

# Challenges of Fiscal Decentralisation Reform in Cambodia: Identifying Own Revenue Sources for the Commune/Sangkat

PORDEC research activities in 2003 and 2004 address the fiscal decentralisation reform. Eng Netra, researcher, summarises some of the findings so far.\*

## Progress and Challenges So Far

Commune/Sangkat councils are now taking on several new responsibilities. One of their most important tasks has been to provide services both in administrative and development activities. Typical service delivery by the Commune Councils thus far has been small basic infrastructure projects such as wells, water pumps, cement ring bridges, and minor construction projects like classrooms, roads, water channels, and public toilets.

On the revenue side, commune/Sangkat councils currently have three major sources of funds. First, Article 75 of the Law on Administration and Management of the Commune (LAMC) specifies the rights of the Commune/Sangkat to receive grants from the national revenue for its budget. Also, the national government is obliged to create a Commune/Sangkat Fund (CSF), which can be used to both receive deposits and function as a source of transfers for the commune/sangkat. The CSF includes both national transfers and donor funds for the Commune/Sangkat level earmarked for development and administration. A second source of funds is fees from civil registration and other appropriate fees and payments that are made for the commune's performance of agency functions, delegated by ministries and other institutions. Today, the only fees and revenues received by the commune for performing agency functions are civil registration fees. This amount is minimal. Pending the issuance of necessary regulations to back the LAMC, the communes are entitled to a third category of funds, namely that from own-sources of revenue, through the collection of taxes, non-taxes and service charges. Currently

the commune does not collect any tax except for local contributions for development projects. The local contribution to the projects funded over the CSF can be seen as the first stage in a local taxation system.

Other than the above discussion on revenue sources of the commune/sangkat, two years after the election of the Commune/Sangkat councils there have been few decisions and little progress on the establishment of guidelines and regulations to allow the communes to collect their own sources of revenue.

Several issues have slowed down this process, the most important being lack of available data and information to help identify potential local government own source revenue, to identify candidates for reassignment from the province to the communes, and candidates for sharing between the province and the communes. For example, the LAMC gives the communes permissive authority to collect land taxes, taxes on immovable properties, rental taxes and user charges, but issuing of actual mandates through sub-decrees remains. Discussion within the MEF has identified some potential taxes the communes can collect including taxes on unused land, taxes on means of transportation, taxes for business licenses, slaughtering taxes, a betterment levy, entertainment taxes, and shared taxes on turnover and VAT.

There are other potential sources of funds including fees for services.

Concerns have been voiced regarding the types of taxes because of the potential conflicts of interest it may cause among the different institutions. Taxes that are likely to face resistance from the national level are

property and land taxes, which will affect the policy of not taxing farmland and agricultural properties.

A second aspect that has slowed down the process of identifying local government own source revenue is the current practice of informal taxation. Hence, establishment of formal taxes and levies may to some extent lead to a degree of 'double' taxation, which in turn may be another burden on the poor. The challenge therefore is to identify potential taxes and levies that in the current climate can be collected while avoiding 'double' taxation. A further expansion of taxation and service levying may then await a greater general compliance with the rule of law. This in turn depends on the establishment of greater accountability at the local level. This is a great challenge which cannot easily be addressed, and which is certainly beyond the fiscal decentralisation reform to handle.

A third challenge is how these own source revenues will be handled. This is both a logistical issue (as the communes lack safety deposit boxes, and there is an absence of a commune banking system) and a capacity issue (as commune accountants are not available). Some pilot experimentation on two options for increased fiscal accountability is in progress. The UNCDF will assist the MEF in 2004/2005 to pilot commune banking as one option, and district treasury offices (rather than the current provincial treasury deposits) as another option.

\* This article is based on a presentation by the author at the CDRI seminar 'The Challenges of the Decentralisation Design', presented at Sunway Hotel January 29, 2004. The article appears in full in Rusten *et al.* (2004). Information to this article is drawn also from the ongoing efforts by the Ministry of Economy and Finance, United Nations Capital Development Fund and CDRI to identify the existing tax structure, as well as potential tax candidates for sharing between the province and the commune.

A fourth challenge has to do with the capacity and willingness of the national government to address the local government own source revenue issue, and options for revenue sharing and reassignment between the province and the commune. This process is to some extent made difficult by the Open Window Service Delivery project as it is now unclear whether the government will allow for a reassignment and sharing of revenues between (i) the province and the district or (ii) between the province and the commune.

In addition, a common challenge within such a process is coordination between institutions at the national level. The decision to go ahead with a proposed plan on commune own-sources of revenue rests at the national level, dependent upon the agreement of the National Committee for Support to the Commune (NCSC) and the relevant line ministries. The task of strengthening local government finance will need to be led and regulated by a strong central government.

### Current Tax Collection

A large number of taxes, licences, fees and charges are currently levied at the commune level. The distinction between taxes, fees/charges, and licences is unclear. A number of levies are referred to as charges although in reality they are taxes, since no service is rendered directly or indirectly to those paying the levies. In addition, a wide variety of fees for forms and permits exist. There are six different formal types of tax currently collected for the province budget, the *salakhet*. These taxes are patent tax, tax on means of transportation, tax on unused land, tax on animal slaughtering, tax on transfers and tax for public lighting.

Revenues from these tax sources are 213 million Riel for Takeo, 2299 million Riel for Siem Reap, and 7668 million Riel for Phnom Penh in fiscal year 2003.<sup>5</sup>

### Management and Structure of Existing Tax Collection

The Provincial and Municipal Tax Department is the only responsible agent for tax collection with actual collection being assisted by district tax offices at the district. All the collected income is transferred into the provincial treasury. Other line departments collect some fees and charges at the commune level. Depending on the types of taxes some are to be shared among stakeholders such as the centre, province, and commune. Most of the tax collection is the responsibility of the Tax Department.

In practice, tax collection organisation varies according to the types of taxes and the places of collection. Some taxes and areas delegate staff at the district level to levy tax; some taxes and areas have mixed central and provincial staff to collect tax. Also some fee and charge collection is delegated to private companies ('pheasie' collection from markets and slaughterhouses). The divi-

sion of assignments between the different levels of governments provides a challenge. This is because each level of sub-national government is involved in tax collection. It is clear neither to the tax collectors themselves nor to the taxpayers which institutions actually hold responsibility for the different types of tax collection.<sup>2</sup> This extensive involvement creates space for rent seeking. Civil servants who get involved in the tax collection seek to find benefit for themselves as a payment for their "responsibilities"; often responsibilities that they have maneuvered themselves into (often through payment) in order to benefit.

The amount of tax collected varies from business to business and between places. Bargaining or negotiation is possible. The negotiations can be done collectively (i.e. groups of rice millers, all sellers at a market) or individually. There might be established regulations in a system for assessment of taxes that are in place but not in use. Interviews with other small businesses in all provinces show that no fixed assessment system for levying taxes on businesses is used. This issue might also be a result of the structure of the markets and businesses. Some well-structured markets have regular taxation<sup>4</sup> while other markets rarely or never pay, and when they do, the enforcement of tax collection is hampered by nepotism and lack of transparency.<sup>6</sup> Hence, the rate

and amount of tax levied varies between the different tax authorities across time and space.

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### Potential Revenue Sources

Potential revenues for the Commune/Sangkat councils are user-fees for services provided by the councils, and tax collection from simple tax bases and small businesses. Well-designed *user-fees* could potentially improve the benefit incidence of public services, particularly in health and education spending, but this decision must be taken with great care to ensure that the poorest groups do benefit and have better access to quality services. The second potential source of commune own-revenue is from tax collection. There are a number of activities and businesses within the communes and villages (in the provinces under this study) that have high potential as revenue sources (excluding big industries and companies). Tax collection from markets may be one of the biggest sources of own-revenues for the Commune Councils. Commune markets operate during the morning only, and may have as many as 200 stands and dozens of other houses around. The markets are commonly managed and run by the provincial agents. Agents who are assigned as government fiscal agents collect market fees (the *Pheasi*). Anybody wishing to become a state agent must submit their bids to the government specifying how much they are willing to pay for the privilege of market tax collection. In principle, the highest bidder will win the contract for a one-year period.

In addition to tax collection from markets, there are several other sources for tax collection from some of the most commonly found taxable businesses at the commune level<sup>7</sup> including rice millers, winemakers, brick makers, icemakers, catering service providers, grocery stores, firewood and forest products sellers, businesses related to natural resources, and battery chargers. These businesses in general pay patent taxes where the amount of tax collected varies from 5,000 Riel to 35,000 Riel per year. Rice millers, for example, usually only pay patent taxes in an amount ranging from 5,000 to 15,000 Riel per year.

Average numbers of businesses per commune can include ten rice millers, three battery chargers, several service providers, couples of small scale industrial businesses, several crafting businesses, and a few other types of businesses in addition to markets (if any).

### Prospects and Challenges in the process of establishing commune taxation

The debate on taxation by the commune often produces arguments that the local level cannot sustain taxes. It is often portrayed as a poverty issue. However, studies conducted by CDRI on resin trade and fish products show that an "informal" tax and fee system is common. The different individuals in these businesses have to pay fees to the many different officials for all types of required permissions for transporting their products to the markets (Prom and McKenney 2003). The presentation above indicates that there is no need in the near future to impose new types of taxes and fees since many activities at the commune level are being taxed already; what is needed is a sharing and reassignment of these revenues.

There are several challenges that might potentially arise in the process of identifying and establishing commune/sangkat own sources of revenue. Among them, the chief challenge will be what taxes and revenue bases are sensible to be reassigned or shared among the *salakhet* and the commune. Given extensive involvement of many different levels of government in tax collection, local resources are being tapped into and hence erode revenue bases for commune/sangkat. The second challenge is pervasive corruption in the form of informal collection and rent seeking practice as part of the tax collection process. Moreover, double and triple taxation is evident on some goods and services leading to excessive burden, which to some extent encourages the informal system of tax payment. The challenge within this

process is further exacerbated by the fact that the Commune/Sangkat lack institutional capacity and formal records to keep and account for collected revenues. This is a great challenge at this stage of the decentralisation reform, as the commune does not have its own accountants, bank account, proper records for public control, or a strong financial structure in place. These are important transparency and accountability challenges in the process of establishing commune taxation. Another aspect is that the commune/sangkat needs to equip itself with an administrative capacity that is experienced and competent in tax collection. Another equally important factor is the political will of relevant ministries at the national level. Despite the fact that there is legal authority and some degree of political will to move forward with the fiscal decentralisation reform, a consultative process to reach consensus among the relevant stakeholders is needed in order to establish mechanisms and strategies for how this process should proceed.

### Endnotes

1. The example of the market in Pouk commune is discussed in the following pages.
2. Interview with district governors and councillors in the provinces visited during this research study.
3. Interview with brick maker in Siem Reap on June 17, 2003 (see Rusten *et al.* 2004).
4. Market survey in Battambang province in May 2003 (see Rusten *et al.* 2004).
5. Interviews with Province Departments of Treasury during this research study.
6. Market survey in Kep municipality (August 2003) and Kompong Speu province (June 2003) (See Rusten *et al.* 2004).
7. Not all businesses and markets are being taxed although most of these businesses do currently pay taxes.

### References

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