1 + (68 \div 408), fn = \mathbf{58}$$
 staff (this number was the sample size for employees and lower level managers).

However, six interviews were added to the sample size from the top and middle level officials in Somaliland Inland Revenue under Somaliland Ministry of Finance.

### 3.2.2 Selecting Sampling Technique

This research used systematic sampling with a random to draw the required respondents from employees and lower level management in Somaliland Inland Revenue, Hargeisa. The research also used purposive sampling to conduct semi-structured interviews of the top and middle-level Somaliland Inland Revenue Management. In systematic sampling, I labeled my target population of 408 with numbers from 1 to 408. Then, I selected every seventh number to include in my sample size by beginning a random number between one and seven. It is due, my sampling interval is approximately seven. Calculation of the interval is shown below.

**Sampling interval = Population size/sample size** (Babbie, 2017).

Therefore, **Sampling interval =  $408/58 = 7.03$ , approximately, 7**

On the other hand, I used purposive sampling to select 6 key informants from Inland Revenue's top and middle-level management.

### 3.3 Data Collection Instruments

This research applied the mixed-method approach, as mentioned above. Hence both quantitative and qualitative data from primary sources were collected. Therefore, two instruments were deployed to conduct data collection: questionnaires and semi-structured interviews. I chose these types of data collection tools to ensure that I collected relevant and reliable data for this research.

### 3.3.1 Self-administered Questionnaires

As my target population (Inland Revenue staff) was large in number. As such, it was difficult in terms of cost and time to question or interview all of them. Then, I used 58 self-administered questionnaires via my sample size to collect the data I required. Questionnaire is a tool used for data collection. Sansoni (2011) defines the questionnaire as “a document designed with the purpose of seeking specific information from the respondents.” I used these 58 self-administered questionnaires for 58 respondents made up of ordinary employees and first line managers from Somaliland Inland Revenue, Hargeisa. However, only 57 respondents filled out and returned the questionnaires. I chose this tool of data collection because it is cheap, useful for large number of respondents, and best suited for those who are literate. Moreover, respondents do not feel pressured and have sufficient time to answer the questions.

### 3.3.2 Interviews

I used semi-structured interviews to interview six key informants, which include top and middle-level officials of Somaliland tax administration. In semi-structure interviews, respondents were asked preconceived questions and then follow-up questions. Gill, Stewart, Treasure, and Chadwick (2008, p. 291) state that the semi-structured interviews “consist of several key questions that help to define the areas to be explored, but also allows the interviewer or interviewee to diverge in order to pursue an idea or response in more detail.” Therefore, I chose semi-structured interview as a tool of data collection as the top and middle-level managers have adequate knowledge, experience, and information about the challenges, causes of the challenges and their impact as well as possible improvements to be made to the institution. I met all the six target interviewees and I conducted all the interviews successfully.

### 3.4 Ethical Considerations

This thesis complied with all the UWC rules, regulations, and ethical concerns associated with academic research. This research is my own work. I provided proper wherever I used someone else's ideas or quoted words/statements directly. Similarly, this research tried its best not cause harm at any stage to the research participants. I obtained advance consent from all the research participants. I informed all the research participants that their participation is voluntary and that they have the right as well as are free to withdraw their participation at any time. Furthermore, I interviewed the participants in a place where they could felt comfortable and assured them of their anonymity and that all information they provided would be treated with absolute confidentiality. I informed them that I use their information for research purposes only.





## Chapter Four

### The Challenges of Tax Administration in Somaliland: Presentations, Analysis, and Discussions of Research

#### Findings

##### 4.0 Introduction

This chapter consists of presentations, analysis, and discussions of the research findings related to tax administration challenges in Somaliland Ministry of Finance, the Inland Revenue Department in particular. Somaliland Inland Revenue is a department under Ministry of Finance responsible for administering Somaliland domestic revenue. The primary aim of this chapter is to cover comprehensive analysis and critical discussion of the research findings and the research results concurrently. The findings are presented in different charts, graphs, tables, and descriptions followed by discussions of these the findings in this section.

Information presented in this chapter was collected through questionnaires and interviews conducted with Somaliland Inland Revenue staff. The chapter covers demographic information of the research participants including gender, age, and education level. The chapter also summarizes the findings and discussions of the challenges in Somaliland tax administration, causes of these challenges, impact of the challenges on domestic revenue, public trust in government, employment, inflation, domestic and foreign direct investments as well as the possible remedies of these challenges to improve Somaliland tax administration.

As Chapter Three in this research discussed, a proper sampling procedure was conducted to avoid any biasness in the data collected. A systematic random sampling was applied to maintain equal respondent distribution in questionnaires. Six interviews were conducted in this research selected using purposive sampling technique under non-probability sampling.

#### **4.1 Background Information of Research Participants**

This section covers the demographic characteristics of the research participants. These characteristics include gender, age, and education level. This demographic information of the respondents is displayed as it might influence the answers to the research questions. It is also presented to reveal the characteristics of the research participants. This information is presented in order to see the influence of this information on research findings, the challenges of tax administration in Somaliland as well as to reveal the characteristics of the research participants.



**Table 4.1.** Demographic Information of the Respondents

Demographic Characteristics of the Research Participants		Frequency	Percentage (%)
<b>Gender</b>	Male	38	67
	Female	19	33
	<b>Total</b>	<b>57</b>	<b>100</b>
<b>Age range</b>	18–30	33	58
	31–43	20	35
	44–56	4	7
	57 and above	0	0
	<b>Total</b>	<b>57</b>	<b>100</b>
<b>Level of education</b>	No Formal Education	0	0
	Primary	1	2
	Secondary	10	18
	Tertiary	46	81

	<b>Total</b>	<b>57</b>	<b>100</b>
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**Source:** Author’s Fieldwork Questionnaires, 2018

**Table 4.1** above indicates that 67 percent (38) of the research participants were males while the other 33 percent (19) of the participants were females. Similarly, six interviews were conducted in this research and all of the interviewees were males. These male interviewees were selected because the interview guide was designed to interview top and middle-level management only and there were no female officials among the top and middle-level tax officials in Somaliland; hence, six male interviews were selected and interviewed.

The table shows that the number of males is higher than the number of females. This might be due to two reasons: traditional or religious beliefs. In the Somali culture, it is always shame to see women working outside when their husband are also working and their husbands’ earnings are good enough to cover family expenses. Some scholars also asserted that Somali culture does not support women going to work when they should be taking care of children. Schofield (2017) stressed that like in other African countries, Somali women have been facing a complex set of challenges in local tradition, culture, and religion in serving public organizations. Similarly, Islamic teachings encourage women to stay at home while men are responsible for providing for the family. According to BinBaz, grand mufti (certified principal scholar in Islamic religion) of Saudi Arabia (cited in Sidani, 2005) asserted that taking women out of their homes, “their kingdoms”, is like taking them out of their inborn nature and character, which God has created in them.

Likewise, **Table 4.1** above illustrates the age distribution of the research participants. Age of staff could be a factor contributing to the challenges of an institution. This is because older workers are less willing to learn and more likely to resist change. As stated by

Wagner-Hartl et al. (2018), as employees get older, they develop age-related sensory, cognitive, and physical changes. As such, they encounter increasing challenges in being productive in their workplaces. The table indicates that the highest age group of these research questionnaire respondents is between 18 and 30. This age range constitutes around 58 percent (33) of the respondents. The second highest age group is between 31 and 43. Correspondingly, among six people who were interviewed in the field, four of them were in the age range of 31 to 43 while the other two were in the age range of between 44 and 56. The table shows that most of staff in the institution are in the age range between 18 and 30. This implies that Somaliland tax administration staff are in the active age group. Hence, the institution has many young employees who can effectively contribute to the institution's operations, i.e., if only if they are well administered, have access to required facilities, and are motivated.

In addition, **Table 4.1** indicates the educational level of the research questionnaire respondents. As we can see from their answers, 81 percent (46) of the respondents have completed education up to the tertiary level, 16 percent (10) up to the secondary level, and the other 2 percent (1) up to the primary level. Tertiary education could include diplomas, first degrees, masters, PhDs, or other. From the answers of the participants, it can be concluded that most of the Somaliland tax administration staff have an education level of high school and above. However, as the most of the interviewees in this research indicated, majority of the staff are not well trained, skilled, ethical, or professional. The succeeding section details the findings of this research on the challenges in the Somaliland tax administration, causes of these challenges, the impact of the challenges on government's revenue collection, public trust in government, employment, inflation, investments, and government development programs as well as possible ways to improve the Somaliland tax system.

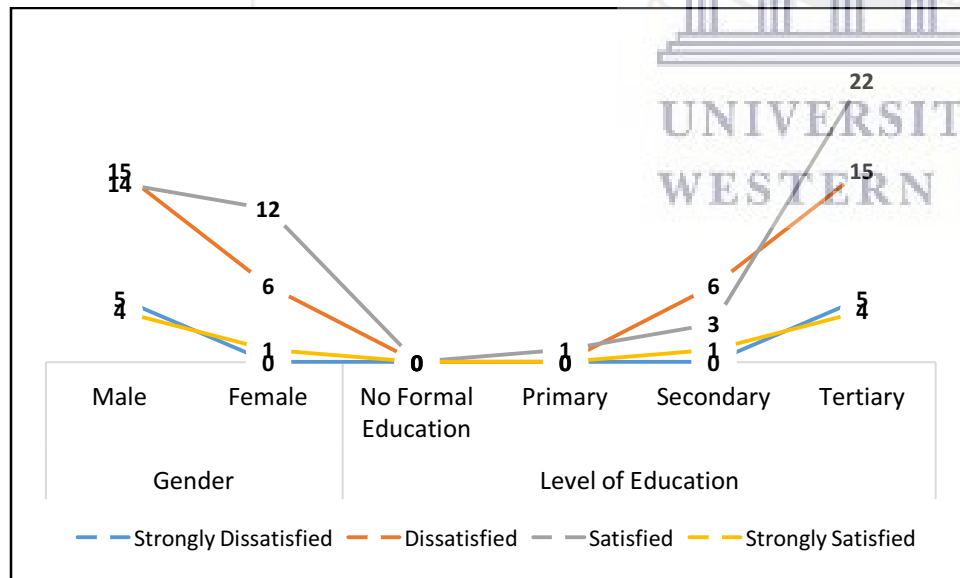
## 4.2 Somaliland Tax Administration: a Practical Perspective

Perhaps more so than other countries, Somaliland tax administration is key for government revenue collection. This is because of the fact that Somaliland is not internationally recognized. Hence, aid, debt, and foreign direct investment are limited. Although a small amount of external assistance appeared in the last two years, in the 2017 and 2018 national budgets, before recently, the Somaliland government had never received direct international aid. According to Eubank (2010), the only aid received by Somaliland is controlled by local non-governmental organizations and other international aid agencies. Therefore, domestic tax revenue is the only reliable source of funding for the Somaliland government. Somaliland Inland Revenue under the Ministry of Finance is responsible for administering all domestic revenue. The most common revenue taxes collected by this institution are payroll tax with a flat rate of 7 percent, of which 1 percent is a stamp duty for civil servants, 6 percent for private workers, 10 percent for rent and business income taxes as well as 5 percent in retail sales tax.

According to the World Bank (2012 cited in Ahmed, 2016) Somaliland collects less than 7 percent of its GDP from tax revenues. Ahmed (2016) also mentions that Somaliland levies only 10 percent of corporate income tax on companies compare to 26 percent and 28 percent in Ethiopia and Kenya respectively. There are no computerized systems in Somaliland tax administration. Tax revenues are collected and recorded manually. Tax procedures including taxpayers' registration, recording of tax returns, and computation of tax liabilities among other functions are all performed manually. This research found that Somaliland tax system is manual, the staff are not professionally trained, and they are not satisfied about the current status quo of Somaliland tax system.

**Figure 4.1** presents the level of satisfaction of the employees in the current Somaliland tax administration. As the graph below illustrates, 46 percent (26 out of 57) of the participants are either strongly dissatisfied or dissatisfied about the current system of Somaliland tax administration. The graph also presents the cross tabulation of employees' satisfaction with their level of education and gender. As the graph indicates, the level of education has no influence on the level of employees' satisfaction. However, there is a relationship between gender of the research participants and their level of satisfaction. The graph shows that male participants are more dissatisfied than female participants are. As we can see from the figure, 53% percent (20 out of 38) male participants are either strongly dissatisfied or dissatisfied about the current Somaliland tax system.

**Figure 4.1.** Level of Satisfaction of the staff in the current tax administration.



**Source:** Author's Fieldwork Questionnaires, 2018

Similarly, 5 out of 6 interviews conducted for the top and middle-level management in this institution indicated that they are not satisfied with the current situation of the Somaliland tax administration. Interviewee 1 (2018, pers. comm., 7 August) stated that he is not satisfied with the current tax system in Somaliland as his employees unmotivated due to lack of incentives. He asserted that some of the staff do not even have transport facilities while they mobilize and collect millions of dollars of tax revenue. Similarly, interviewee 3 (2018, pers., comm., 25 August) argued that he is not satisfied because there is a lack of international exposure and experience of tax officials that put Somaliland tax system far behind its counterparts in other developing countries. In addition, interviewee 4 (2018, pers., comm., 25 August) and Interviewee 2 (2018, pers., comm., 22 August) highlighted that they are not satisfied because the tax system is weak, old, and needs reform. These findings indicate that Somaliland tax administration staff are dissatisfied because they are underpaid and not professionally trained in their places of work and as such, career growth is limited.

These findings support the arguments of Bakotic and Babic (2013 cited in Rahman et al., 2017), that poor working conditions can cause employees dissatisfaction. Furthermore, the findings that indicated the higher percent of dissatisfied males can indicate a heightened level of responsibility for males. As mentioned in the preceding section discussing demographic information, males are responsible for providing for their families. As such, due to the expectation on males to provide for their families on lower earnings, males are more stressed and dissatisfied than females.

However, dissatisfaction of employees is not the only challenge in Somaliland tax system but the institution has been facing hardcore challenges in collecting the required revenue and establishing a sound tax system. The other challenges include capacity



constraints, corruption, tax evasion and avoidance as well as a lack of technology to mention a few. The succeeding section presents the findings of this research on the current tax administration challenges in Somaliland as well as the analysis and discussions of these findings.

### 4.3 Current Somaliland Tax Administration Challenges

The Somaliland tax administration has been suffering from the formidable challenges of capacity constraints in terms of infrastructure, the lack of skilled and trained staff, outdated tax laws, tax evasion, tax avoidance, and the informal economic sector among others. This section provides the findings and discussions of this research about the above-mentioned challenges. **Table 4.2** below summarizes the answers participants gave to the research questionnaire about the challenges of lack of institutional capacity, lack of technology, outdated tax laws, inadequate staff, economic structure, tax evasion, and tax avoidance in the Somaliland tax administration.

**Table 4.2.** Challenges in Somaliland Tax Administration

Options	Responses	
	Frequency	Percentage (%)
<b>Lack of institutional capacity</b>	36	13.8%
<b>Lack of technology</b>	44	16.9%
<b>Outdated tax laws</b>	36	13.8%

<b>Inadequate staff</b>	32	12.3%
<b>Country's economic structure</b>	34	13.1%
<b>Tax evasion</b>	41	15.8%
<b>Tax avoidance</b>	37	14.2%
<b>Total</b>	260	100.0%

**Source:** Author's Fieldwork Questionnaires, 2018

As the table shows, 36 out of 57 respondents mentioned that there is lack of institutional capacity in Somaliland Inland Revenue Department, and 44 respondents out of 57, highlighted that there is lack of technology in the institution. This indicates that the system is manual.

Likewise, 36 out of the 57 participants agreed that tax laws are outdated, 32 mentioned that there is inadequate staff, and 34 of the respondents highlighted country's economic structure as a challenge in the Somaliland tax administration. Similarly, 41 and 37 out of the 57 respondents respectively indicated that challenges in Somaliland tax administration are tax evasion and tax avoidance.

Comparably, six interviews for top and middle level management in Somaliland Inland Revenue Department were conducted during the fieldwork of this study. All these interviewees mentioned the same challenges that questionnaire participants highlighted and more. These interviewees stated that capacity constraints, corruption, tax evasion, tax avoidance, informal economic structure, outdated tax laws, and others are the challenges faced by the Somaliland tax administration.

Interviewee 1 (2018, pers., comm., 7 August) stated, “there is no equal justice under the law; tax officials are favouring to their relatives and friends by giving them illegal tax exemptions.” This implies that nepotism and tax corruption exist in the Somaliland tax system. Similarly, interviewee 3 (2018, pers., comm., 25 August) asserted that the main challenge they face is lack of both material resources and skilled employees. This statement emphasizes the responses of 36 questionnaire respondents in **Table 4.2 above**, who stated that capacity constraints is a challenge in the Somaliland tax administration. In addition, Interviewee 5 (2018, pers., comm., 25 August) stated that one of major challenge that Somaliland tax administration face is the lack of taxpayers’ education, where the taxpayers are not taught about tax or its benefits. Moreover, interviewee 6 (2018, pers., comm., 26 August) highlighted that poor tax administration as well as poor tax policies are principal challenges in the Somaliland tax administration.

From these findings, it can be concluded that there are numerous challenges faced by the Somaliland tax administration. These challenges could be divided into three broad but interrelated categories: **institutional challenges, attitudinal challenges, and political and economic structure challenges.**

### **4.3.1 Institutional Challenges**

The research found that the main challenges that exist in the Somaliland tax system include capacity constraints, where the institution severely lacks funds, materials, and skilled human resource to address the huge tax challenges the institution encounters. Research participants repeatedly mentioned that capacity constraints in the tax administration office are one of the major challenges they face. The lack of tax administration capacity represents one of the biggest problems in the system. This proves that the institution

does not have financial resources to invest in sophisticated software to automate its tax system or to hire and retain skilled staff. Carnahan (2015) argues that the first constraint in having a sound tax system is lack of funding. Without financial resources, the institution would not have the capacity to hire skilled employees, and it would not have capacity to purchase the necessary operational facilities.

In addition, as we can see from the research results in our demographic section, majority of the employees have a tertiary level of education. The lack of human resources are then due to lack of ethical proficiency, diligence, and proper training. According to Mascagni et al. (2014), The challenges presented by capacity constraint is worsened as skilled and experience workers drain to international organizations and companies.

Moreover, Research participants emphasized that lack of technology as a barrier to Somaliland tax system fulfilling its tasks. Employees are fed up of manual system. The manual system impedes tax procedure operations and hinders the institution to raise required tax revenue. The manual system does not only reduce the speed and accuracy of the work but it also diminishes transparency of the system, which maximizes corruption.

The research participants of both data sets agreed that capacity constraints and dissatisfaction of the staff are among the major tax administration challenges in Somaliland. Nevertheless, capacity constraints, absence of technology, and unmotivated staff are also common in other African countries or the developing world in general. As Ndikumana (2010, p. 4) stated, capacity constraints in terms of appropriate skilled staff and financial resources, among others, are recognized as some of the major tax administration challenges in developing countries.

### 4.3.2 Attitudinal Challenges

The research also discovered that the Somaliland tax system has suffered from tax evasion and tax avoidance. As the **Table 4.2** presents, 41 and 37 out of 57 respondents stated that tax evasion and tax avoidance respectively are among the main challenges that Somaliland tax administration faces in performing its businesses. Although the research did not discern the magnitude of tax evasion and tax avoidance, these affect both the quantity of the government revenue as well as the quality of the tax administration system.

The research found that most taxpayers, particularly those in businesses, do not provide proper financial statements showing their income such that the officials may impose income tax. As interviewee 1 (2018, pers., comm., 7 August) mentioned, tax liabilities is unknown and negotiable in Somaliland. In other words, taxpayers have a choice to pay their tax liabilities or to evade. This could be due to a lack of patriotism in taxpayers, a lack of taxpayers' awareness, or their non-compliant attitudes. This could also be due to taxpayers taking advantage of loopholes in the tax systems or the incompetence of the tax administration staff. Finally, another reason could be the perception of taxpayers that there is an absence of law enforcement and tax audits in the Somaliland tax administration, increasing their likelihood to evade taxes.

Moreover, these research participants from both data sets believe that corruption is among the major challenges in Somaliland tax administration. This is often due to the frequent bribery and nepotism between taxpayers and top government officials, tax officials as well as tax collectors. Corruption also happens when taxpayers do not meet their tax liabilities because they believe that the institution is corrupted so they do not pay their correct tax liabilities but bribe government officials to escape their taxes due.

Corruption undermined the capacity of the institution to collect revenue to a significant extent. As Evans and Tjen (2017) argue, tax administration in the developing world are poor because of the extensive corruption in the system. The corruption also seriously hurt public trust in the institution and the government in general, which in turn reduces tax revenue and hinders the economic growth as well as development of the country. Ajaz and Ahmed (2010), Kangave (2005), Martini (2014), and Salami (2011) highlight that corruption, non-compliant behaviour of taxpayers and their perception that public institutions are corrupt are all significant challenges for tax administrations in the developing world, and the findings of this research imply that there is no exception in Somaliland.

#### **4.3.3 Political and Economic Structure Challenges**

The research also discovered that the informal economic sector, outdated tax laws, and a lack of tax tribunals are among the major challenges in the Somaliland tax administration.

In Somaliland, many enterprises do not have proper accounting records or financial statements. Many others are not in the tax net because they are not registered taxpayers. Additionally, there is no public commercial bank in Somaliland to track economic transactions in the country. Private commercial banks, on the other hand, do not voluntarily cooperate with the government. Therefore, the informal economic sector is a persistent phenomenon in Somaliland, in which the tax administration might incur significant administrative and operation costs in taxing this sector. Taxing the informal sector is costly because the institution does not have proper database that track these businesses. In fact, not taxing it could yield less benefit than taxing it. The same applies to other developing

world, as Prichard and Heard (2012), Ndajiwo (2017), and Udoh (2015) stress that tax regimes in developing countries are facing difficulties in taxing enterprises due to the absence of databases, accounting records, and well-trained staff.

Moreover, as the **Table 4.2** indicates, 36 out of 57 respondents highlighted that outdated tax laws is a challenge in Somaliland tax administration. Although of the research participants mentioned that there is new revenue act, this act is not yet applied in Somaliland. Interviewee 1 (2018, pers., comm., 7 August) stated that they have been using the same tax laws since 1996. In addition, there are no tax tribunals in Somaliland. Hence, all tax cases are taken to ordinary courts. Due to the outdated and complicated tax laws as well as a lack of tax tribunals in Somaliland, the tax administration cannot raise revenue required in order the government to provide necessary public goods and services.

This research also discussed potential causes of tax administration challenges in Somaliland, as reported by the respondents. The succeeding section provides the details of these findings and discussions.

#### **4.4 Causes of Somaliland Tax Challenges**

In the preceding section, as reported by the respondents, we have seen the different challenges of establishing an effective, efficient, and equitable tax administration in Somaliland. This section of the chapter covers the major causes of these challenges. The section highlights the quantitative findings of whether the lack of taxpayers' education, poor administration, inadequate resources, and lack of government trust as well as complications in the tax system are the causes of the aforementioned challenges. The section also

covers the views of top and middle-level administration of Somaliland tax system about the causes of the existing tax administration challenges. Graphs, tables, and figures are used to present these findings.

In the section, various questions were posed for the participants of this research about the causes of Somaliland tax administration challenges. The following question was asked to investigate if a lack of taxpayers' education is among the causes of the challenges in Somaliland tax administration.

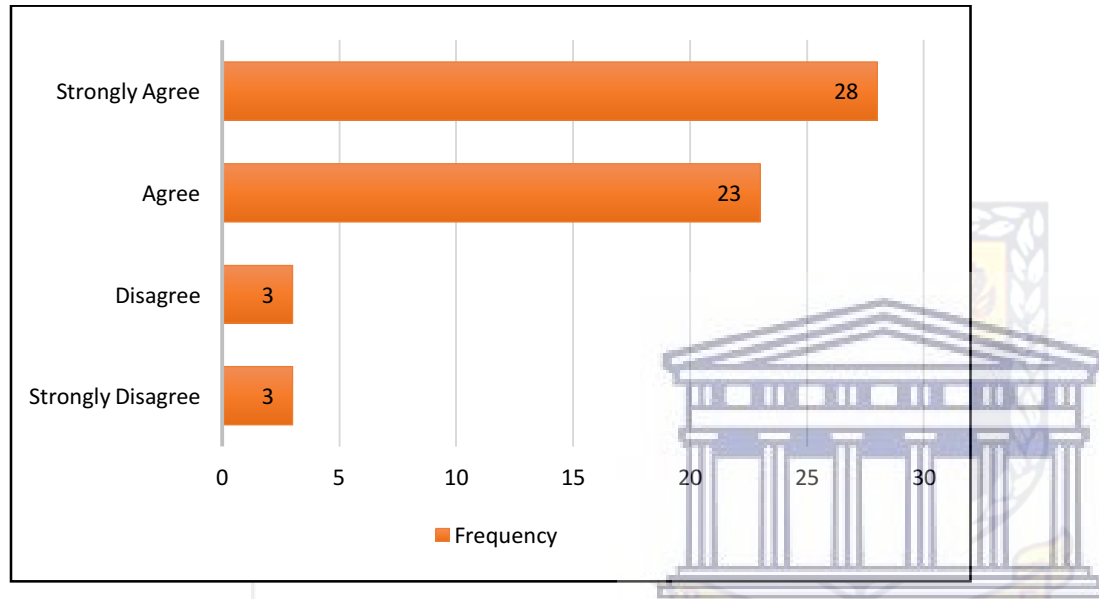
#### 4.4.1 Lack of Taxpayers' Education

**Figure 4.2** illustrates that 6 out of 57 respondents strongly disagree or disagree that the lack of taxpayers' education is among the causes of tax administration challenges. In contrast, 51 of the respondents strongly agreed or agreed that lack of taxpayers' education is among the major causes of the tax administration challenges in Somaliland.





**Figure 4.2.** Lack of taxpayers' education.



**Source:** Author's Fieldwork Questionnaires, 2018

Similarly, interviewees in this research mentioned that lack of taxpayers' education is a challenge to the Somaliland tax system. Interviewee 5 (2018, pers., comm., 5 August) argued that lack of taxpayers' education is among the major challenges in Somaliland tax administration. Likewise, interviewee 3 (2018, pers., comm., 25 August) claimed that tax education is missing hence taxpayers know nothing about taxes. 90 percent of the research respondents and five interviewees out of six interviews conducted agreed that a lack of taxpayers' education about taxes and their benefits is a major cause of tax administration challenges in Somaliland. Taxpayers' education is critical to the voluntary compliance of taxpayers. It helps taxpayers voluntarily meet their tax liabilities to the government (Gitaru,

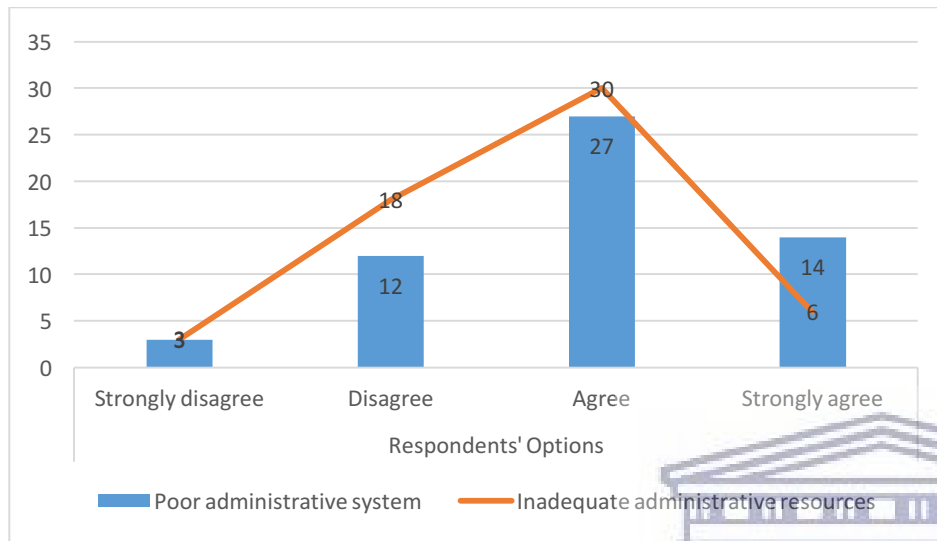
2017). Unfortunately, the research findings concluded that taxpayers do not know about their social responsibility to pay taxes to the government. Specifically, they lack knowledge in taxation processes and the reason they should pay taxes.

Similarly, respondents were asked if tax administration challenges exist because of poor administrative system and inadequate administrative resources. **Figure 4.3** below presents the respondents' answers for this question.

#### **4.4.2 Poor Administrative system and Inadequate Administrative Resources**

**Figure 4.3** below represents answers of the research participants concerning whether they think if poor administrative system and inadequate administrative resources are among the causes of tax administration challenges in Somaliland tax administration. The figure shows that 15 and 21 of the respondents strongly disagreed or disagreed respectively that a weak administrative system or scarcity of administrative resources are among the causes of the existing tax administration challenges in Somaliland. Conversely, 41 and 36 of the respondents agreed or strongly agreed respectively that deficiency in administrative system or insufficient administrative resources respectively are among the causes of tax administration challenges in Somaliland tax administration.

**Figure 4.3.** Poor administrative and inadequate administrative resources.



**Source:** Author's Fieldwork Questionnaires, 2018

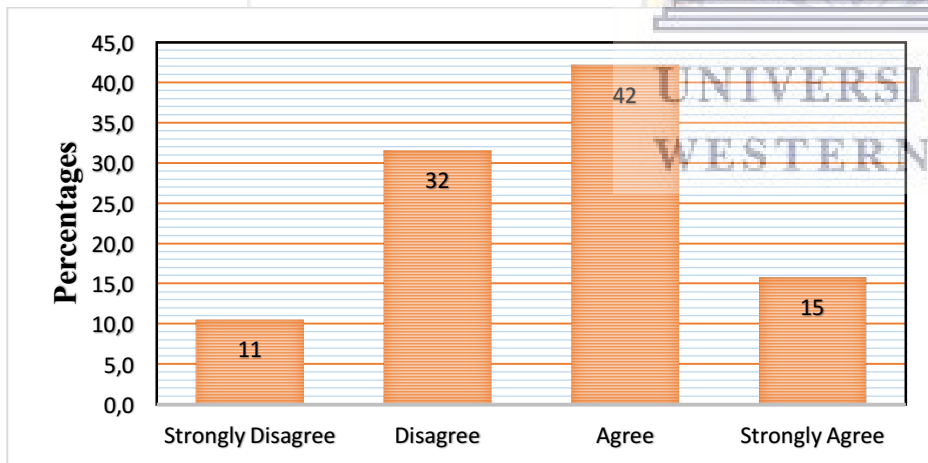
Correspondingly, interviewees highlighted that the scarce administrative resources and weak administrative system played great role in the current challenges in the Somaliland tax system. Interviewee 3 (2018, pers., comm., 25 August) stated that top officials are not collaborating among them. This weakens the the operations in the institution. Research participants agreed that the Somaliland tax administration is very weak and the administration does not have sufficient resources to manage the system. According to Ng'eni (2016), weak tax administration and insufficient administrative resources are significant drivers of tax administration challenges in developing countries. As the findings indicate, this is no exception in Somaliland. These findings indicate that adequate revenue could not be collected. As such, the government would always be in deficit and dependent on external assistance. Likewise, competent staff could not be attracted or retained and resources will remain scarce.

Likewise, these research participants were asked if a lack of government trustworthiness is one of the factors causing tax administration challenges in Somaliland. The following bar chart shows the answers of the research participants to this question.

### 4.4.3 Lack of Government Trustworthiness

The bar chart below demonstrates that 43% of the questionnaire respondents either strongly disagreed or disagreed that lack of government trustworthiness is among the existing factors that cause challenges for the Somaliland tax administration. Conversely, 57% of the respondents agreed or strongly agreed that lack of government trustworthiness is one of the factors causing the current challenges in Somaliland tax administration.

*Figure 4.4.* Lack of government trustworthiness.



Source: Author's Fieldwork Questionnaires, 2018

Similarly, Interviewee 6 (2018, pers., comm., 26 August) stated when the government fails to implement a project as a result of funding deficiencies, people may perceive the government as untrustworthy as it breaks promises. Likewise, interviewee 4 (2018, pers., comm., 23 August) declared that one cause of the challenges is that people lose trust in government and avoid paying taxes when they expect to see material and concrete returns for the taxes that they pay and the government fails to deliver.

The findings illustrate that Somaliland tax administration is also suffering from lack of public trust in government. These findings confirm the research of Hassan and Tellander (2016) that Somaliland tax administration faces difficulties in operating effectively due to poor public trust in government. Public trust determines compliance of taxpayers. As Bird and de Jantscher, (1992), Boly, Konte, and Shimeles (2017), and Torgler and Schneider (2009) state, people obey tax laws and pay their tax liabilities as far as they trust that the government works towards their interest or the public interest.

Furthermore, the respondents of these research questionnaires were asked if tax challenges exist due to complication of the tax system in Somaliland. The next heading and the following **Table 4.3** below represent the results of their answers.

#### **4.4.4 The Complication of the Tax System**

**Table 4.3** below shows that 44 percent of the respondents strongly disagreed or disagreed that the Somaliland tax administration is complicated. The rest 56 percent strongly agreed or agreed that the existing tax system in Somaliland is complicated. Some of the interviewees in this research also raised that Somaliland tax system is complicated mainly due to unfriendly manual system. The complication of the tax system creates tax evasion, tax avoidance, corruption, and delays for the institution's operations among others.

**Table 4.3.** Complication of the System

<b>Options</b>	<b>Frequency</b>	<b>Percentage (%)</b>
<b>Strongly disagree</b>	4	7.0
<b>Disagree</b>	21	36.8
<b>Agree</b>	18	31.6
<b>Strongly agree</b>	14	24.6
<b>Total</b>	57	100.0

**Source:** Author's Fieldwork Questionnaires, 2018

Moreover, the research participants were asked about the impact of the existing tax administration challenges in Somaliland. The succeeding section highlights their views about the impact of these challenges on revenue collection, employment, inflation, investments, economic growth as well as development of Somaliland among others.

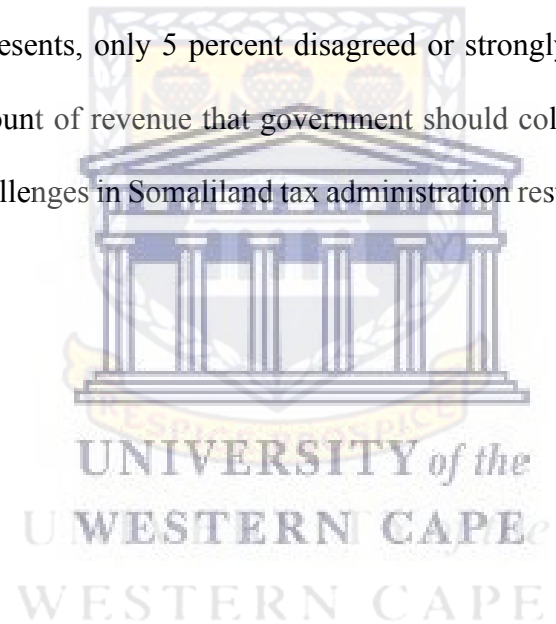
#### **4.5 The Impact of Tax Administration Challenges in Somaliland**

Research participants were questioned through interviews and questionnaires about the impact of current tax administration challenges on government revenue collection, public trust in government, public development programs, existing inflation as well as foreign direct and domestic investments. This section presents the answers of the research participants about the impact of these

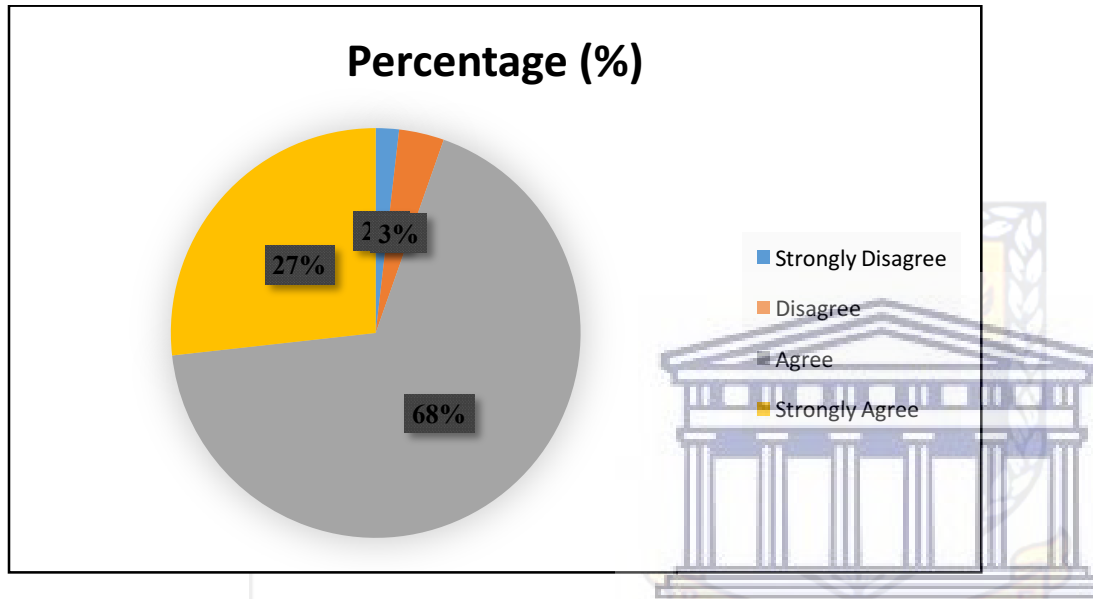
challenges. Different presentation tools, including tables, charts, and other figures, are used in this section to present the findings. The impact of these challenges on the above-mentioned factors are analyzed individually.

#### 4.5.1 Challenges' Impact Government Revenue Collection

**Figure 4.5** shows that 56 people responded to the question, which means one is missing from the research participants who returned the questionnaires. As the chart presents, only 5 percent disagreed or strongly disagreed that the existing challenges in the Somaliland tax administration limit the amount of revenue that government should collect. In contrast, 53 respondents or 93 percent agreed or strongly agreed that the current challenges in Somaliland tax administration restrict the amount of tax revenue that government could collect.



**Figure 4.5.** Challenges restraining government revenue collection.



**Source:** Author's Fieldwork Questionnaires, 2018

Similarly, interviewees agreed with the questionnaire participants that these tax administration challenges in Somaliland affect on government revenue collection. Interviewee 1 (2018, pers., comm., 7 August) asserted that big companies in Somaliland do not pay their tax liabilities properly. Even if they were asked for their tax returns, they are granted unwarranted tax exemptions from the top officials in the Ministry of Finance, reducing the amount of government revenue collected. Similarly, interviewee 5 (2018, pers., comm., 25 August) stated that because of regular tax evasions, revenue under collection is common in the institution. Another interviewee



affirmed that because law enforcement and tax tribunals are missing in the tax system, expected revenue has never been collected (Interviewee 3, 2018, pers., comm., 25 August).

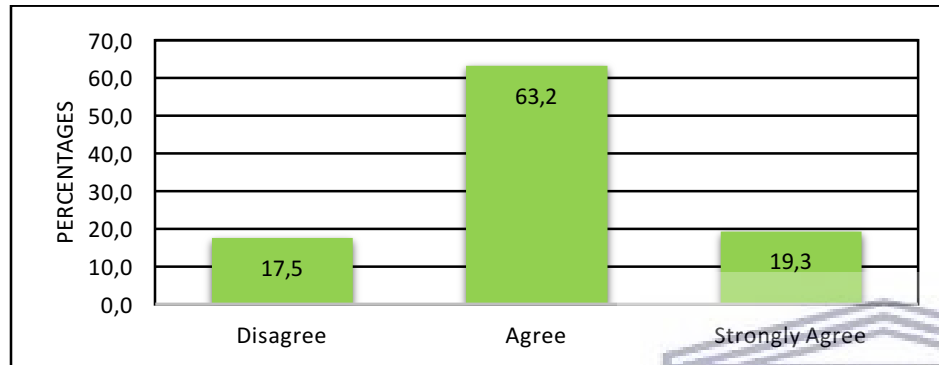
Although this research did not quantify the impact of these challenges on government revenue, the research participants from both data sets believe that the impact of the tax administration challenges in Somaliland on revenue collection is huge. Poor revenue collection weakens the capacity of the institution to aid government operations. Poor collection of tax revenue means poor return delivery of public education, health care, water, security, and other public services. These findings are in line with Kipilimba's (2017) conclusions that ineffective tax administration due to various challenges decreases revenue collections.

Likewise, respondents were asked if current challenges in Somaliland tax administration have an adverse impact on public trust in government. **Figure 4.6** below as well as flowing paragraphs illustrate the results of this question.

#### **4.5.2 Challenges' Impact on Public Trust in Government**

**Figure 4.6** below displays that 81 percent of the questionnaire respondents either agreed or strongly agreed that the challenges in Somaliland tax administration adversely affect public trust in government. For example, interviewee 6 (2018, pers., comm., 26 August) argued that challenges in Somaliland tax administration delay government expenditures for public services and public projects." He emphasized that when government operations are delayed, the public loses trust in government as they perceive the government to be breaking promises. The findings confirm that challenges in tax administration can even impact the relationship between a government and its citizens.

**Figure 4.6.** Challenges' impact on public trust in government.



**Source:** Author's Fieldwork Questionnaires, 2018

Correspondingly, the respondents were questioned if tax challenges have an impact on employment and the existing inflation in the country. **Table 4.4** and next few paragraphs below demonstrate the answers of the research participants.

#### **4.5.3 Challenges' Impact on Employment and Inflation**

As **Table 4.4** shows, 27 and 13 percent out of (57) of the respondents either strongly disagreed or disagreed that challenges in Somaliland tax system have promoted inflation or cause unemployment respectively. In contrast, 30 and 44 percent of the participants either agreed or strongly agreed that challenges in Somaliland tax system have an adverse effect on inflation and employment respectively. Correspondingly, tax officials interviewed during the field indicated that inflation rises due to the absence of strong tax administration as well as monitoring and fiscal policy. They also highlighted that because of decreased government revenue, no job opportunities are created at the national level and the rate of unemployment increases day by day. These findings show that Somaliland

tax administration challenges have an impact on the existing inflation and unemployment in the country. The findings also mean that tax administration is not only a revenue mobilization body, but it also stabilizes economy and improves citizens' lives.

**Table 4.4.** Challenges' Impact on Employment and Inflation

Statement		Frequency	Percentage (%)
<b>Promote Inflation</b>	Strongly Disagree	0	0.0%
	Disagree	27	47.4%
	Agree	21	36.8%
	Strongly Agree	9	15.8%
<b>Cause Unemployment</b>	Strongly Disagree	1	1.8%
	Disagree	12	21.1%
	Agree	29	50.9%
	Strongly Agree	15	26.3%

**Source:** Author's Fieldwork Questionnaires, 2018

Moreover, respondents were asked if these challenges in Somaliland tax system limited development programs of the government as well decreasing both foreign direct and domestic investments. **Table 4.9** demonstrates the answers of the research participants with regard these questions.

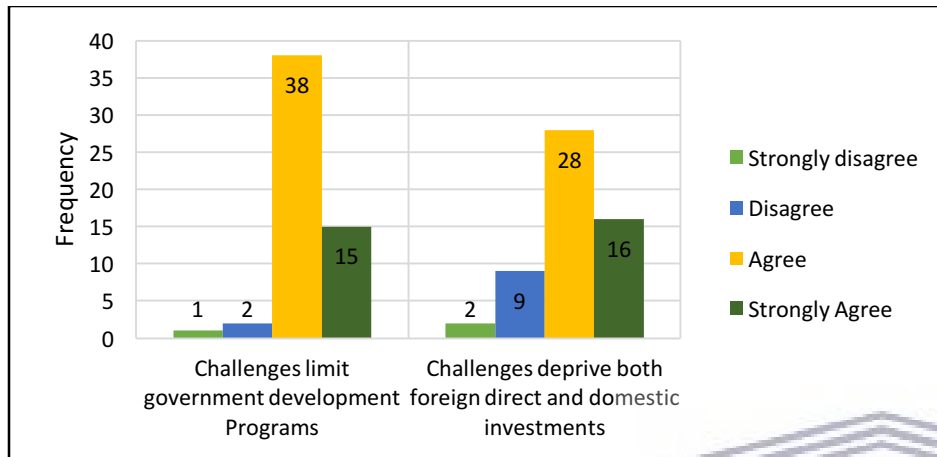
#### 4.5.4 Challenges' Impact on Government Programs and Investments

**Figure 4.7** below shows that 3 and 11 respondents out of 56 respondents strongly disagreed or disagreed that challenges limit government development programs or have any impact on both foreign direct and domestic investments respectively. However, 53 and 44 research participants either strongly agreed or agreed that challenges in Somaliland tax system have an effect on government development programs as well as both on foreign direct and domestic investments respectively.

Correspondingly, tax officials mentioned in their interviews that Somaliland tax administration challenges have severe impacts on investments and government development programs. Interviewee 5 (2018, pers., comm., 25 August) argued that these challenges restrain construction of infrastructures and other public projects and hence limits government programs. Other interviewees highlighted that due to weak tax administration as well as absence of economic policies, i.e., fiscal and monetary at the national level, these challenges affect the investment opportunities in the country. Interviewee 3 (2018, pers., comm., 25 August) stated that Somaliland tax administration did not create an attractive environment for investment.

These findings conclude that due to scarce government funds, capital expenditures would be cut, reducing implementation of public development programs. These cuts not only limit government development programs, but they also discourage both domestic and direct foreign investments as a result, there would not be the demanded infrastructure for these investments.

**Figure 4.7.** Challenges' impact on government programs and investments.



**Source:** Author's Fieldwork Questionnaires, 2018

Lastly, these research participants were asked the possible ways that Somaliland tax administration could be improved. The subsequent section of this chapter details the answers for this question from both the questionnaire and interview participants.

#### 4.6 Ways of Improving Somaliland Tax Administration

In this section, research participants were asked the possible ways that Somaliland tax system could be improved. The questionnaires' respondents were given options to select from Likert-type response options. These options included updating tax laws, simplifying tax procedures, automating the system, capacity building, educating taxpayers, broadening tax base, reducing tax rates, improving administration, and fighting against tax corruption. **Table 4.5** summarizes the responses of the questionnaire participants. Similarly, six interviews were conducted among top and middle-level management of Somaliland Inland Revenue to suggest possible

remedies for the current tax administration challenges in Somaliland. The findings from the two data sets, i.e., quantitative data set from questionnaires and qualitative data set from interviews, are combined in findings as well as in discussions.

**Table 4.5.** Possible Ways of Improving Somaliland Tax Administration

Statements	Strongly Disagree	Disagree	Agree	Strongly Agree	I don't know	Total
Updating tax laws	2	4	23	25	3	57
Simplification of tax procedures	1	1	34	21	0	57
Automation of the tax system	1	3	28	24	1	57
Building the capacity of staff	0	2	24	28	3	57
Educating taxpayers	1	3	19	31	3	57

Broadening the tax base	0	5	23	20	5	53
Reducing tax rates	5	13	32	6	1	57
Improving the tax administration	0	0	27	26	4	57
Fighting against corruption	0	2	17	36	2	57

**Source:** Author's Fieldwork Questionnaires, 2018

**Table 4.5** above shows that all questionnaires' respondents who returned their questionnaires either agreed or strongly agreed that Somaliland tax system could be improved through updating tax laws, simplifying tax procedures, automating the tax system, building staff capacity, providing taxpayers education, broadening tax base, reducing tax rates, and fighting against tax corruption. The table shows that out of 57 respondents, 48, 55 and 52 participants agreed or strongly agreed that updating tax law, simplification of the tax system, automation of the tax system respectively could potentially solve the Somaliland tax administration's challenges. Likewise, 52, 50, 43, and 38 respondents out of 57 agreed or strongly agreed that building staff capacity, providing taxpayers' education, broadening the tax base, and reducing tax rates would potentially make Somaliland tax system better. Similarly, 53 and other 53

respondents out of 57 participants agreed or strongly agreed that improving tax administration and fighting against tax corruption respectively are viable methods of improving the Somaliland tax system.

In the same tokens, six officials of top and middle-level management of Somaliland tax administration who were interviewed stated several possible ways they think would lead to the betterment of the Somaliland tax system. The most important methods they believed would contribute include taxpayers' awareness/education, building capacity of the institution, enforcing laws as well as increasing transparency of public revenue, i.e., how it is used and where. Interviewee 4 (2018, pers., comm., 23 August) argued that creating capacity building programs for the staff would make the institution better. Similarly, interviewee 6 (2018, pers., comm., 26 August) asserted that capacitating administrative staff and hiring tax experts would create a sound tax system in Somaliland. These findings significantly implicate that capacity building is critical in Somaliland tax system. Building capacity of the staff and upgrading working facilities could establish efficient, effective, and equitable tax administration. Capacity building in tax administration bodies bridges the gaps in these institutions (Stef et al, 2017). Building capacity of the staff might include on/off job relevant trainings, experience sharing, and professional ethical trainings.

Likewise, according to the findings, automation of the tax system is core for the improvement and transparency of the system. The findings are in line with Nnadozie et al.'s (2017) findings that effective utilization of technology in tax administration is an important way of improving tax system. Computerization of the system is very important for the accuracy, speed, and data access of the tax system operations. Moreover, interviewee 1 (2018, pers., comm., 7 August) also believed that providing incentives to hard working staff



members as well as increasing operational facilities could improve the system. These findings are consistent with Bird et al. and (1992) de Jantscher & Bird's (1992) findings that improving tax administration, proper implementation of tax laws, and adequately providing required resources are essential for a desirable tax administration. In the same tokens, some of the interviewees stressed that awarding good taxpayers, conducting performance appraisal, delegating power, and implementing the new Somaliland revenue act could improve the current tax system.

These findings confirm that improving the tax administration and fighting tax corruption could play an important role for achieving a sound and transparent tax administration where taxpayers are willing to pay their tax liabilities voluntarily. Correspondingly, the research findings conclude that taxpayers' education is essential for strengthening tax administration.

#### **4.7 Summary**

Domestic revenue is definitely an important source of government revenue in the world today. Yet, Somaliland needs domestic tax revenue more than any other country. This is because of the fact that Somaliland is not internationally recognized hence the external assistance and foreign investments are very limited. However, this research found that Somaliland tax administration faces formidable challenges that can be broadly categorized into three; institutional challenges, attitudinal challenges and economic and political challenges. The research also confirmed that lack of taxpayers' education, inadequate resources, lack of public trust in government and rigidity of the tax system are the main causes of tax administration challenges in Somaliland. In addition, as the research findings indicated, tax administration challenges in Somaliland restrain tax revenue collection, government capacity of providing public services, investments, economic growth and development in general. Therefore, the research concluded that updating tax laws, simplifying tax

procedures, automating tax systems, building capacity of the institutional staff, educating taxpayers, broadening tax bases, improving the administration and fighting against corruption are the possible ways of establishing a sound tax system in Somaliland.



## Chapter Five

### **The Challenges of Tax Administration in Somaliland: Conclusions and Recommendations**

This chapter provides the main findings and conclusions of the thesis in the context of its major focus and hypothesis. Recommendations are also developed based on the key findings and conclusions.

#### **5.1 Conclusions**

Tax administration plays a key role in the existence of a government. The principal responsibility of a tax system is to collect tax revenue from taxpayers. Public services and non-excludable public goods are provided to taxpayers in return for taxes paid. However, tax administrations, particularly those in developing countries such as Somaliland, face formidable challenges of under-skilled workers, outdated tax policies, an absence of technology, and corruption to name a few. Poor tax administration weakens government legitimacy and its ability to finance public services and goods, resulting in poor countries.

As indicated in Chapter One, Somaliland is one of the poorest countries on the African continent. According to the World Bank (2015), Somaliland places fourth last, just above Burundi, DR Congo, and Malawi, when its GDP is compared to that of other countries. To make matters worse, the total tax revenue percentage of GDP of Somaliland is only 7% (Ahmed, 2016). Although the state in Somaliland is internally legitimate and many citizens participate in state building activities like paying their taxes, the research findings show that there is no sound tax system in Somaliland. This means that the government is forced to rely on non-reliable sources of

funding, which hinders the consistent provision of public goods and services. Taxes are a crucial source of funding for public expenditures for most of the countries, and this is no exception for Somaliland. Therefore, Somaliland needs a sound tax administration. As mentioned in Chapter One, the most important attributes of a sound tax system are efficiency, transparency, and equity (Stiglitz, 2000). However, the Somaliland tax administration embodies none of these principles.

Therefore, this research was set out to assess the challenges in Somaliland tax administration that provoke collecting demanded tax revenue and the causes of these challenges. The research problem also focuses on the effects of these challenges on tax revenue collection, economic growth, and development in general as well as on the viable improvement that can be made to the Somaliland tax system.

The research presumed that the tax administration challenges in Somaliland are related capacity constraints due to the absence of well-trained and professional staff and reliable technology as well as the in-compliant attitudes of taxpayers, corrupt practices, and policy gaps.

Therefore, to achieve the objectives of this research fully, a mixed method approach was employed. Deploying this mixed method approach; both quantitative and qualitative data were gathered from 63 members of Somaliland Inland Revenue Department through self-administered questionnaires and interviews. This mixed method approach was applied to collect comprehensive data to achieve the objectives of the research. Applying mixed method resulted in a triangulation, where two approaches, two data sets, and different analytical tools were used in attaining the aim of this research. However, this method was more time-consuming than I had planned in

collecting and interpreting the two sets of data concurrently. In addition, the smaller sample size in this research, as a result of financial constraints limits conducting some inferential statistical analysis that might have provided detailed insights.

Bearing all this in mind, the succeeding section provides the summary of the major findings of this thesis under the following headings:

1. Institutional Challenges;
2. Attitudinal Challenges;
3. Political and Economic Structure Challenges; and
4. Possible Improvements, Participants' Perspectives.

### Institutional Challenges

The Somaliland tax administration faces institutional challenges in poorly motivated and unskilled staff. The research concluded that the number of staff in the institution with tertiary certificates is more than the number of staff with secondary and basic education. However, the institution lacks skilled, well-trained, professional and ethical employees. The institution also faces financial constraints. The scarcity of funding limits the capacity of the institution to buy software to automate its operations and the ability to hire people with the requisite skills and experience. Similarly, an absence of software and databases to capture and store taxpayers' information is a barrier to the Somaliland tax system.

Moreover, the research findings indicate that a lack of sufficient funding, equipment, and proper human resources promoted the existing challenges in Somaliland tax system. Moreover, poor administrators due to the absence of international exposure, relevant experience, and proper education as well as a manual, rigid, and misanthropic tax system impeded the institution in its task to fulfill its obligations soundly.

A country's standard of living depends on government's ability to invest in infrastructure and other public services like health, education, clean water, and security among others and there is no exception for Somaliland. However, this research found that, as results of the above-mentioned challenges, government revenue collection, public development programs, investments for creating job opportunities and economic growth as well as the development of the country, in general, are hampered.

### Attitudinal Challenges

Somaliland tax administration also has suffered from attitudinal challenges of tax evasion, tax avoidance as well as corruption. These attitudinal challenges are due to several reasons. One of the major causes of attitudinal challenges is the lack of taxpayers' educations and taxpayers' lack of awareness that paying taxes is a social responsibility. Similarly, as the findings indicated, the poor public trust, as well as the complex and unfriendly taxation system from registration to payment worsens the negative effects of these challenges. In addition, the research found that attitudinal challenges are due to the weak administration and unskilled staff in the institution as well as the attitudes of taxpayers towards corruption practices in public institutions, particularly in the tax administration

office. Similarly, due to the perception of individual taxpayers and corporations that the risk to being detected for non-compliant behaviour in taxation is low, tax avoidance is one aspect of the attitudinal challenges for the Somaliland tax administration.

These challenges weakened the capacity of the institution to collect the required tax revenue, resulting in poor public service provision. In addition, these challenges ultimately erode public confidence as well as nurture the distrust of public in government.

### Political and Economic Structure Challenges

Moreover, the institution has been encountering political and economic structural challenges. The research found that there is new revenue act that was voted in by the Somaliland parliament but not implemented into practice by the Somaliland government. This is because the new revenue act specifies the establishment of an independent Somaliland revenue authority. As such, this law could only be practical when a revenue authority is established. Therefore, the research concluded that current Somaliland tax administration works with an old and unamended tax law that is 22 years old. The old laws are not enforced adequately as there are no tax tribunals in the country.

Correspondingly, the institution's operations are constrained by the huge informal enterprises in the country. This research uncovered that the majority of enterprises in Somaliland do not have proper accounting records due to nature of their business; mainly very small enterprises, unskilled businesspersons and the illiteracy of some of the business owners. The large existing of informal businesses in Somaliland that is mainly due to the absence of database in the institution is a serious impediment to efficiency and effectiveness of Somaliland tax administration.

These findings indicate that because of the outdated and complicated tax laws, the absence of tax courts as well as the huge number of eligible taxpayers who are outside of the tax net, the government cannot raise the required revenue for service provision. These challenges also deteriorate the government ability to implement new public projects and create employment opportunities for its citizens.

Furthermore, the research provides recommendations for how the Somaliland tax administration could solve its challenges and build a sound tax system. However, as the staff of the institution who participated in the study have in-depth knowledge about the challenges since they are very close to the problems faced by the institution in their day-to-day operations. As indicated in Chapter Four, the research asked staff through data collection tools, i.e., questionnaires and interviews, the possible improvements that could be made in the Somaliland tax administration. The succeeding section provides a summary of these findings.

#### Possible Improvements, Participants' Perspective

The research discovered research participants' perspective on some possible ways of improving the current tax administration in Somaliland to create an efficient, effective, and equitable tax system. The research participants agreed that upgrading the capacity of the institution, constantly updating tax policies, automating, and simplifying the system, improving the administration as well as fighting against corruption are all possible ways of improving Somaliland tax administration to curb the existing challenges and achieve future endeavours in the best possible ways. The following section offers recommendations considering the major findings of the research.



The section also points out the confirmation or refutation of any of the major assumptions and suggests areas that might need further research.

## 5.2 Recommendations

Somaliland has been recovering in its institutions, society, economy, and infrastructure from the severe destruction of the Siad Barre regime and subsequent civil wars. However, there are plenty of problems still left to address. Similarly, the tax administration system has been facing the challenges of capacity constraints, attitudinal challenges, an economic structure as well as political challenges since its establishment under an independent Somaliland in the early 1990s. The findings of this research indicated that the Somaliland tax system is weak and is incapable of realizing its duties. The following recommendations are offered based on the key research findings and conclusions.

### Capacity Constraints

The absence of skilled and well-trained staff, lack of technology, financial obstacles and absence of other operational facilities among others are all capacity constraints in addition to tax leaks. Thus, sealing any gaps that might affect the tax revenue collection and improving the efficiency of tax administration should be promptly addressed. Somaliland needs to improve the capacity of its tax administration in order to achieve its revenue goals and increase the role of tax revenue in state building and public service delivery. A tax system with well-trained, skilled, and professionally ethical staff could be an essential precondition for establishing efficient, effective, and equitable tax system. Somaliland needs to allocate a good share of its scarce budget for to invest in human capital. The

top and middle-level administrators need to have extensive regional, continental, or international exposure and experience in order to learn about effective tax administration. A tour of neighbouring countries' tax administrations, like the Ethiopia Revenue and Customs Authority (ERCA), Kenyan Revenue Authority (KRA), and Uganda Revenue Authority, would be inexpensive and could provide good exposure for officials. The tax administration staff also need significant professional trainings and further education that incorporate international best practices and standards. Therefore, the institution needs to create a center for professional training and development of the staff in the institution. This center needs to hire professional trainees with technical expertise who can understand the context of Somaliland tax system.

In addition, taxpayers' information is at the heart of any tax administration. Therefore, Somaliland tax administration needs to automate its operations to early store and access required taxpayers' information. Automation of the tax system would facilitate all key functions of the institution and encourage staff as it reduces the workloads of the staff as well as saving time for taxpayers. Automation of the system would be a daunting task due to unavailability of financial resources and limited IT personnel. However, it should still be marked as top priority

### Attitudinal Challenges

As the research findings highlight, Somaliland tax administration has been facing several attitudinal challenges in its operations. These attitudinal challenges include tax evasion and tax avoidance from the taxpayers' side as well as low work performance and corruption from the employees' side. Thus, Somaliland tax administration needs to work closely with other Somaliland public

institutions to create a favourable environment where taxpayers trust their public institutions and, as a result, pay their tax liabilities voluntarily. Somaliland tax administration needs to show taxpayers that the taxes they are paying are fundamental to the provision of public goods and services through awareness programs and material public projects. Taxpayers tend to respond favourably to tax laws when they feel that the government is protecting their interests. This is in line with Birds (2007) argument that taxpayers are more willing to comply with tax policies if they accept that their governments are legitimate and credible. Therefore, Somaliland tax administration needs to ensure the quality of public services delivery. Similarly, as mentioned before tax administration needs to avoid complex systems and prioritize the automation of their systems. Thus, the system would be transparent and corruption would decline. In addition, Somaliland tax administration also needs to restructure its salary scheme and implement effective performance appraisal systems where employees and administrators would closely work together for the betterment of the institution. Performance appraisal motivates employees as hard workers would be promoted or awarded, and it would reduce the skilled employees' turnover. According to Javed et al. (2013), one of the primary goals for performance appraisal is to retain employees and minimize turnover.

### Political and Economic Structure

Taxing the informal economic sector has potential consequences for government revenue collection as well as the economic growth of the nation in general. Somaliland informal sector is large, and bringing this sector into the tax net is a daunting task. What makes taxing this sector worse is the lack of strong public banking system as well as the absence of private banks' collaboration with government, resulting in a constraint of revenue raising capacity in the tax administration. Therefore, Somaliland tax administration

needs to find a way to bring these informal businesses into the tax net. The most likely effective approaches for this task are the two indirect taxes approaches of presumptive tax and value-added tax (VAT). These two approaches would widen the tax base and register these taxpayers into the national tax system. However, the tax system should conduct a cost-benefit analysis of any taxes levied to avoid discouraging these small enterprises, as they are important to the economic growth of the nation.

Moreover, one of the major challenges in the Somaliland tax administration is the outdated tax laws. The new revenue act in Somaliland is applicable to a revenue authority and does not fit the current tax department under the Ministry of Finance. Thus, Somaliland tax administration needs to speed up the undergoing reforms of establishing the Somaliland Revenue Authority. Likewise, a political will from the top government officials to the front line administrators is needed to solve the current tax administration challenges and to overcome future threats. Similarly, taxpayers and all other key stakeholders are needed to be involved tax policy formulations so that the implementation of these policies would be easier. Somaliland tax administration lacks the capacity of both material and financial resources to undertake comprehensive reforms on its own and international aid is limited. As such, the institution needs persisting amendments of tax policies and regulations. The updated tax laws would not only increase tax revenue but also would create a friendly environment for new investments as well ordinary existing taxpayers. Furthermore, the research identified that enforcement of tax laws is very weak and that tax courts do not exist. Therefore, the institution should focus on enforcement of the tax laws to enhance taxpayer compliance and encourage the Somaliland Minister of Finance to establish a tax appeal commission, as the Articles 210 and 211 of the Somaliland Revenue Act (2017) states.

### 5.3 Concluding Remarks and Recommendations for Further Studies

The findings of this study confirm the assumption of the researcher that capacity constraints due to absence of well-trained and professional staff and technology as well as incompliant attitude of taxpayers, corruption practices, and policy gaps are the major challenges in the Somaliland tax administration. However, the small sample size, time, and nature of the mini-thesis presented limitation to this study. Therefore, the following further studies are recommended:

- ✓ Determinants of voluntary tax compliance to explore and solve non-compliance behavior of taxpayers;
- ✓ A quantitative study of the impact of tax evasion to quantify the magnitude of the impact on revenue generation as well as possible measures to avoid it; and
- ✓ Challenges of attracting and retaining professional employees come up viable strategies that could address scarce and unskilled human capital in the institution.



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## Appendix A: Questionnaire Guide

### Questionnaire Guide

*I am Faisal Haginour, a Master's Degree student at School of Government, University of Western Cape, South Africa. I am approaching you for data collection on my topic entitled "The challenges of tax administration in Somaliland Ministry of Finance: A Critical Analysis of Intuitional Perspective" in the partial fulfillment of the requirement of my Master's Degree in Public Administration. Your information will be very useful and it will contribute identifying current challenges in Somaliland taxation, causes of these challenges, impacts of the challenges and possible solutions to existing problems. The questionnaire duration is about 20 minutes. Your information will only be used for the purpose of this study and it will be held very confidentially. Your participation is voluntary and free so you can withdraw from participating in it at any time should you to do so.*

Please use the options below in each questions from section A to E to respond to each statement in the table by ticking (√) in the cell that corresponds to the option that best matches your opinion. **Please note: in question 2 of section B you can tick (√) more than one option.**

### Section A: Background Information

1.	What is your gender?	i. Male	
		ii. Female	
2.	What is your age range?	i. 18-30	
		ii. 31-43	
		iii. 44-56	
		iv. 57 and above	

3.	What is your marital status?	i.	Single	
		ii.	Married	
		iii.	Divorced	
		iv.	Widowed	
4.	What is your level of education?	i.	No formal education	
		ii.	Primary	
		iii.	Secondary	
		iv.	Tertiary	
5.	What is your salary range?	i.	Less than 500, 000 S/land/Shillings (less than \$50)	
		ii.	S/L/SH300,000-800,000 (\$50-\$80)	
		iii.	S/L/SH800,000-1,000,000(\$80-\$100)	
		iv.	S/L/SH1,000,000-1.500,000 (\$100-\$150)	
		v.	S/L/SH1,500,000-2.0000,000 (\$150-\$200)	
		vi.	S/L/SH2,000,000-2,500,000 (\$200-\$250)	
		vii.	S/L/SH2,500,000-3,000,000 (\$250-\$300)	
		viii.	S/L/SH3,000,000-3,500,000 (\$300-\$350)	
		ix.	S/L/SH3,500,000-4,000,000 (\$350-\$400)	
		x.	S/L/SH4,000,000 above (\$400 above)	
6.	Do you have secondary source of income?	i.	Yes	
		ii.	No	

### Section B: Challenges in Somaliland Tax Administration

No.	Questions	Strongly dissatisfied	dissatisfied	satisfied	Strongly satisfied
1.	How satisfied are you about the current situation of the Somaliland tax administration?				
2.	What are challenges of tax administration in Somaliland	Lack of institutional capacity			
		Lack of technology			



	Ministry of Finance (the Inland revenue)?	Outdated tax laws	
		Inadequate staff	
		Country's economic structure	
		Tax evasion	
		Tax avoidance	
		All of them	
Others, please specify----- ----- ----- ----- -----			
3.	Do you follow the tax procedure steps of registration of the taxpayer, taxpayer identification number, assessing tax, processing files return, collecting the liable tax, tax audit and appealing?	Yes	
		No	
4.	Have you ever been trained since your stay at the office of Inland Revenue?	Yes	
		No	
5	Do you have adequate operational resources to do your task efficiently?	Yes	
		No	

**Section C: Causes of the challenges in Somaliland Tax Administration**

Statements	Options			
		Strongly disagree	Disagree	agree

1. Lack of government trustworthy				
2. There is poor administrative system				
3. There is inadequate administrative resources				
4. lack of taxpayers tax education				
5. The tax system is complicated				

**Section D: Impacts of Tax Administration Challenges on Country's Economy and Development.**

Statements	Options			
	Strongly disagree	Disagree	Agree	Strongly agree
1. These challenges adversely affect the public trust in government				
2. The challenges restrain government revenue generation				
3. The challenges limit government development programs				
4. The challenges of tax administration promote inflation				
5. The challenges cause unemployment				
7. The tax administration challenges deprive both foreign direct investment and domestic investment				

**Section E: Ways of improving the tax administration**

Statements	Options
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	Strongly disagree	disagree	agree	Strongly agree	I don't know
1. Updating of the tax laws					
2. Simplification of the tax procedures					
3. Automation of the tax system					
4. Building the capacity of the staff					
5. Educating taxpayers					
6. Broadening the tax base					
7. Reducing tax rates					
8. Improving the administration					
9. Fighting against tax corruption					

10. Mention any other suggestions or recommendations that you think, would create effective, efficient and equitable tax administration in Somaliland.

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**Thank you very much for your participation**

## **Appendix B: Interview Guide**

### **Interviewees' Guide**

*I am Faisal Haginour, a Master's Degree student at School of Government, University of Western Cape, South Africa. I am approaching you for data collection on my topic entitled "The challenges of tax administration in Somaliland Ministry of Finance: A Critical Analysis of Intuitional Perspective" in partial fulfillment of the requirements of my Master's Degree in Public Administration. Your information will be very useful and it will contribute identifying current challenges in Somaliland taxation, causes of these challenges, impacts of the challenges and the ways forward. The interview duration is between 30 to 40 minutes. Your information will only be used for the purpose of this study and it will be held very confidentially. Your participation is voluntary and free so you can withdraw from participating in it at any time should you to do so.*

### **Section A: Current challenges of national tax administration in Somaliland**

1. What extent, does tax generated revenue contribute to the national budget?
2. How satisfied are you about the current situation in Somaliland tax administration? Please briefly indicate the current situation of the institution.
3. What are the main challenges that the Ministry of Finance and particularly Somaliland Inland Revenue experience in administering taxes?

### **Section B: Causes of the challenges in Somaliland tax administration**

1. What do you think cause the challenges of tax administration in Somaliland?
2. Why do you think that the factors you mentioned are the causes of the challenges in the tax administration?

### **Section C: Impact of challenges in the tax administration on revenue collection, economic growth and development in general in Somaliland**

1. How do these challenges affect on the institution's performance of revenue generation?
2. What significant effects do the challenges of tax administration have on country's economy and development?

### **Section D: Ways of improving the country's tax administration**

1. What actions have you taken so far to solve current challenges and to prevent possible future ones?
2. How do you think about the effectiveness of the steps that you have taken to improve the tax administration?
3. What are the possible ways that Somaliland tax administration could be improved

