

Ways of Consensus Building for Income Tax Compliance in Cooperatives

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Abstract

Income tax compliance is a significant phenomenon in the tax administration in both developed and developing countries. Literatures stress on the consensual way of resolving disputes on tax policy process. By virtue of its identity, cooperative model of development is regarded as a pathway of establishing the equitable society based on social justice and personal dignity. The demand of setting a reasonable income tax has exposed a considerable debate in cooperative sector in Nepal. This study was carried out in order to find ways of building consensus for income tax policy process through a sample survey based on Israel (1992) in 100 savings and credit, multipurpose and consumer cooperatives in Kathmandu district and 25 policy makers, bureaucrats, cooperative leaders and professional as key informants. The district was supposed to be the most potential in terms of both tax contribution and evasion. The data were analyzed with qualitative method using descriptive statistical techniques in SPSS. The study found out the ways of consensus building for the full compliance of income tax through the fair service and consensual policy process that needs to be delivered by the government. The value based operation of the cooperatives needs to be carried out within the legal frame while contributing to increasing production, creating employment, and enhancing the quality of life. Therefore, it is suggested to both stakeholders for regularly interact to show mutual trust and flexibility while developing and pursuing the income tax compliance policy decently.

Keywords: Cooperatives, Income tax compliance, Consensus building

1. Introduction

Income tax compliance is a significant phenomenon in the tax administration. Income tax compliance and evasion go side by side. Tax evasion behavior can be changed by improving the social or moral behavior of the tax payer (Awan, & Hannan, 2014). As a part of social behavior, negotiation about the tax policy could be made based on the principle of fiscal social negotiation. Negotiation is considered as bargaining between the state and the stakeholders/citizenry for consensual change in the taxation and public expenditure (Broms, 2011; Schneider, Lledo, & Moore, 2004). Kaplanoglou, & Rapanos (2013) stressed on the need of disputes resolving mechanism for the improvement of tax system whereas Moore (2007) argued on the consensual tax system as a pathway for improving the

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governance of the public sector. Consensus is a cooperative way of resolving disputes or making decisions that is acceptable to tax payers and the government. Irrespective of the economic or rational model of tax compliance, consensual taxation is the study of behavioral aspects of tax compliance through the negotiation among the stakeholders (Lumberton, De Neve, & Norton, 2014). The values of mutual respect, equality & the flexibility are the prerequisites for building consensus (Seeds for Change Lancaster Cooperative, 2013). In Nepal, there is no such policy particularly in the taxation, however the stakeholder consensus has been envisaged with the objective of successfully implementation of agriculture development strategy (ADS) (MoAD, 2014). Consensus building even in tax policy was initiated in USA in an open forum of advocates, experts and researchers with the objectives of refining & making the inclusive & fair tax policy (Brown, & McCulloch, nd). Such initiation may foster the common consensus and develop common bonds on issues for tax compliance among the stakeholders.

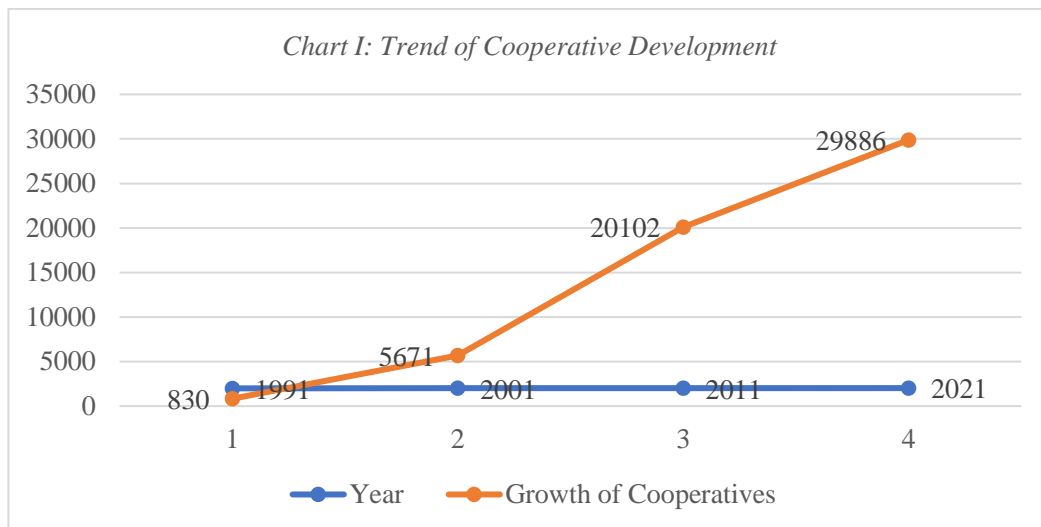
2. Literature Review

Accountability & responsiveness requires government to justify its work to the people (Moore, 2007; Province of New Brunswick, 2007). It also implies to the cooperatives to be accountable to justify their work either to members or to the government and public at large. It creates positivity for increasing the service including to leverage tax incentives. It also implies to the government for its presence to the citizen in designing and delivering the services so that tax payers need not go to any intermediary /agents for tax services (ibid). Alm, & Martinez-Vazquez (2001) discussed the negotiated tax approach executed in Soviet Union. ADB called “cooperation and the trust” (ADB, 2016, pp. 44) approach as a form of negotiated approach for tax compliance between the revenue bodies, taxpayers and other tax intermediaries. Thus, mutual cooperation and trust could enhance the consensual change in fiscal policy including taxation (Schneider et al., 2004). Citizens’ believe on government as it is doing for them is the trust which is built (Birskyte, 2014; Bitrd, 2008) and is reflected through its fair services, transparent and open in listening views of others (Levi, & Stoker, 2000). Thus, these all build an environment for consensus building on tax compliance.

By virtue of its identity, cooperative model of development is regarded as a pathway of sustainable development while establishing the equitable society based on social justice, personal dignity, cultural enhancement and environment conservation (Khanal, 2021). After the enactment of Cooperative Act 1992 autonomy to the management of cooperatives by members themselves was granted in Nepal. The cooperative act also exempted income tax irrespective of all types of cooperatives. Consequently, different types of cooperatives at the primary, secondary, tertiary and national level were established overwhelmingly. The growth was increased from 830 in 1991 to 29,886 in 2021 (Chart1). The reasons of such a numerical growth of cooperatives within the period were like open provision to establish the cooperatives, attraction of people to unite in cooperatives for their socio-economic benefits including the exemption of income tax.

Moreover, nearly \$ 38 billion has been mobilized in Nepal out of \$ 42 billion deposits with around 80 thousand direct employment and more than a million self-employment. The total number of members in the cooperative movement of Nepal has counted as more than 7.3 million having more than 56% female members (DOC, 2021). Although, there are agricultural, savings and credit, consumer, livestock, communication, transportation, herbal, micro hydro cooperatives, most of the cooperatives were inclined to do the financial services. Study showed the executives of 130 cooperatives having

more than \$ 93 million deposits are prone to be problematic cooperatives. The main reason of failing into problematic cooperatives was lack of governance & regulatory flaws. Specifically, lack of member control, nonmembers deposits, unsecured loan, lack of systematic book keeping, insufficient and ineffective follow up & inspection etc. (MoCPA, 2014, NCF, 2010).



Source: DoC,2021

In order to correct the regulatory flaws, parliament set a new provision in the Cooperative Act 1992 stating that the association and cooperatives can only accept the deposits from members and lend loans only to member. Similarly, deleting the clause about income tax free provision in article 38 (1 c) of the same act., parliament made a new provision in Financial Act 2001 to impose the income tax with 30 percent rate to urban cooperatives from 2001 except agriculture, forestry and rural based cooperatives (DoC, 2015; NCF/N, 2008; MoF, 2001) (Box 1) .

#Agriculture and forest based cooperatives

Incomes derived by cooperative, registered under Cooperative Act, 2048 (1991), from business mainly based on agriculture and forest products such as silk production, fruit processing, animal husbandry, diary industries, sericulture, poultry & fishery farming, tea gardening and processing, coffee farming and processing, horticulture and herb processing, vegetable seeds farming, bee-keeping, honey production, rubber farming, floriculture and production and forestry related business such as lease-hold forestry, agro-forestry, cold storage established for the storage of vegetables and business of agricultural seeds, insecticide, fertilizer and agricultural tools (other than machine operated)and rural community based saving & credit cooperatives are exempt from tax. Dividends distributed by such cooperatives will have no tax (MoF, 2004).

Rural community

The areas other than the metropolitan, sub metropolitan, adjoining village development committee of those metropolitan & sub metropolitan areas and municipal areas (MoF, 2004).

Box 1 (NCF/N, 2010; MoF, 2000; IRD, 2000).

The income tax rate was changed in three times during last 20 years (NCF, 2010). (see the table.).

Table No. 1: Income tax rates

S.N.	Fiscal Year (FY)	Income tax (%)	Tax Areas
1.	2001/2002 to 2003/2004	30	Municipality, Sub metropolitan city & metropolitan city
2.	2004/2005 to 2005/2006	15	Municipality, Sub metropolitan city & metropolitan city
3.	2006/2007 to 2020	20	Municipality, Sub metropolitan city & metropolitan city
4.	2020 to till	5 %	Municipality, Sub metropolitan city & metropolitan city
		7%	Sub metropolitan city
		10%	Metro Politian city

After the income tax began to levy, most of the urban cooperatives were arguing that the income tax rate was unjust for them because they were clamming that the tax rate was higher than the share dividend (15%) despite their service to the community (NCF/N, 2014). As the lobbying is taken as the pressure to the government for revising the law (Demirbag, et.al. 2013), the cooperative organizations also kept on lobbying with the government to revise the income tax rate in Nepal. As a response, with the enactment of Financial Act 2004, the income tax was lowered into 15% in 2004 (FY 2004/2005) to the community based SACCOS## operating even in metropolitan, sub metropolitan, and municipal areas as verified by the department of cooperatives (DoC) including the agriculture, forest and rural based cooperatives (IRD, 2015). However, the Financial Act 2006 (FY 2006/2007) provisioned 20% income tax to the cooperatives operating in the metropolitan, sub metropolitan & their adjoining village development committees (VDCs) and rest of the municipal areas in the country (MoF, 2006; IRD, 2015) except agriculture, forestry and rural based cooperatives.

Major political parties were positive to revise the tax rate for the sake of equitable development through cooperatives. Moreover, the task force, commission and committees constituted by the then government recommended to revise the income tax rate (MoCPA, 2013; MOF, 2012; NCF/N, 2010). Although the recommendations of the committee were varied. For example, Dahal Committees' study reports 2006 recommended not to impose the corporate tax to the cooperatives arguing that the cooperative are the member based organization having social objectives. Whereas, Khatiwada Committees' study reports 2006 and Committee under the then Vice Chairman of National planning Commission 2011, suggested to continue the existing tax less policy to rural, agricultural & forestry based cooperatives and also lower the tax rate to the rest of other types of cooperatives (NCF/N, 2010). Specifically, the study report 2011, proposed 10% income tax rate in metropolitan, 7% income tax rate in sub metropolitan and 5% income tax rate in municipality. The government continued announcing the income tax exemption policy till FY 2016/2017 to cooperatives with different schemes & strategies as such to encourage cooperatives registering into the permanent account number (PAN), to covering more cooperatives and to widen the tax base (MoF, 2016; MoF, 2014; MoF, 2013). However, the study in other country found that the principle of tax exemption is based on whether it provides the benefits to a specific industry, firm, individual or not. If yes, it may be the subject of tax privilege as

such incentives, exemption etc. Different countries have given different tax exemption or incentives to cooperatives (European Commission, 2014, Lerman, 2013, USAID, 2013, Prabhu, 2003, MoF, 2000, Taimni, 1994). Even though it is always hard to prepare a balance tax policy (World Bank, 2015). Study also has shown the negative effect of high tax rate in economic growth but there is the tradeoff between efficient tax system and giving privileges; exemption/incentives. In a study, FAO in Tazikistan and Krygyzstan noted, the income tax levied on the members discouraged the member to retain in cooperatives and added the burden to members against their limited earning (Lerman, 2013). The reason behind this as claimed by Lerman was that the cooperatives are not for profit and they cannot distribute all the surplus to the members as they separate the reserve fund first out of the surplus. Horpedahl (2014) mentioned in a study that lowering the tax rather than exemption will be an option if it benefits the society by increasing the production and creating jobs. Whereas, policy makers claim that the evasion of tax is the main problem for tax administration (Kaplanoglou & Rapanos, 2015). Therefore, the cooperatives need to keep transparency in account and other records (Lerman, 2013; DoC, 1992). Notwithstanding this, the debate of income tax revision goes on which has exposed a considerable discussion in cooperative sector.

3. Need and Justification of the Study

Study has shown that there is the partial income tax compliance situation in urban cooperatives in Nepal (Khanal, 2017). Some studies have been carried out in other parts of the world regarding the consensus building as one of a best medium of income tax compliance but so far I found, no such study was done in cooperative sector in Nepal previously. Therefore, an empirical research was relevant out in order to finding a way of consensus building in income tax policy process. As I am also working in the cooperative sector in Nepal, my intuition also guided me to do this kind of research for finding the fact and suggestive measures that would be useful for the policy makers and government officials for the further improvement of income tax compliance situation.

4. Methodologies of Data Collection and Analysis of the Result

In regard to obtain the data about the issue on consensus building on income tax compliance, I randomly collected data form 100 primary cooperatives covering savings & credit, multipurpose, and consumer cooperatives applying Israel (1992) as sample size in Kathmandu district which is supposed to have been most potential district in terms of both tax contribution and evasion. with 25 key informants representing the high level bureaucrats, cooperative activists and professionals Basically, the queries designed to collect the data were: Is the consensus building an important factor for income tax compliance in urban cooperatives or not? If yes, what are the obstacles for consensus building? What is the level of participation and suggestion given by the stakeholders? What would be the ways of building consensus for tax policy development process? etc. The responses were analyzed with qualitative method using some descriptive statistical techniques in SPSS.

5. Data Analysis and Result of the Studied Cooperatives

5.1 Consensus Building as a Factor for Tax Compliance

While knowing the perception of consensus building as factor for income tax compliance with the key informants, most of the key informants perceived it as a factor of tax compliance. However, there were different view of some key informants who did not see the consensus building as a factor for tax compliance. They said that income tax was a matter of state and so state rule is obligatory to all.

5.2 Obstacles for Consensus Building

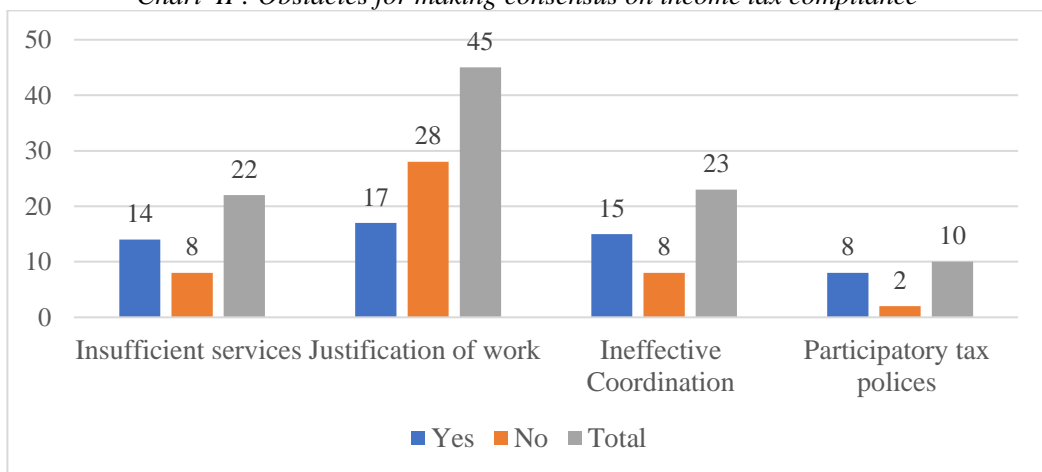
The reason why there is the obstacle for consensus building, first of all the views were gathered from the key informants representing the government and cooperatives. They expressed the reluctance of state specifically the bureaucrats for reducing the tax rate. They expressed that the bureaucracy did not consider the tax rate as an issue for tax compliance. Secondly, it was the inability of the cooperators to persuade the government about their nature of business as well as reason for lowering the tax rate. Thirdly, the government & cooperatives’ representatives also confessed that the conflict of interest between them was another obstacle for building consensus. However, key informants representing the cooperatives expressed double taxation (tax in cooperative level and tax in members level in case of share dividend) was obstacle for consensus building. Whereas key informants representing the government expressed lack of corporate culture like satisfaction of the members and staff relation through transparent and accountable services was obstacle for consensus building. They mean to say that the transparency and accountability of cooperatives towards their members was insufficient.

On the other hand, key informants representing professional experts expressed that the lack of understanding in bureaucrats about the cooperatives and the private sector was the main obstacle for consensus building. As per them cooperatives have distinct characteristic in terms of providing services and giving benefits to the members while getting the limited dividend after distributing the profits in different funds. Whereas private sector seeks profits and distribute the whole profits whatever they earn. Some experts also expressed that the deteriorating good will of the urban cooperatives has negatively affected their image in public. That’s why the public reliability of the urban cooperatives lost. They expressed the lack of coordination and mutual trust among the concerned ministries, departments and the national federation, central and district level cooperatives unions has constrained for the consensus building.

5.3 Consensus Building (Cooperatives Level)

While assessing the obstacles for making consensus for tax compliance in studied cooperatives comparing with those which allocate the funds and which do not allocate the funds, we find results as follows:

Chart II : Obstacles for making consensus on income tax compliance



Source: Field Survey, 2017

Most of the respondents expressed that cooperatives should justify their work in result. The indicators of justification is to show the activities of poverty focused activities. For example, they should show the public that they operate cooperatives ethically with honesty and high morale keeping in mind of business safety. Non-politicization and professional work was also necessary for sound & safety business because the bureaucracy was suspicious over the politically exposed cooperative leaders whether they mishandle the cooperative for their interest or favor even to those which commits mistake. Demand of tax incentives to all kinds of cooperatives was also obstacles. The lack of follow up and inspections were also pointed out which obstruct to verify the activities run by cooperatives in a justifiable way. However, in this category the number of the cooperatives who comply the income tax fully seem bigger than those cooperatives which don't comply.

Majority of respondents expressed ineffective coordination as obstacle for consensus building. So, ineffective coordination among the stakeholders - government offices and the representative organizations having no regular interaction obstructed to foster the mutual understanding. They require effective, responsive government and efficient bureaucracy.

For building the consensus in tax compliance insufficient services like training, orientations, financial management and taxation to the cooperatives were also another obstacle. The reward & punishment in terms of the performance rating system was also lacked which had negatively impacted for tax compliance. The respondents who expressed the less number of stakeholders' participation while formulating tax policy. Even if the participatory tax policy based on the research would have theoretical as well as empirical insights, it was lacked., however, the number of cooperatives which don't comply the tax fully in this category were high than those who comply.

6. Discussion and Findings

Based on the above discussion, transparent accounting system, timely reporting, members accountability, misunderstanding between the cooperatives and policy makers, lack of corporate culture are found as main obstacles for consensus building. This might have negatively impacted to build the image of cooperatives. Activities of cooperatives could not justify their work as it ought to be complement to increase the investment in agriculture and their value added activities i.e. processing, marketing and so on. So, due to those causes and lack of persuasion, the government is reluctant to lower the tax rate in cooperatives. The findings also shows that as per the cooperatives which don't comply the income tax fully, ineffective coordination, insufficient government services and lack of participatory tax policy are the main obstacles for consensus building for the tax compliance.

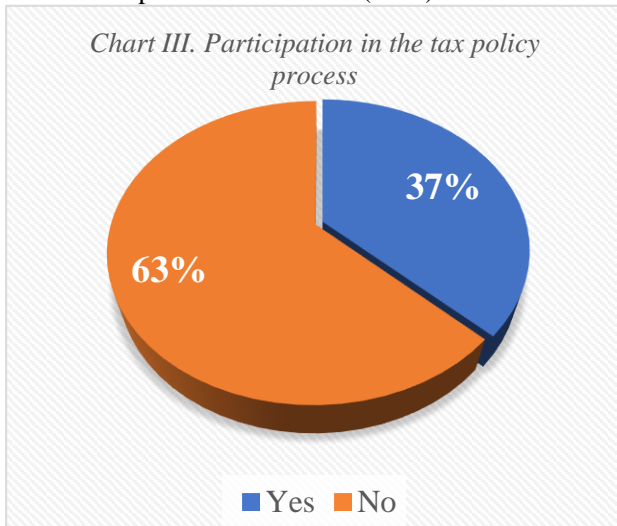
Conversely, the cooperatives which comply the income tax fully indicated that the cooperatives need to justify their work with the policy makers for building consensus. This findings seem valid since key informants and respondents have acknowledged it too. It is also recommended that the coordination among the stakeholders in setting up the income tax policy could be an option to make consensus building as Ortega et al. (2015) also validate this finding emphasizing the need to build more coordination between the state and taxpayers while developing the tax policy and its implementation. Alm, & Martinez-Vazquez, (2001), mentioned that the participation in the decision-making process increases the level of tax compliance and coordination. So, the stakeholder's participation in making the decision about tax policy process also seems to be implementable.

6.1 Participation

Participation obviously fosters the commitment and consensus in the decision-making process. Greater participation ease to implement the decision too. So, as we already discussed, stakeholders' participation in tax policy decision increases the level of tax compliance, let's see the level of taxpayers' participation in the tax policy process in the studied cooperatives.

The result shows there was no full participation in the surveyed cooperatives while formulating the income tax policy. Because, majority of respondents mentioned that they had never been involved in the income tax policy process whereas some responded that they were involved in tax policy process directly/ indirectly. Because the government body only involve in the process. They told that the national cooperative federation (NCF) and the central cooperative unions and national cooperative

bank represent sometimes in the meetings and give suggestions to the ministries and departments. Some expressed that the NCF used to collect the suggestions and submit even to the cabinet secretaries. Whatsoever it may be, the suggestions were not fully included into tax policy (See Chart III).

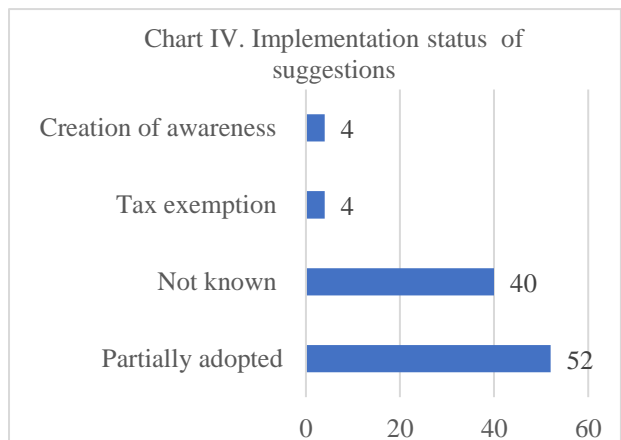


6.2 Implementation Status of the Suggestions

Although cooperative institutions and their representatives were participated in the meetings of the policy process several round however the policy makers were not fully convinced on the suggestions provided by cooperatives.

The cooperatives who were involved directly or indirectly in the tax policy process, Majority of them expressed that their suggestions were partially adopted. Whereas 4 % expressed that it had brought an awareness about cooperative and tax issue among the policy makers, and promoters. Another 4 % expressed that suggestions contributed to bring the policy of tax exemption. However, still 40% cooperatives did not know about the implementation status of the suggestions (see Chart IV).

Whereas some officials representing government agencies were unknown about the implementation status of the suggestions given by the cooperative representatives. However, there were mix opinions about the implementing status of the suggestions provided by the taskforce/ committees. Because some respondents opined full implementation of suggestions and some expressed their partial implementation. Expressing a distinct opinion, respondents expressed that the reports of the taskforce/ committees are not legally binding



documents. Therefore, it is revealed that the suggestions had no legally binding status for implementation. Hence, it was a conscience of the decision makers whether to adopt or keep them in showcase. Nonetheless, the suggestions have contributed to put ahead the issues to policy makers for their consideration. Moreover, the suggestions made them conscious about the tax issue of cooperatives regardless of its full or partial implementation.

6.3 Findings about the Implementation Status of Suggestions

Most of the government officials didn't know/ find the suggestions submitted by the government taskforce, committee or cooperatives in the past because 1) They had no records/ documentation in the ministry/department 2) They were newly transferred from other office. Thus, the frequent transferring of the bureaucrats had negatively impacted to keep on update the organizational memory systematically. The suggestions, which were partially implemented, were not only through the normal bureaucratic process but through the political influence. As most of the reports were made through political influence and not from the bureaucratic process. So, the concerned bureaucrats might not have convinced to revise the tax rate. Thus, as a result of misunderstanding among cooperative activists and bureaucrats, there was no legal obligation for implementation of the suggestions. But as there was the low level of participation in the policy process, the problem was created in implementing the policy i.e. noncompliance of income tax and so on. UNESCAP (n.d.) mentioned that participation of the interest groups directly or through their authentic institution/representative include their voice or they can mediate them in making inclusive/consensual decision.

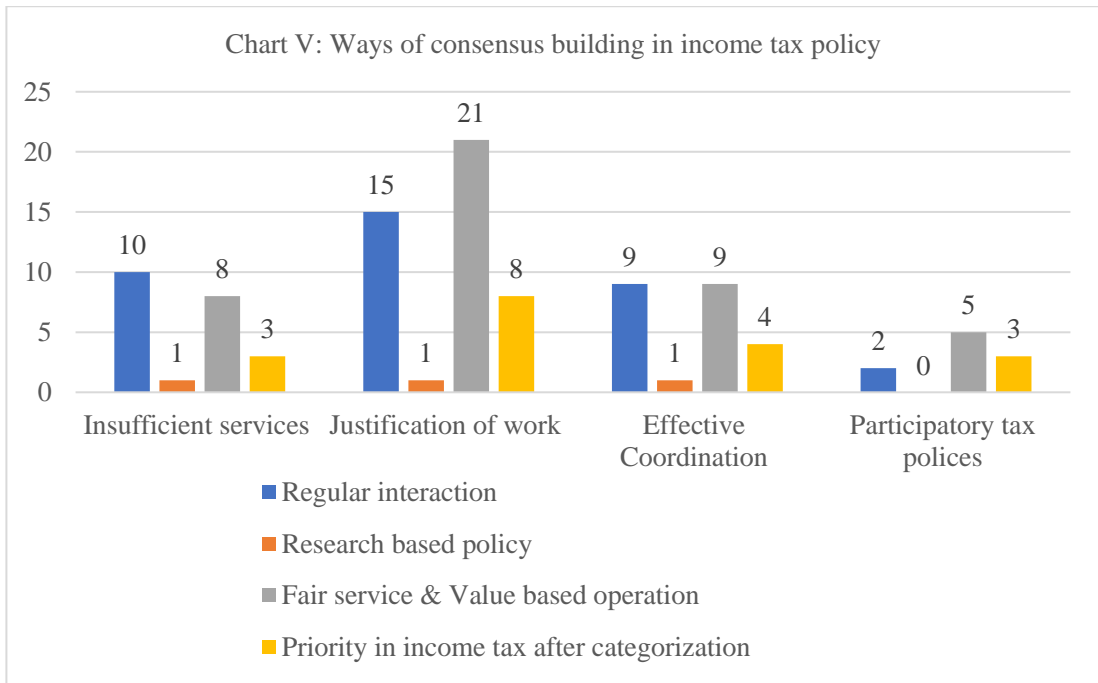
Greater participation eases the implementation of decisions. It is also applied in the income tax policy decision too. Therefore, in order to fully implement the tax policy, common consensus based on mutual understating among the stakeholders is considered as the best option to develop the tax policy. Literature in the other country validates that the stakeholder's participation in tax policy decision increases the level of tax compliance (Alm, & Martinez-Vazquez, 2003).

6.4 Results and Discussion on the Ways of Consensus Building

Significant number of respondents required the fair service & value based operation. It was partly concerned with the government and partly concerned with the cooperatives themselves. To the part of government agencies, it is suggested to deliver sufficient, fair and impartial services transparently complying with the ethical code of conduct while inspecting the cooperatives along with the reward & punishments. Whereas disinterestedness and values based operation of the cooperatives, compliance with laws and ethics are suggested to the part of cooperatives. Ways of increasing the level of income tax compliance are suggested to have regular interaction, mutual discussion and clarification on participatory basis for common consensus. The key informants also have similar views on maintaining the judicious dialogue among the stakeholders. Some other views on making the common consensus in income tax policy are suggested to fix tax rate based on the grading of cooperatives i.e. location, nature of business and volume of transaction. Research based income tax policy are also regarded as more scientific approach for building consensus.

As options for building consensus on income tax policy process, the experts and government officials suggested to increase the education & training services to both taxpayers & tax authority. Furthermore, experts also suggested for the effective service delivery, inspection and cross check to the inspectors & auditor's reports as well. They pointed to strictly adhere the ethics of auditing and amend the existing laws to control the corruption and comply tax. Cooperative experts suggested for committed and stable government including bureaucrats for making consensus on tax compliance. They also

agreed with the view that the cooperatives need to be justify whether they were working based on ethical values, policy, regulation and the spirit of collective action. As others, cooperative experts also emphasized on regular education, awareness and trainings. Reward for good practice, penalty and punishment against the illegitimate activities were also recommended to adhere the rules and regulation. Experts also opined for progressive tax in contrast to the average tax system. Similarly, it is suggested to provide the sufficient, fair, transparent services based on ethical code of conduct. Likewise, ineffective coordination lack of regular interaction among the stakeholders are found as obstacles for building consensus. As two variables are correlated each other, it may be true that ineffective coordination was due to the absences of regular interaction.



7. Recommendations

Looking at the suggestion as mentioned above, the government should deliver the training, education, awareness, inspections, monitoring and others services sufficiently as common way for making consensus in tax compliance. Moreover, services without corruption, quick payment process, impartiality, rewards & punishment system impact positively for the tax compliance. Tax policy based on the interaction & research, reformation of the loopholes of laws to strictly adhere with the laws and regulation are some other factors to comply with the income tax. Furthermore, tax rate based on the nature of works, volume of business and location of cooperatives categorizing the agriculture and non-agriculture or financial or non-financial cooperatives. The findings like the justification of cooperatives' work should be reflected through the agricultural production, creation of employment and contribution to improve the quality of life of the people is also considerable by all cooperatives. As the literature in the other countries have also established the similar findings with this study, the coordination between the cooperative activists and bureaucrats is another factor for making consensus.

8. Conclusion

Cooperatives are important vehicle sustainable development mobilizing the local resource through member's participation based on the cooperative values and principles. We found the service, business and policy as three important aspects to be dealt with while building consensus on the tax policy process. Whereas fair service and consensual policy needs to be delivered by the government. The obligations of cooperatives is to operate the business based on ethical values and cooperative principles within the legal frame. Notwithstanding this, both stakeholders should regularly interact showing mutual respects and optimum flexibility in developing and pursuing the income tax policy decently. In order to build the consensus oriented tax policy process, fair and increased services and tax incentives is required to the cooperatives by categorizing them in terms of their contribution in increasing production, creating employment, and enhancing the quality of life. Therefore, justification of works performed by the cooperatives is desirable for consensus building. Accountability, responsiveness, proper services and other amenities have to be delivered by government and cooperatives for consensual tax policy.

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