



Inter-American Center of Tax Administrations  
Canada Customs and Revenue Agency



General Assembly of CIAT

## Opportunities for Improving Tax Compliance through Interaction and Cooperation

Quebec Canada  
May 20 - 23, 2002

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Canada Customs and Revenue Agency



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## **Opportunities for Improving Tax Compliance through Interaction and Cooperation**

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Executive Secretariat

P.O. Box 2129, Zone 9A  
Panama, Republic of Panama  
Web site: <http://www.ciat.org>  
E - mail: [ciat@ciat.org](mailto:ciat@ciat.org)  
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## **Presentation on CIAT**





## **Executive Secretariat**

<b>Executive Secretary</b>	Jorge Cosulich Ayala
<b>Director of Strategic Programming and Studies</b>	Claudino Pita
<b>Research and Training Manager</b>	María Raquel Ayala Doval
<b>Information and Publications Manager</b>	Damaris Bolaños
<b>Tax Computerization Manager</b>	Francisco Da Cunha
<b>Technical Cooperation Projects Manager</b>	Celso Antonio Mora
<b>Technical Cooperation Projects Manager</b>	Francisco J. Beiner
<b>Internal Administration Manager</b>	Enma de Al-Karkhi

## **Representatives and Correspondents of CIAT**

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Bermuda	Heather A. Jacobs Matthews	Heather A. Jacobs M.
Bolivia	Jorge Eduardo Zegada Claure	José Luis Carvajal Burgos
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Dominican Republic	Teófilo Quico Tabar	Nieves Vargas Collado
Ecuador	Elsa Romoleroux de Mena	Oswaldo Aguirre
El Salvador	Carlos M. Funes / Francisco José Rovira M.	Gelson Vinicio Valladares M.
France	François Villeroy de Galhau	Josiane Lanteri
Guatemala	René H. Pérez Ordóñez	Abelardo Medina B.
Haiti	Jocelerme Privert John E. Desroches	Jean-Baptiste Télémaque
Honduras	Mario Duarte C.	Olga Sabillón
Italy	Carlo Antonacci	Luigi Ambrosio
Jamaica	Clive Nicholas	Michael Campbell
Mexico	Rubén Aguirre Pangburn	Consuelo Arce Rodea

Netherlands	Cedrid Pisco	Cedrid Pisco
Antilles		
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Panama	Estelabel Piad	Maribel T. Sousa A.
	Eduardo Antonio Quirós	
Paraguay	Luis Aguirre	Daniel Pose
Peru	Marta Beatriz Merino L.	Clara Loza Ramírez
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Spain	Salvador Ruíz Gallud	Fernando Díaz Yubero
Suriname	Roy May	Philicien Rene Rodrigues
The Netherlands	Jenny Thunnissen /	Pieter J. Vogelaar
	Jan De Waard	Matthijs Alink
Trinidad & Tobago	Haseena Ali	Anirudh Maharaj
United States	Bob Wenzel / Carol Dunahoo	Socorro Velázquez
Uruguay	Marcelo Brasca	Margarita Faral
Venezuela	Trino Alcides Díaz	Luis N. Alvarado C.

### **Missions of Technical Assistance**

#### **Spain**

Head of Mission      Raúl Junquera Varela

#### **France**

Head of Mission      Edmond Lacroix



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«Opportunities for Improving Tax Compliance through  
Interaction and Cooperation»

Quebec, Canada, May 20 - 23, 2002

**INAUGURAL CEREMONY**

## INAUGURAL CEREMONY

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**Welcome Statement by the CIAT  
Executive Council President, Mr. Juan Toro Rivera,  
Director of the Internal Revenue Service of Chile**

Ladies and gentlemen:



In my capacity of Executive Council President of the Inter-American Center of Tax Administrations, I shall have the honor and privilege of chairing the 36<sup>th</sup> General Assembly of our organization, whose main theme convenes us to analyze and share experiences regarding: *Opportunities for improving tax compliance through interaction and cooperation.*

*Mr. Juan Toro Rivera* The theme of this Assembly highlights the fact that as tax administrations, interaction with various external agents (apart from the taxpayers) is an essential and permanent aspect of our activity. It also stresses the fact that cooperation with these agents should be the preferred form of interaction. All of the foregoing should not be carried out in a vacuum, but rather for the ultimate purpose of improving tax compliance in our countries.

In previous CIAT meetings, interaction and cooperation for improving tax compliance has been analyzed from the perspective of the relationship between the tax administration and the taxpayer. The emphasis has been placed on the appropriate measures and managerial techniques for promoting taxpayer compliance with the tax laws.

## INAUGURAL CEREMONY

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In this General Assembly in Quebec, we will have the opportunity to discuss the factors that contribute toward compliance with the payment of taxes, although from a different approach; namely: the analysis of elements aimed at said objective, which originates from the relationship of the tax entity with the country's public and political institutions, as well as foreign elements mainly generating from the international sphere.

Within this framework, several tax administrations from throughout the world will give us their experiences (successful and some not as successful) with interaction and cooperation in such areas as: determination of the ideal level at which interactions between the tax administration and the powers of the State should take place; the administration's mechanisms of interaction with private sector corporate members and international cooperation actions that are ever more necessary, in an environment of forthright internationalization of the economies.

Reflecting on the aforementioned issues should assist us in reviewing the framework of understanding and strategies we have been using in our various interactions. Otherwise, if such definitions are lacking, we may run the risk of interacting on the basis of "emergencies" which, as we all know generate pressure on "everyday" situations that rather render difficult (and at times undermine) the effective maximization of tax compliance, which is the ultimate goal of our activity.

Accordingly, I most cordially urge this distinguished Assembly, to actively participate in the meetings scheduled in the Agenda that has been prepared by the CIAT Executive Secretariat.

I also wish to convey to the participants in this 36th General Assembly my heartfelt greetings and best wishes for a pleasant stay in this beautiful city of Quebec, as well as our deep gratitude and sincere recognition to the authorities of Canada and, in particular the authorities of the Canada Customs and Revenue Agency for the warm reception given to the members of the delegations and the excellent organization of this event.

**Welcome Statement by Messrs. Robert Wright,  
Commissioner and Alain Jolicoeur, Deputy Commissioner  
of the Canada Customs and Revenue Agency**

FRIENDS OF CIAT:



*Robert Wright  
Commissioner*

On behalf of the Canada Customs and Revenue Agency (CCRA), we are privileged to welcome you to Quebec City for the 36th General Assembly of CIAT.

The CCRA is honoured to host this year's event, perhaps even more so because Canada is assuming the presidency of this important

organization. Bill McCloskey, Assistant Commissioner of the Policy and Legislation Branch, brings to the presidency the same expertise and enthusiasm he has demonstrated while serving as a member of CIAT's executive.



*Alain Jolicoeur  
Deputy  
Commissioner*

This year's General Assembly promises a fascinating exchange of information as we examine a fundamental issue: how to increase compliance and reduce non-compliance with tax obligations. In particular, we will discuss both the opportunities and the constraints facing a national tax administration as it attempts to support these objectives by co-operating with public- and private-sector organizations at the local, provincial/state, national and international levels.

While the focus during our annual gathering is the important work and discussions we are undertaking, we also hope you will enjoy the social activities and outings that have been organized to give you a glimpse of Canada and Canadians.

Please accept our best wishes for a pleasant stay in Canada and a rewarding experience at the 36th General Assembly of CIAT.

Cordially yours,

**Topic 1**

**INTERACTION WITH THE PRIVATE SECTOR  
FOR IMPROVING TAX COMPLIANCE**

TOPIC 1

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*Lecture*

*TOPIC 1*

## **INTERACTION WITH THE PRIVATE SECTOR FOR IMPROVING TAX COMPLIANCE**

**Roberto Serrano López**

Director, Human Resources & Economic Administration  
State Agency of Tax Administration  
(Spain)

*CONTENTS: 1. Collaboration in the Elaboration of Tax Returns.-  
2. Collaboration in the Filing of Statements Through Internet.-  
3. Collaboration in the Collection Procedures.- 4. The Automation  
of the Customs Department.- Conclusions.*

The State Agency of Tax Administration is the Spanish administrative organization in charge of effective application of the state and customs tax system, as well of being responsible for the management of those resources that other Public Administrations, national or foreign entrust to it. The Tax Administration assumes the fundamental objective of collecting a very important amount of the revenue foreseen every year in the General State Budget. Therefore it has adopted an action model to promote voluntary compliance with tax obligations among citizens.

This means that the satisfaction of citizens' needs, which are the recipients of the different services offered by the Agency, constitute the axis on which the organization must be built on. This public service vocation requires the organization to adopt a proactive attitude, so that the true needs of citizens and their evolution be continuously analyzed, by satisfying them as soon as possible.

The interaction with certain private sector actions allows promoting voluntary compliance with tax obligations and it is transcendental in the extension of the process to improve the services offered by the Tax Administration. Modern Tax Administrations cannot be the margin and isolated from the society they serve. The implication of the different social, economic, professional sectors, etc., in the obtainment of the objectives of the Tax Administration, increases society's acceptance of the tax system.

To attain excellence in the services offered by the Tax Administration requires:

- An open and flexible organization model to guarantee its permanent adaptation.
- The search of greater efficacy and efficiency mandates permanent and integral reengineering of tax procedures.
- The promotion and impulse of social collaboration in tax management.

Furthermore, the articulation of the different projects to be executed by the Tax Administration requires the determination of a series of inspiring **basic principles** that act as axis to bestow with continuity the efforts that are carried out in the tax management setting.

- A) Order and Comfort** in the realization of material and formal procedures coming from tax obligations, promoting a standardized and harmonious environment, avoiding unnecessary movements for citizens, by offering new ways of forming relations with taxpayers that will allow the Administration to come close and facilitating payment.
- B) Swiftiness** in the response offered by the Tax Administration in issues that arise in their relations with citizens, in the articulation and practical development of tax procedures and in detecting and adapting changes that take place in the environment.
- C) Simplicity** in the procedures required from taxpayers. Tax procedures must be directed in a way that they result to comprehensible and are of easy compliance.

This is the only manner to guarantee the social acceptance of tax obligations. Undoubtedly, information and assistance tasks contribute to this in a decisive manner.

- D) Technological Innovation** that allows the most effective and efficient use of the means at the disposition of the Tax Administration to perform the service tasks developed by citizens.

**Security** in the relation that the taxpayer maintains with the Tax Administration, in terms of confidentiality of the communication means with the Agency and the information provided, as well as the juridical technical criteria used.

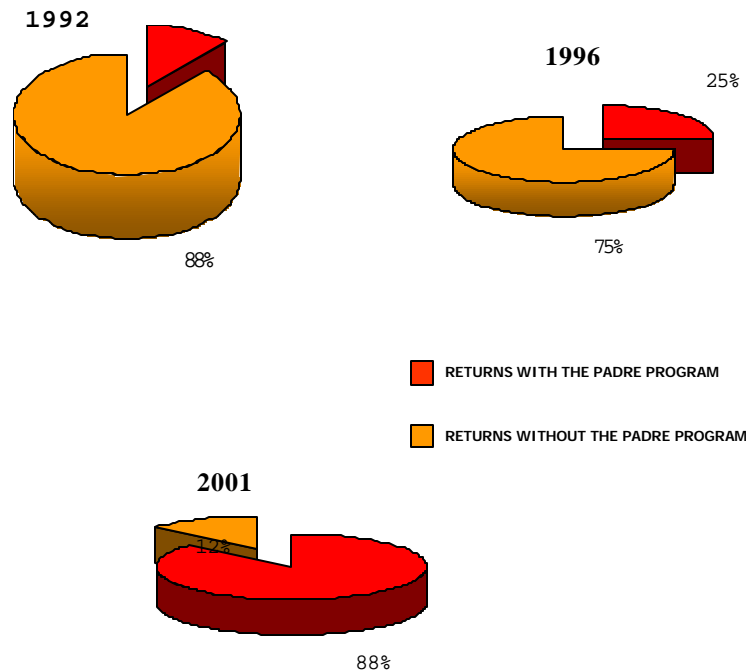
According to these principles, the Tax Administration has promoted many initiatives, inspired in the idea of excellence, which are directed to facilitate the citizen's compliance with its obligation through the promotion and support of social collaboration in tax environments such as:

- 1. Preparation or elaboration of tax returns.**
- 2. Filing of tax returns through the Internet.**
- 3. Collaboration in the collection procedures** of determinate financial entities: Savings and Loans Banks, Banks and Credit Cooperatives.
- 4. Automation of customs dispatch.**

## **1. COLLABORATION IN THE ELABORATION OF TAX RETURNS**

The Tax Agency makes help programs available to citizens for the preparation of almost all tax returns. Due to its transcendence, the most known program is PADRE (Income Tax Return Help Program). This program is used by citizens that prepare their own Individual Income Tax Return (IRPF, as is known in Spain) and serves as a support for the tax return preparation services at the Tax Agency offices as well, and by the entities that collaborate with the Tax Agency in bringing this service closer to the citizen.





The interaction between the Tax Administration and the private sector in this specific aspect – reflection of the social collaboration in the social procedures – is instrumented by means of making available to the different collaborating entities the PADRE program adapted by the Tax Agency to the specific needs of these collaborators in order to facilitate their work. Simultaneously, and in order to guarantee the citizen the maximum quality in the rendering of the service, the Tax Agency develops training programs aimed at the employees of the different collaborating entities.

**Collaboration with financial entities.** In 2001 a total of 120 financial entities have collaborated, with over 27,000 points of citizens service for rendering statement preparation service distributed throughout the national geography. Almost 14,000 persons have been trained thus guaranteeing a quality service. The amount of statements carried out rose to 2,144,000 (out of a total of 13,400,000).

**Collaboration with the Autonomous Communities (regional authorities).** A total of 377 service rendering points have been made available to the citizens, preparing a total of 237,883 statements using these means.

**Collaboration with Local Corporations (municipal entities).** In its third year of inception participation was requested by 30 local entities, and the collaboration resulted in the preparation of 21,423 statements.

**Collaboration with other collaborating entities,** among which we highlight Unions, Chambers of Commerce, agrarian, as well as business Associations that have prepared, under the PADRE program, a total of 57,492 statements by the IRPF.

In total, these collaborating entities performed almost two and a half million statements, with over 27,000 points of service having trained over 15,000 persons to guarantee a quality service. The data presented, referring to the last IRPF campaign, clearly show the need to continue empowering this road of interaction and collaboration with the private sector in following campaigns.

## **2. COLLABORATION IN THE FILING OF STATEMENTS THROUGH INTERNET**

Services currently offered by the Spanish Tax Agency to the citizens through the so-called “Virtual Office” are varied. Citizens can carry out, among other things, the following operations on the Internet: file their tax statements resulting in an amount receivable, query and print relevant tax data for the preparation of the IRPF statement, query the state of the returns, request the change of the tax address of physical persons, directly print on his personal computer the identifying labels, receive periodic information on the main novelties in the Tax Agency web page through e-mail, request and download the Physical Persons Income Tax statement certificate, request and download certifications stating that the compliance with tax obligations is fulfilled, or file motions to set aside and other requests of a tax nature.

These services allow for a permanent interaction between the citizen and the Tax Agency, in such a way that the user can carry out the aforementioned proceedings in an agile, comfortable way, without leaving home, 24 hours a day, seven days a week, and through a safe transmission system that fully guarantees the confidentiality of the data transmitted by Internet. To that end, the citizen that wishes to file statements or gain access to whichever one of the main services the

Tax Agency offers through the Internet, must previously request and obtain the so-called “*user certificate*”.

Among the advantages this mode of communication offers, we can highlight the following:

- The immediacy in the relation with the citizens, reducing the time invested in carrying out the different administrative procedures.
- It constitutes a means of communication that avoid unnecessary displacements.
- It facilitates the handling of information by the Tax Agency, which in turn translates into the facilitation of the subsequent administrative procedure.

Now, a modern tax Administration must make the advantages offered by the use of the Internet available to the largest amount of citizens possible, even those who for diverse reasons do not have easy access to new technologies. To achieve this, it becomes necessary to engage the different social agents in this project.

It is at this point where social collaborators must play an important role: the other Public Administrations, and the entities, institutions, and agencies representing social, labor, business or professional interests. Through these institutions we arrive, as we will see, at an ample set of citizens with less possibilities of gaining access to the Internet.

Thus, once again, interaction with other Public Administrations and with entities, institutions and agencies of the private sector has been the road chosen to make available all the advantages of online statement filing to all citizens, through, in this occasion, the so-called collaboration Agreements.

Through these collaboration Agreements, the Tax Agency authorizes entities parties thereto to file statements online in representation of third parties. This way, not only can collaborator entities prepare the statements of the citizens that resort to them, but they can also file them online, obtaining at that same time a voucher certifying said filing.

For this to be possible, Spanish law requires that a citizen that resorts to a collaborator entity for the same to file his statement through the Internet, grant a written authorization to the filing entity. To facilitate the work of the collaborator entities, the Tax Agency has designed

a “*representation model*” that is generated and is printed directly by the PADRE help software. This representation document is available to the Tax Agency for the event it may require its submittal.

Currently, the Tax Agency has entered into over 200 collaboration agreements for the online filing in representation of third parties, particularly with professional association entities that customarily render services in tax procedure matters (economists, lawyers, agents, tax advisers).

Nevertheless, among the entities that have signed the collaboration Agreement for the filing of statements through the Internet we must also mention the regional Governments, City Councils, Unions, business Associations, official professional colleges, Cooperatives – fundamentally from the agrarian sector -, Universities, etc. Furthermore, even the large companies are beginning to show interest for this manner of social collaboration, in the measure that it allows them to provide a service to their own workers in the filing of the IRPF statements.

Recently, the Ministerial Order that approves the IRPF statement models, empowers tax collection collaborator entities - banks – so that they, under a previous collaboration agreement with the Tax Agency, may file IRPF statements or communications online in representation of third parties, in such a way that these entities may file the IRPF statements of their clients offering a service that goes beyond the payment of taxes or the aid in the preparation statements.

Currently, the amount of persons and entities that have entered into the aforementioned Agreements, considering that those that are authorized for the filing on behalf of third parties of the majority of the tax statements, is over 12,000.

The citizens acknowledge efforts made in this aspect by the Tax Agency. In just two years, a figure of 497,789 IRPF statements filed by these means has been reached, with a 330 percent increase over the previous year. Nowadays, the main tax statements can be filed through the Internet (Value Added Tax, Corporation Tax, Special Taxes, etc.).

## TOPIC 1

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	1997	1998	1999	2000	2001
Internet Access	163,048	1,497,222	5,777,514	8,108,944	18,322,044
IRPF statements through Internet			21,559	115,244	497,789
Small company statements through Internet			542	20,480	154,309

From the surveys performed among Internet users during the last three Income campaigns we see that the online statement filing occupied the first place among the Tax Agency's Internet services considered as "useful" by those interviewed. 85.5 percent of the users that had filed their statement through the Internet during the last Income campaign were "satisfied" or "very satisfied" with this service.

Furthermore, the Tax Agency has achieved international recognition for its work in this regard, when it obtained in the year 2000 the award of excellence for information technologies in the public sector, awarded by the World Information Technologies Alliance (WITSA), for the use of the most advanced technologies in the benefit of the taxpayer, particularly for the services offered through the Internet. More recently, the Spanish Tax Agency has received the "e-Government Good Practice" award from the European Commission in recognition for the approach towards the citizen through the Internet.

Along this line of work already undertaken, the Tax Agency plans to develop more and better services through the Internet in the future, consolidating an "electronic Tax Administration", given the countless advantages this means of communication offers.

### 3. COLLABORATION IN THE COLLECTION PROCEDURES

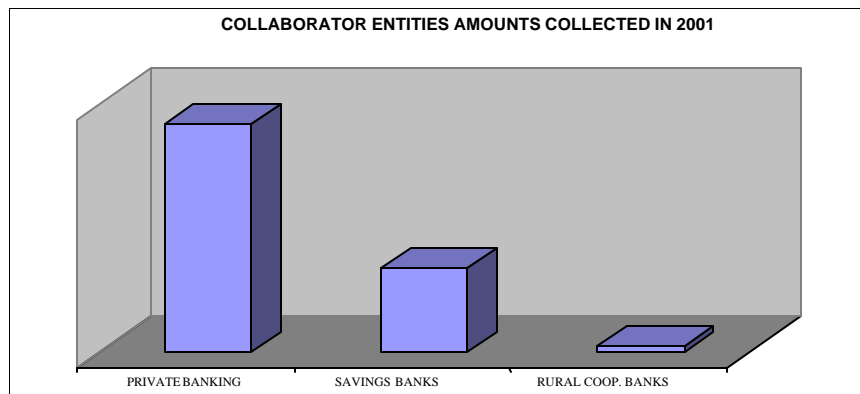
The interaction between the tax administration and the private sector is expressed in a direct manner in the authorization that, since 1986, the Tax Administration has granted to most Spanish financial entities to collaborate in the collection procedures. Along with the collaborator entities, Spanish law foresees that the Cash Service in the Delegations and Administrations be provided by the Deposit Entities that, in turn, can act as collaborators.

In this way, not only can citizens fulfill their payment and statement filing obligations at the Tax Agency offices, but they can also do so in the more than 39,000 offices of said entities.

Furthermore, in the fulfillment of their tax obligations that have been subject to extension, and with a simple communication to the Administration regarding the payment order, the citizen can domicile the payment in a banking entity. In this same fashion, the citizen can receive in those accounts opened in any collaborator entity, the sum for the corresponding tax returns by means of simply communicating an account number to the tax administration.

The system implies important advantages for the citizen, as it multiplies points of payment, but also for the Tax Agency, since by foreseeing the electronic transmission of the entry data and important costs savings takes place, and it also limits and reduces the use of large amounts of cash at the Tax Agency offices, reducing the risks that, otherwise, could take place.

On December 31, 2001, 199 financial Entities were authorized to act as collaborators. The importance of this mode of collaboration is unquestionable if we bear in mind that during the aforementioned year, the sum collected through those surpassed 123,900 million Euros. Also, over 32 million revenue documents have been processed through said Entities.



In order to guarantee the quality of these services, it becomes necessary to establish systems to follow-up and control collaborator entities.

Follow-up operations are aimed at:

- Verifying the fulfillment of the obligation of the authorized Entities to communicate the balances of restricted accounts.
- Controlling the quality of the detailed information transmitted by the Entities in support of the documents filed at their offices.
- Following-up the deposits made at the Banco de España as well as the conciliation of these revenues with the detailed information supplied.

On the other hand, verifications aimed at verifying possible irregularities in the rendering of the service are periodically carried out, from which the application of sanctions could result that, in some cases, assume the adoption of restrictive measures – such as the temporary suspension of the authorization granted to the entities in file to act as a entity collaborating in the collection procedures – or the settlement of past due interests for deposits made after the deadlines.

#### **4. THE AUTOMATION OF THE CUSTOMS DEPARTMENT**

The interaction of tax administrations with agents that intervene in foreign trade, not only facilitates and favors the voluntary compliance of the tax obligations associated to the trade of goods, but also supposes a benefit for the national economy since it provides greater fluidity to said traffic, avoiding the loss of “market share” and, furthermore, promoting its growth.

The challenge faced by tax Administrations is to reach a level of modernization and facilitation of the goods dispatch procedures – both for imports and exports– that facilitates the fulfillment of the obligations by the operator and, concurrently, guarantees the customs Administration the adequate tax control in the foreign trade environment.

During the last years, the Spanish Tax Agency has made progress in that direction promoting the facilitation of the dispatch of goods on the basis of three concrete actions: the implementation of a one-stop window system, the new design of customs procedures and the interconnection between foreign trade operators aimed at eliminating the paper support through the use of an Electronic Data Interchange - EDI software.

- The creation of a one-stop window system required the signing of an Agreement between the State Ports Public Entity (under the Ministry of Development) and the Tax Agency, whereby the documents identifying the goods in maritime traffic – *preliminary statement* – filed by electronic means before the port Authority were construed as also filed before the customs Administration. Thus, with a single e-message, obligations were fulfilled in both Administrations.

This same strategy was carried out later on with a particular Spanish entity (Aeropuertos Españoles y Navegación Aérea - AENA) to apply the same model to air traffic.

- Also, an administrative processing system was designed based on the aforementioned Electronic Data Interchange. This is a service free of charge and of voluntary application that consists on the transmission of information by means of teleprocess and on real time between customs facilities and Customs Agents – who represent the importer or exporter– in one direction or the other, in such a way that, after only a few seconds have elapsed since the sending of the statement to the Tax Agency Office, the Agent knows the procedures to follow (for example, if the goods or the accompanying documents will be subject to inspection upon arriving at the customs facilities).
- Last of all, it became necessary to adapt the regulations on customs dispatch to the new trends established by the use of the new technologies that allow for the automated dispatch of goods.

Simultaneously, information technology applications were developed, some that, based on “risk analysis” techniques, allowed to carry out the control of goods in an automated manner, in such a way that a selective control were carried out, at the customs facilities, of the goods according to risk index (proceeding, as it may correspond, to the physical inspection of the goods, the verification of documents, both or none). In its case, controls had to be transferred to a time after the goods had been withdrawn.

In the planning and latter development of these projects, there was the participation of all interested sectors. Surveys were carried out among the importers, exporters, Customs Agents, transit handlers,



consignees and officers, and direct contacts were made with the Official Colleges and professional associations of the main foreign trade operators, as well as with the Public Administrations involved.

The measures implemented for the automation of customs dispatch have promoted a spectacular reduction in the time for dispatching goods in the last years. Specifically, in 1995 the dispatch time was always over four hours, said time has been gradually reduced, in 2000, 96 percent of the dispatches are made in under two hours.

Also, the new dispatch system allows Customs to control its maximum dispatch times and the establishment, with a general nature for all Spanish Customs, of uniform dispatch criteria and the establishment of risk indices that will give rise to a selective goods control.

Summarizing, we are facing evident Prof. That the employment of new technologies and the interaction of the tax Administration with the different agents that intervene in the foreign traffic of goods has allowed to improve the quality of services associated to foreign trade and to facilitate voluntary compliance of tax obligations, through the reduction or total elimination of the use of support documents for the exchange of information in the customs dispatch, the diminishment of the time of stay of the goods in Customs, the expansion of the schedules derived from the permanent connection to a Network, the knowledge of the time of unloading the goods that will be inspected by Customs or other agencies -competent in sanitary control, veterinary control, etc. -, the possibility of requesting specific operations and customs destinations at Customs (even before the arrival of the goods to the facilities) and the reception of the "pulling-out" of the goods at the offices of the interested party.

## **CONCLUSIONS**

The future of the tax administrations is marked by the commitment of permanent improvement of the help provided to the citizen, evolving towards an Administration that is closer and more sensible to their demands, aimed at obtaining the maximum quality in its acts.

To that end, it is necessary to promote those actions aimed at involving society in the projects of the tax Administration itself, particularly through the use and development of the **new technologies**. The objective is to make the different tax services available to the citizens at large, through the **social collaborators**. In this way, not only will the fulfillment of the tax obligations be facilitated, but also the tax Administration will become, as it is happening in Spain, one of the main engines of the “information Society”.

Mr. Roberto Serrano López  
Director, Human Resources & Economic Administration  
State Agency of Tax Administration  
(Spain)  
E-mail: [rserano.rrhh@aeat.es](mailto:rserano.rrhh@aeat.es)

*Case study:*

*TOPIC 1.1*

**STRATEGIES FOR ACHIEVING GREATER ACCEPTANCE  
OF TAXES AND OF THE TAX ADMINISTRATION  
(INTERACTION BETWEEN COMMUNICATIONS MEDIA  
AND THE TAX ADMINISTRATION)**

**René Humberto Pérez Ordóñez**  
Superintendent  
Superintendency of Tax Administration  
(Guatemala)

*CONTENTS: Communications Media: Governance and Democracy.-  
Strategy Proposal.- 1. Community Means of Communication.-  
2. Private Sector's Social Communications Media.- 2.1 Public  
relations.- 2.2 Advertising.- Conclusions.*

The topic chosen for the deliberations of the 36th CIAT General Assembly, that is: “*Opportunities for improving tax compliance through interaction and cooperation*” is of utmost importance and interest. In this respect, Guatemala has been assigned the development of a paper wherein we will propose a strategy that will allow for achieving a greater acceptance of taxes through interaction between communications media and the tax administration.

Undoubtedly, the mass communications media –as part of the private sector of our societies -, are essential in contributing to a greater acceptance of the taxes and of the tax administration itself. There is no doubt that, since they are direct instruments for forming opinions, it is important that they be taken into account in developing a strategy that may allow for optimizing this interaction.

Therefore, without been exhaustive and as general reference framework, prior to developing the strategy, we will present concepts dealing with the State and governability –understood as basis or support of the relationship between the tax administration and the communications media -, as well as what we consider some difficulties for achieving such relationship or interaction between both sectors.

### **COMMUNICATIONS MEDIA: GOVERNANCE AND DEMOCRACY**

According to the United Nations Development Program –UNDP-, the challenge for societies is to create a system that may promote, support and maintain human development.

The document Governance and Sustainable Human Development indicates that governance entails the exercise of economic, political and administrative authority in the management of affairs of a country at all levels. It covers the mechanisms, processes and institutions whereby the citizens and groups express their interest, exercise their juridical rights and fulfill their obligations and mediate their differences.

Good government –the document points out– is characterized by, among other things: participation, transparency and accountability. In addition, it is considered that it should be effective, equitable and promote the authority of the law.

These concepts lead us to affirm that in democratic States, taxation is the mechanism that facilitates satisfaction of the general interests of a nation, which, through the execution of programs and projects will result in social benefits. Therefore, we coincide in that the State faces the challenge of ensuring that good government may respond to the concerns and needs of the poorest, thus increasing the opportunities for the people, to seek, achieve and maintain the standard of living they hope for.

We thus coincide with the proposal of the aforementioned document in that the challenge of all societies is to create a participative system that may promote, support and sustain human development. From there follows that the concept of governance includes the State, but also goes beyond to private sector and civil society organizations, being the private sector understood as the main element which influences the country's social and economic policies.

In this way, social communications media as important performers of the private sector become a center where their balance, transparency and professionalism are determinant factors for consolidating the democracy of the countries. However, it is an undeniable fact that there are still problems for arriving at a better journalism that may be a communication source, promoter of culture and former of opinion, although it is admitted that most communications media have shown significant progress in the journalistic and informative areas, have expanded their coverage in time and space; as well as developed the quality of their programming.

As stated by the authors, Stefan Roggenbuck and Ricardo Bracamonte, in many cases, exercise of the communication activity is seriously affected by the discretionary use of words and programs, mediated information and sensationalism that many times conceal the improvised investigation. Undoubtedly, the authors indicate, not everything is the responsibility of the communicators. The owners of the communication media have much to do since, definitely, they are the ones that trace the path and rate for transmitting a specific opinion, article, comment or editorial.

Many times, the owners are the ones who, through corporate interests direct the media and accordingly, the communicator. Commercial usefulness and interests prevail over any collective interest. There is or has been little concern for truth and its knowledge by the public. If it affects the interest of a sponsor, it is believed that it should not be published or denounced –this is an indication of the complexity of interaction between both sectors- .

We definitely support and agree to the importance of tightening or strengthening the relationship with the communications media. Thus, based on the existing difficulties, we will agree on the common aspects that will allow us to develop what could be the strategy.

It is necessary that we understand the importance of the commitment that must be assumed by the tax administration as well as the private sector –in this case through the mass communications media – and face the challenge of giving priority to the interests of the community, rather than those that hinder the development of an objective, critical and impartial journalism that may cover the essential issues of the national agenda and be a channel for forming opinion and culture –in this case, tax culture-.

Roggenbuck states that the influence of the social communications media has led many authors to call it the “fourth power”. However, what is important is their responsibility and duty vis-à-vis the consolidation of democracy, rather than the level of power they exercise.

The author notes that the commercial nature of businesses involving communications media directs them toward economic success, which in many cases, in our countries, has led to the production of speedy and low cost programs, as well as the acquisition of imported series unrelated to the real situation. Such action *is contrary to the educating and training mission of the communications media*, which is many times provided in the national Constitutions.

This way of producing the news has made it difficult to openly discuss problems, consider issues of national interest in great depth, promote understanding of events in their real context and reflect thereon. Issues dealing with the citizens’ obligations toward the State have not been in many cases, priorities in the daily exercise of journalism in our countries.

Due to their business and informative nature, the media are exposed to permanent confusion. On the one hand, they must yield profits as a business and, on the other, they must operate as institutions of public interest with a formative mission.

It is thus necessary that the communications media and the tax administration establish a *fair balance*. On the one hand, the communication media must balance their profit making activity as such and their responsibilities toward society as a whole. They *must* fulfill the social objective of transmitting to the members of society, the necessary elements that may allow them an objective interpretation of reality.

On the other hand, the Tax Administration *must* establish mechanisms for complying with its accountability or allow the right of *social auditing* of its administrative acts.

Therefore, we must endeavor to determine how to achieve a positive interaction between social sectors based on the commercial nature of businesses and the government, when, as stated by Ignacio Ruiz Jarabo, in his paper presented at the 33rd CIAT Assembly, there are factors that render difficult the social acceptance of the tax

system, beginning with the fact that the relationships between the tax administration and the citizen are marked with a certain level of tension and conflict.

According to the author, this marked tension and conflict are due to the fact that taxes are economic burdens of an obligatory nature from which the taxpayer does not derive a direct, personal and immediate benefit.

According to Ruiz Jarabo, it is also essential to take into consideration that the level and composition of public expenditure, the efficiency of public administration and its relationship with the tax levels, are problems that go beyond the sphere of the tax administration.

How then can one propose a strategy of goodwill and understanding between two sectors which, since each pursues its own interest, must begin by generating trust in each of them and additionally, commit themselves to obtain information –on the one hand -, and give information –on the other-, on aspects that many times go beyond their own sphere of action?

The strategy of good understanding and interaction between the tax administration and the social communications media must go beyond the sphere of the tax administration and develop within a global policy of communication of the governments, that may show the efficient use of public resources as a premise for the acceptance of the tax administration and subsequently, to promote among the citizens, the culture of payment of taxes.

Although interaction between both sectors is essential, it would be isolated if carried out or attempts are made at detaching it from the public expenditure policy, since the latter, as part of fiscal policy should go hand in hand with it.

We thus believe that before determining the parameters for establishing a true interaction of the tax administration with other social sectors, –regardless of the sector -, it would be necessary to pay greater attention to solving the 5 factors which, according to Dr. Ruiz, render difficult the acceptance of taxes:

1. Economic factors related to opportunities of evading and the risk assumed

2. Psychological factors related to the attitude vis-à-vis the State and the individual perception of justice
3. Sociopolitical factors related to the level and quality of public expenditure and the necessary resources for responding thereto
4. Organizational factors that deal with the Administration's difficulties for providing the service expected from it; and
5. Legal factors arising from normative complexity.

Once headed toward the solution of these factors that directly influence the taxpayers' perception, we must promote a rapprochement toward different sectors of our societies -not only toward the social communications media -, so that in this way we may show the positive aspects and changes carried out by the tax administration, in order to generate a multiplying effect in the positive positioning of the institutional image.

It is necessary to insist that the government must commit itself to transparent management of its information and communications policy. The latter should be clear, open and sincere, since we cannot avoid mentioning that for many years, the communications media and citizens in general had no access to government information. Therefore, it would be convenient to evaluate the need to improve the legal framework that governs information, whether from government sources or from private levels with social support and public resources.

Communications media must necessarily be promoted as participants in democracy, in the understanding that they must comply with the obligation to create an environment of political calmness and promotion of culture in general terms and specifically, the tax culture in interaction with the tax administration.

## **STRATEGY PROPOSAL**

To formulate a communication strategy that may allow for achieving a greater acceptance of taxes and the tax administration, through interaction with the media, it is essential to note that such strategy should be related to a process of overall government information.



Based on the fact that in a great majority of countries, press-government relationships have been tinged with confusion, conditionings and mutual loyalties to the detriment of the right of information, the first aspect proposed in this strategy, parallel to the rescue and conferring of dignity to such relationships is the strengthening of the community means of communication, as starting point that may promote achievement of a greater acceptance of taxes and the tax administration.

## **1. COMMUNITY MEANS OF COMMUNICATION**

In this sense, we share the proposal related to social communication, democracy and civil society of Mexico, wherein it is stated that community means of communication are forums whose purpose is to provide truthful, partial and balanced information; allow several and equitable spaces of expression to different political, social and cultural trends and attitudes, and promote educational programs that are compatible with the democratic values that strengthen civil society.

Therefore, we share the proposed actions in the sense of aiming our priority efforts toward:

- Determining that the purpose of the community means of communication is not to compete with the commercial media but, on the contrary, that they should promote education through quality programming in the different expressions of human activity. In this context, one must emphasize the importance of strengthening tax education and culture.
- Wherever it is nonexistent, we propose a legal framework that may favor community diffusion, especially through written newsletters, radio and television that may reach the population in several languages –as is the case in Guatemala, where some Mayan language is the primary language of approximately 55% -, to become channels for promoting tax culture and education.
- Creating an editorial council represented by social and civil organizations devoted to education, to aim the information toward the community benefits that will be received through the payment of taxes.

- Promoting programs involving the participation and discussion with public officials, oriented toward tax education as part of democratic strengthening.
- Guarantee the citizen's access to community information programming in a plural, diverse and tolerant manner to guarantee access to free information.
- Promote professional relationships between each one of the community media and the universities, professional associations and trade organizations for the research, production and development of activities aimed at strengthening the tax culture and education in each of these media.
- Integrate the media of a community nature into a single coordination system, with a view to unifying information priorities, determining communication policies, exchanging experiences and optimizing resources, to adopt common decisions that may position their social presence.

## **2. PRIVATE SECTOR'S SOCIAL COMMUNICATIONS MEDIA**

The payment of taxes is an obligation of the citizen. Within this framework, the Government must promote tax culture in order to change the taxpayer's mentality, through the provision of clear information, as well as transparent accountability, based on the efficiency of services and implementation of public works.

It must be admitted that communications media must prevent the democratic regime from being corrupted, due to the natural tendency of human beings of managing other's properties as if they were their own. Because of this important social function, the tax administration must contribute to develop the communicators.

Economic and especially tax issues, require specialized knowledge in order to be understood and transmitted. It should be our priority task, as fundamental part of the rapprochement strategy, to provide communicators the elements and knowledge for understanding and interpreting and subsequently transmitting the tax processes.

Bearing in mind the technological development, the complexity of the social processes and scientific specialization and development, we may say that it will be ever more important to train the communicator.

For this reason, we support Margarita Kaufmann's proposal in the sense of aiming efforts at the development of modern communicators for:

- Transmitting to a greater extent, specific knowledge in order that the communicators may evaluate the opinions of experts, scientific developments and their meaning for society.
- Transmitting knowledge about methods for the search of information, in order that the communicators may be capable of investigating through data banks and processing the information electronically.
- Orienting themselves toward the public tasks attributed to the media, which involves compliance with the function of providing timely information, training and interpretation.

It must be noted at this stage, that the role of communications media will be strengthened to the extent that public officials are capable of holding a sincere and open dialogue. It is up to the communications media and to the communicators to assume their role within the current democratization processes in such a way that societies may find in them, true information, training and participation channels.

If we wish to give a new thrust to the relationships between the tax administration and the communications media, we deem it convenient to initially undertake an audit of the institutional image, through which one may objectively determine the citizens' perceptions of the administration, with a view to orienting our work toward converting weaknesses into strengths involving changes that may be communicated.

To bring about this rapprochement, we consider it important to act in two different but not distant areas, namely: public relations and advertising.

## **2.1 Public Relations**

The fundamental objective is to ensure that the tax administration may hold a positive space in the communication sphere. This does not mean that the information media must be overwhelmed with a multitude of messages. The Institution's importance is not measured by the centimeters it occupies in the newspapers. Care should be given to its appearance, so as not to popularize the institution. One must take into account that in public image, omnipresence is usually not a synonym of quality.

We propose that care be given to the solvency of the image as regards credibility, by recalling that lies are not profitable and end up destroying the most solid image. We must focus on the development of tax culture, by promoting our participation in opinion programs.

As part of the strategy of rapprochement and interaction with the communications media, we consider it necessary to invite the members of the Editorial Councils to meetings in order to make known the main achievements of the Tax Administration. It is also essential to pay a courtesy visit to the communications media to generate the good will of the tax administration for providing information dealing with issues of interest for national development.

Likewise, tax administrations should have a specialized department or information office that may guide and focus its work, if possible, 24 hours a day, to provide information on the administration, through the use of instruments that may facilitate the journalistic work.

The information office should let the officials know which communication instrument must be used for transmitting the message. These instruments may range from:

- Press releases or notes to report all those events that are considered of general interest.
- Press Conferences to inform the communications media about a specific event.

- Statements when a tax administration official wishes to express opinions or provide explanations on some specific issue.
- Folders with documents to provide journalists all the information deemed necessary. It may include various documents for providing the journalist or communicator all the necessary elements for carrying out a satisfactory investigation.
- Addresses for electronic assistance or consultations

To be efficient, we must recall that communications media have different needs and that the tax administration must respond to all of them. The relationships between any organization and the communications media should not end with the provision of information, but rather, the positive interaction will depend on the personal contact established with the information professionals.

## **2.2 Advertising**

Another fundamental aspect on which external communications is based is advertising, a persuasion technique that will greatly support the work of development of tax culture.

Undoubtedly, the Tax Administration should have an aggressive communication policy to achieve the acceptance of taxes. We thus believe that campaigns for promoting and developing the tax culture, that may clearly explain the role of the administration and indicate the results of management, are highly convenient for affording the institution a positive position, as well as for persuading citizens.

We must be careful with the use of language and the message being communicated so that it may reach society and promote – what Ruiz considers as – tax consciousness. It is necessary that information campaigns be used to transmit concepts dealing with obligation, solidarity and justice, without losing sight of the need to make it clear that there will be an implacable persecution of tax evasion as a practice that affects society as a whole.

As a complement, it is obligatory to reinforce in the message the values and strongholds that govern the tax system, focusing and centering attention on the concepts of transparency, efficiency, effectiveness, modernization, simplification, honesty, professionalism, ethics and service.

Finally, we believe that information campaigns must guide the taxpayer and provide assistance for facilitating voluntary compliance with tax obligations.

## **CONCLUSIONS**

In order that there may be a real interaction between the communications media and the tax administration, accountability to society on the part of the tax administration and public finance must be transparent, since, if there are doubts as to the use made of the citizen's contributions, there will be more suspicions and less willingness to sacrifice the individual economy in the interest of a collective welfare that is perceived as belated or never achieved.

The Tax Administration should provide the State the necessary resources for carrying out the activities determined in the Constitution. Tax culture must be promoted by basing work in such values as transparency, efficiency and effectiveness. Undoubtedly, within the framework of transparency, it is necessary to make available to the communications media every type of information intended to make known to public opinion the relevant aspects of this administrative task.

On the other hand, social communications media must establish a balance between their own profit making activity and the representation of the financial interest of their sector and assume their responsibility toward society as formers of opinion and promoters of the tax culture.

The responsibility of promoting the tax culture should be in its purest expression a two-way mechanism: on the one hand, there are the individual taxpayers or those represented in sectors, complying with their obligation toward society, and on the other, the Government making the most honest and clear use of the monies contributed by the country in exercising its vocation of solidarity.

The best way to promote tax culture will be by showing the public the adequate use of revenues that are sacrificed in the interest of common welfare, and denouncing the taxpayer who hinders the country's development by evading the payment of his taxes. Only thus will it be possible to generate a true interaction between the different social sectors and the tax administration.

**“The entity is for society the image that the  
communications media provide of it”**  
(Tomás Álvarez)

Mr. René Humberto Pérez Ordóñez  
Superintendent  
Superintendency of Tax Administration  
(Guatemala)  
E-mail: [r.perez@sat.gob.gt](mailto:r.perez@sat.gob.gt)

*Case Study:*

*TOPIC 1.1*

## **INTERACTION BETWEEN COMMUNICATIONS MEDIA AND THE TAX ADMINISTRATION**

**Victor Sancho**  
Public Relations  
General Directorate of Taxes  
(Portugal)

*CONTENTS: Introduction.- 1. Determining a Social Communications Policy.- 2. The Need to Invigorate Quality Policies.- 3. What Is the Image of the Tax Administration.- 4. Marketing and Communication Strategies.- 5. What Type of Management Model?.- 6. Conclusion.*

### **INTRODUCTION**

A positive image of the Tax Administration services and, within a long-term perspective, that such image may contribute to the structuring of collective awareness of the rights and duties of citizens in the field of taxation is what would be expected from a relationship with social communications media.

In fact, the objectives that are essential for the Tax Administrations, such as the struggle against tax fraud and evasion will be doomed to fail if there is no collective awareness of the rights of citizens in the field of taxation. When the common citizen condemns tax fraud and evasion and contributes to fight against it, conditions will be given for delimiting the phenomenon and rendering more effective the means used in said combat.



In a society that is ever more demanding, anything that may be the subject for criticizing the operation of public administration, in general and the tax administration, in particular becomes news. And fortunately it is so. What we must do is to learn to live with this reality, by reacting to criticisms with an increasing level of demand and endeavoring, simultaneously, to generate positive information.

Taxes are and will always be a good news item. However, this appetite of the social communications media for news related to the Tax Administrations also favors us, to the extent we find therein a vast space for intervention. It is a matter of knowing how to use such appetite to produce positive images for social communications, either through the dissemination of positive events or through the constructive treatment of negative events.

I will refer to some of these issues through a series of reflections that, some years of professional experience in this field have led me to solve:

— **Determining a social communications policy**

With either positive or negative results, we must get used to the fact of establishing a quasi-intimate relationship between Tax Administrations and Social Communications Media. It makes no sense to adopt a passive position vis-à-vis social communications when we can obtain favorable results by establishing a positive relationship strategy with it.

— **Dynamizing quality policies**

If one hopes to have a good image (or what is commonly known as a good press), we must implement active quality management policies, leaving aside the passive attitude of betting on internal efficiency and waiting that it will (unequivocally) result in improvement of the effectiveness of the service rendered, then, in the quality of such services.

— **Evaluating the image of the Tax Administration**

What is the image of the Tax Administration before its users/ customers, in general, and before the taxpayers, in particular?

It makes no sense to pretend to interact with social communications media without being fully aware of the image we have and the one we endeavor to show. Although we may admit that it is not always true, we must begin from the assumption that, to a great extent, communication is not only responsible for our image, but also for reflecting the image which users have of our services.

— **Framing the relationship with social communications media within a marketing and communication strategy.**

Competitiveness in our societies ceased to be, a very long time ago, of the exclusive private sphere of its products and services. Public institutions are also involved in this context. At present, any citizen has a scale for evaluating the various institutions, by judging them according to what they assume should be their way of operation. Therefore, it is not enough to act on the quality of our services, but it is likewise necessary to promote them among our users.

— **Discussing the model for managing the relationship between the Tax Administration and Social Communications Media.**

The ministerial offices on which the Tax Administrations are dependent have their own press offices. Of course, the main activity of these government departments is the political management of the dossiers, and by definition, they do not assume long-term strategies.

## **1. DETERMINING A SOCIAL COMMUNICATIONS POLICY**

Ultimately, social communications is a reflection of the relationship between the Tax Administrations and their users/clients. Deficiencies at the level of technological developments, only aimed at improvements in internal efficiency, without entailing improvements in the quality of the service rendered on the one hand, and the lack of marketing and communication policies, on the other, may probably result in a duality between the effectiveness resulting from the modernization processes and the image of the institution and its products.

It makes no sense to adopt a paternalistic relationship with the social communications media or with the taxpayers. We are living in competitive societies and I would likewise say, in an environment of total competition. This means that in Tax Administrations, in particular, and with greater reason, in Public Administration, in general, the convenient idea that we are here to do the best is no longer enough.

Users, either of hospital services, the teaching system or the tax administration, demand ever more and better things. And the improvement of the quality standards in a service, inevitably entails the demand for identical quality standards in all the others.

Besides, such attitude no longer distinguishes between the public and private sectors. Rather, substantial improvements in the relationship between private businesses and customers, lead citizens to be ever more demanding with respect to public services, expecting from them increased quality standards.

**In sum**, I believe that in a strategy of relationship with social communications media the following "*orientation vectors*" should be considered:

- **High professionalism**

The relationship with social communications media is not a task to be undertaken with a simple impulsive attitude; rather, it involves a range of technical capabilities of relationships and human complexities, which are possible only if we count on specialized technicians and structures. Tax Administrations must have a highly professional response capability in this sphere, capable of undertaking permanent work before the social communications media.

- **Clear definition of the Tax Administrations' area of intervention**

There should be a clear delimitation between the communication structures of the Tax Administrations and the ministerial offices. Without this separation between these two areas of relationship with the social communication entities numerous opportunities for transmitting positive images before many of these entities will be lost. In addition, such separation is a condition for rendering feasible the adoption of effective communication strategies.

- **A transparent relationship with social communications media.**

It is not isolation and the silence of our services which prevents us from diffusing negative news. Without involvement and complicity with social communications media, negative or lie bearing news will undoubtedly be more frequent. A transparent relationship with journalists will never eliminate negative messages, but rather will truly contribute to promote positive information.

- **Systematic work vis-à-vis social communications media.**

Be it directly, or through the indication of positive events (the so-called positive news), deserving the attention of social communication entities, there should be a permanent intervention with the social communications media. Such intervention must take into consideration the various levels of reality (central, regional and local), giving special attention to regional and local communication entities, without disregarding, in the meantime, the specialized communication bodies.

Thus, it is not enough to set the conditions in order to obtain positive results in social communication. To this end, there are fundamental policies which the Tax Administrations should establish. Our image, as diffused by the social communications media will be more the result of what we are than what we actually believe we are. Much in the same way many news do not reflect the truth, the image we transmit to our taxpayers, as well as the opinion which a great number of them have about us does not correspond to the truth.

Applicable herein is the old maxim, which says that it is not enough to be, it is necessary to seem. If we accuse social communications media of a poor job and are not concerned about whether the image introduced by it, corresponds to that which many users have about us, then, probably, we are about to make a serious mistake.

It is impossible to win over our users if we do not seriously establish quality, marketing and communication policies.

## **2. THE NEED TO INVIGORATE QUALITY POLICIES**

We insist, from now, on the need to prevent transformations from becoming mere cosmetic operations. From the foregoing item we

may conclude that there is a need to have a diagnosis of the image, which users have of our services and much more so, that we must act at various interface levels in the relationship between the Tax Administration and the taxpayers.

Therefore, it is imperative to adopt strategies that may result in actual improvements in the quality of the services. The adoption of these strategies forces us to consider that modernization cannot be limited to achieving internal efficiency objectives, but rather it must evolve in the sense of guaranteeing that our investments will not end with the internal modernization, but rather such modernization must continue on to the final product, that is, up to the relationship with the user.

This premise arises from objective data:

*In a group of users examined, dissatisfaction in relation to the culture of the services represented 27%, while complaints about the operation represented 54%. The remaining 19%, referred to various aspects, such as legislation, examination, etc...*

These data are clear, as regards the need for internal modernization, reflecting itself in substantial improvements in the capability of response to user requests; also with respect to the importance to be attributed to the need for promoting cultural changes.

**A practical example:** - The filing of income tax returns through Internet:

*Even though this service has been available for some years in Portugal, the number of users is still extremely reduced and when we listen to the reasons why, it happens that we find the most varied justifications, ranging from greater security when delivering the documents in the hands of an official (who merely receives them) up to the apprehension that eventual collections may be processed faster.*

We must necessarily face this issue from the perspective of management of the product and then, some questions will be inevitable:

- Is the interface used friendly and easy to understand?
- In case of errors, can they be easily corrected through the use of the same means?
- Is it easy to obtain access codes? If their validity expires, is revalidation expeditious?
- Does the *site* have sufficient information to clarify doubts that could arise when filling out the forms?
- Is the telecommunications bandwidth sufficient for ensuring prompt access to the electronic returns module?
- What is the waiting time in case the user resorts to obtain support from the Help Desk?

After making this diagnosis perhaps one may find the deficiencies, either with respect to the product or the user's image thereof.

### **3. WHAT IS THE IMAGE OF THE TAX ADMINISTRATION**

We are talking about the interaction between the Tax Administration and Social Communications media. However, this interaction may also be seen inversely, which brings us to the issue:

- How do journalists see the Tax Administration services?

Or, said otherwise:

- If we expect that from the interaction between our institutions and the social communications media there may result a citizenship culture and a positive image of the Tax Administrations, would it then, not be advisable that we begin with being concerned about our own image?

If we resort to a simplification and say that our image is 50% negative, perhaps we may have reasons for having some satisfaction. But the fact is that, very probably, under the perspective of the users, the image is 50% poor, or, more precisely, for 50% of the user we have a poor image. We cannot be surprised if the journalist frequently opts for this perspective.

What, then, makes up the image of our Tax Administrations?

In our opinion, the image of the Tax Administration depends on:

- **The actions and procedures that affect the population:**

The cause here is what we do at the level of what can be called *interfaces* of relationship with the users.

The citizen is ever more demanding, with those increasing standards of demand being motivated by the public administrations themselves which, at the same time, are not capable of following up that same evolution.

- **Cultural biases, existing in the collective memory**

Such opinions, very probably, are either negative or show a high trend in that direction.

Seven years have elapsed since I last visited a user quality finance service. I must admit that the experience was not one of the most pleasant ones.

There was no vision of the institution under the perspective of someone who has participated in a great effort of change and modernization and, probably, it would be that negative image the one that would prevail. The same happens with many of our customers, since they are not aware ( and have no reason to be aware) of all the internal efforts made to improve and modernize the institution. It is thus essential that such effort may bring about results at the level of the final product and the relationship which, as a result thereof, is established with the users.

Added to this situation is an entire past of authoritarianism of the public administrations which leads most citizens to have a negative impression of the State services.

- **Effects of socially diffused messages,**

It is at this stage that one finds the reason for the role of social communications media.

If we hope to achieve positive results from the relationship with the social communications media, we will have to work on our image, which presupposes, above all, a strict evaluation of the image we have of ourselves and that which our users have of our institutions, that is:

- what they think is wrong;
- what they judge as good;
- what they expect from us;
- what they demand from us.

A few years ago, the General Directorate of Taxes of Portugal undertook an analysis of its image, which, in spite of the passage of time, may be considered quite updated. For this reason, I will mention here some of its considerations.

We concluded on that occasion, that it is necessary to:

*A – Change the actions of the Tax Administration*

*B – Reformulate the cultural references*

*C – Transform the messages diffused*

The analysis endeavored to render operational the way of making transformations in these three areas, in order to change the existing image of the Tax Administration.

The maximum effect in the restructuring of this image is achieved through an organizational intervention in the following three levels (which are different but complementary):

**1<sup>st</sup> level – changes in existing operations with the “customer”**

This level refers to the Tax Administration’s daily actions in conducting the processes relative to the “citizen-taxation” system”.

These changes should take place in three areas:

- Internal effectiveness, in particular in the reduction of bureaucracy and delinquency and increase in informative efficiency/effectiveness;
- Effectiveness at the “border” (assistance) at the technical level, and
- Effectiveness at the “border” (assistance) at the level of relationships.

**2<sup>nd</sup> level – changes in the “customer’s” immediate impression**

This level deals with creating infrastructure conditions that may cause immediate positive impressions, capable of bringing about the change in process and acting as “memorizer” and “detonator” of the new vision/image of the Tax Administration.



Below is a brief **practical example**:

*Early this year we inaugurated some local finance services conceived according to a new model, where we practically eliminated the traditional counters. The Minister of Finance in the inaugural speech mentioned this fact, and this key phrase was recalled by the greater part of the press.*

Changes at this level occur in two areas:

- esthetic/functional improvement of the offices;
- dissemination of identity /compilation of external images;

**3<sup>rd</sup> level – changes in the “customer’s” perceptive context.**

This level refers to cultural references preexisting in the “customer”, which have been obtained either through historical experience or through coverage by the media, main instrument for the diffusion of news.

Another **example** may be given in this case:

*Until some time ago, television documented news relative to taxes with images taken in traditional services. Since at least one of the channels with the greatest audience came to use images from recently inaugurated facilities, it is this new image of the services the one retained in the mind of the viewers, who are successively faced with images of modern services, conceived in such a way as to eliminate physical barriers between officials and users and developed according to a modern and pleasant design.*

In the specific case, and considering that the objective is not to create an image from “zero”, but rather to cause the change of a pre-existing image found in the collective memory, it is essential to take into account two events:

1.º in the social memory of past experiences, there are changes that are but processes constituted by “appearances without essence”. This gives way to a predisposition of discredit in relation to the validity of efforts made, which are always seen, either as “cosmetic make-up”, or as an exception that will weaken a “fad” within short term. Any of these positions prevents the change of the current negative image.

To avoid this dynamics, it is important to show that the change currently underway is not:

- a “cosmetic make-up”. Thus, the “new appearances”, (2nd level changes must arise after, and only after making real changes in the operation (1st level), sought/desired by the “customers” (essence).

To achieve this effect, it is important to know what the “customer” wants and, in the specific case, such knowledge already exists.

- a “fad” or exception. It is necessary to prove that the organization is committed and involved in this change.

2.º In the social memory of past experiences there is also, knowledge of advertising/publicity, normally void of contents about the institutions themselves. This promotes a rejection/mistrust by the citizen with respect to information about improvements originating from the organization itself, thus rendering difficult the implementation of the new image.

To avoid this dynamics, it is important to be the very social body that creates and diffuses “news” about the change underway, “naturally” validating it through a dynamics of “positive news”.

This aspect has already begun with news in the journals about this process of change.

Changes in this level deal with:

- insertions in social and community life,
- dissemination of news about the Tax Administration (but not derived therefrom).

#### **4. MARKETING AND COMMUNICATION STRATEGIES**

The availability of good products is not enough, rather, it is necessary that such products have a good image and acceptance by its users, corresponding to their expectations and that such image may reach all users. In order for messages to reach taxpayers undistorted, specifically at the level of social communications media, it is essential that there be a marketing and communication policy. It is not strange to listen to top service leaders argue that taxpayers

visit our services to fulfill tax obligations and, therefore, there is no reason to improve such services under the perspective of a product. This is a very strong cultural characteristic and constitutes the denial of the need to adopt marketing policies.

The need to determine a marketing policy shows one of the most frequent deficiencies of our organizations, inasmuch as being firmly responsible for the effective collection of State resources and subject to successive efforts of adaptation to new fiscal rules, all the priority is attributed to the internal efficiency of the fiscal mechanism and, accordingly, the necessary importance is not always attributed to the acceptance of our services by their users.

It is necessary to change this position and adopt a more aggressive and consistent marketing strategy. And, the definition of a marketing strategy implies:

- **The elaboration of an analysis-diagnosis of our reality.**

Identify the qualities and deficiencies of image of our organizations and the services we render;

Be aware of what our users desire;

Make an evaluation of the demands of our societies.

- **The establishment of a clear set of objectives.**

- **The definition of strategic options, highlighting the definition of our objectives.**

The establishment of the *marketing mix*;

The establishment of action plans.

After defining a marketing strategy, we must establish a communications policy to ensure that our message will reach the addressees for whom it is intended.

To convey the message to the user is not the only aspect to be considered in a communication policy. On establishing a communications policy we are:

- Creating an instrument of internal cohesion that involves the entire organization and all its collaborators.

Since it is an organization with hundreds of directors and thousands of officials in permanent contact with society, it is essential to ensure optimization of the actions of all the structures;

Since the communications strategy is the result of an evaluation divided between the structures and collaborators, it is also an instrument of co-responsibility.

The need for communications strategies shows an essential aspect of the process – the definition of objectives. Perhaps this is the aspect where there is the greatest potential for progress.

Frequently concerned about internal efficiency, worried about the most immediate objective of our concerns – tax collection -, when we take small steps in the direction of communications, we frequently end up with a restricted segment of our users, for example, those responsible for the accounting records of businesses.

Let us consider, again, the **example** of the electronic returns:

The establishment of a communications strategy, taking into consideration the increased use of this resource implies:

- **Evaluating the current situation:**

Who and why does he use electronic returns?  
 Who does not resort to this means and why not?  
 Is the user aware of this possibility?  
 Do the services and officials promote their use?

- **Establishing quantitative objectives which may be measured, located in time, realistic, clear and precise:**

What is the proposed increased in electronic returns?  
 What is the proposed increase in each region, age stratum, type of return, etc?

- **Precisely determining the public objectives**

It must be taken into account that these are not as broad as those of marketing, which concentrates on the group of filers. In the case of electronic returns, we may consider, by way of example, the following objectives:

- Opinion leaders: personalities linked to the use of Internet;
- Initiators: demonstrations in schools, universities, fairs, etc...
- Influencers: account technicians, Internet portals, newspapers, reviews, specialized radio and television programs;
- Generic social communications.

- **Classifying the communications formula:**

In the case of electronic returns, the user will go, until its use, and much in the same way as when he looks for any other product, through three mental steps: - cognitive (learn); - affective (feel); - procedural (do). We know that this is not a standard sequent from product to product and I would say that to support the filing of electronic returns, the user will go through the following phases: know, experience and use.

This approach allows for solving the context of our relationship with social communications:

- It is not an exclusive or final objective, and must be framed within the context of a communications strategy;
- We can hardly have positive *feedbacks* in social communications if we lack a good communications policy for our services. A good image in the press will not result directly from the quality of our services, but rather, from an adequate communications policy.

On concluding this item, it is worthwhile to refer to the possibilities which this new media has for reaching our users, in particular, the strata of society that are opinion leaders. I do not believe (nor do I hope) that this means may be the solution to all our problems. Nevertheless, it constitutes a powerful communications means, through which we directly reach our customers, without the filter of social communications media. In this sense, it is a powerful means whose integration in a communications strategy should be considered.

## 5. WHAT TYPE OF MANAGEMENT MODEL?

We have discussed four aspects of the same problem:

- quality,
- image,
- communications and
- marketing.

However, before concluding that there is a need for a communications policy, it is essential to ask whether there are conditions for adopting a consistent communications strategy based on objectives clearly defined within the various time frames; - short, medium and long terms.

The adoption of strategies in this area requires, above all, that the Tax Administration be afforded autonomy for such purpose.

In some countries, as is the case of Portugal, there is a strong tradition of relationship with the social communications media at the level of the political power. That is, the definition of policies involving the relationship with the social communications media depends on the model established at the political level. When a minister is change the press office is replaced and everything begins again from zero.

It is obvious that rulers cannot do without a decisive power in this field. However, it is also obvious that there is a vast space in social communications media that is not dependent on political objectives.

It is not to be expected nor would it make sense, for example, that a minister's press office would issue a press release addressed to reviews devoted to Internet, announcing an innovation at the Tax Administration's site. Even so, this news may be a positive event that must be disseminated before an important segment of public opinion, giving way to positive appraisals. Some ten examples could be mentioned where decentralization in the relationship with communications would favor the image of the Tax Administration vis-à-vis social communications.

Another argument in favor of decentralization in the relationship with social communications media deals with the local and regional spheres. As examples, there are hundreds of small communication

entities, specifically newspapers and local radio stations which are not given attention by the central body. These newspapers and radio stations, of strong impact in their regions, do not only have more space available, but also a more instructional and many times more correct approach to the information. In addition, local newspapers and radio stations, normally, do not count on specialized journalists, for which reason, for these social communications media the news must be presented in a more complete and elaborate manner than is usually done with ministerial office releases. I will provide an **example** here, by using a true experience:

If we want to disseminate the initial date for receiving income tax returns, we may do it in two ways:

- Through a brief release sent the day before or on the same day: in this case there is very little probability that the issue would arouse the interest of the journalists;
- Through a press release with some application information (returns delivered, returns pending delivery, data relative to the result of examinations, etc.) and an explanation of the advantages of filing via Internet (for example, greater expeditiousness in refunds): in this case, the news may be dealt with by the journalists of the specialty, who have time to consult our home page and, eventually, to pick up images from the services.

I found out about the two situations: - in the first case, no television took the news into consideration, while in the second, all the television stations considered the issue in an extensive manner, while in the two main channels, it opened the newscast in the one with the greatest audience and closed it in the other.

It is not difficult to promote decentralization of relationships with social communications media. Rather, suffice it to distinguish between what has political impact, to the extent it is the direct result of the decisions of political power, and that which results from the Tax Administration's regular management.

Without the adoption of a clear and stable model of relationships with the Social Communications media, it will hardly be possible to determine long-term strategies and very rapidly the social communications media cease to perceive the Tax Administration as spokesman for obtaining the news.

## 6. CONCLUSION

To conclude, I pose some questions, which although not intending them to be a diagnosis, may contribute to a self-evaluation of our options:

- Do we have a strict evaluation of our image before the taxpayers?
- Do our activities plans include a chapter dealing with marketing or communications?
- Do new products or services allow for communication strategies?
- Do we make a strict evaluation of the news produced about us?
- Is there a communications plan which involves all the structures?
- Which resources do we devote to marketing and communication?
- In evaluating investments in marketing and communications do we consider their positive effect on the struggle against tax fraud and evasion or are they considered a deviation of resources as regards these objectives?
- Do we have specialized staff capable of developing sustained policies at the level of quality, marketing, communications and public relations?
- What importance do we attribute to creativity in our communications?

Mr. Victor Sancho  
Public Relations  
General Directorate of Taxes  
(Portugal)  
E-mail: [vsancho@dgci.min-financas.pt](mailto:vsancho@dgci.min-financas.pt)



*Case study:*

*TOPIC 1.2.*

**LEVEL AND DISTRIBUTION OF THE TAX BURDEN:  
THE EFFECTS ON COMPLIANCE IN THE CONTEXT  
OF ECONOMIC INTEGRATION**

**Luiz Villela**

Tax Specialist, Fiscal Division  
(Inter-American Development Bank - IDB)

*CONTENTS: Introduction.- Tax Potential.- Effective Tax Rates.- Limits to Taxation.- Laffer Curve.- Tax Aversion.- Evasion and Avoidance.- Globalization and Economic Integration.- Conclusions.*

**INTRODUCTION**

The economic approach to taxation is centered in three main aspects: efficiency, equity and sufficiency. The main function of a tax system is to transfer funds from the private to the public sector in order to finance the activities of the State. As this is done it affects the income distribution and changes the market signals that inform the decision-making private economic agents. The non-intentional negative effects of taxation result in inefficient use of production factors and results in a general loss of welfare. This is called deadweight loss, since it corresponds to resources that are extracted from society but are not converted into corresponding benefits. Equity is also an essential factor since society only accepts to be taxed if it feels that everyone is paying their fair share and the resources are used according to desired ends. And lastly, sufficiency is also paramount, since the tax system has to be able to raise the adequate amount of funds in order to finance the expenditures required by society.

The amount of tax that people effectively pay – the tax burden – is essentially related to the nominal or legal rates, the tax bases, and the level of compliance. It is important to note that the tax burden that we normally care about is the aggregate of all taxes for the whole economy, which by no means is evenly distributed among all citizens or taxpayers. The tax instruments that are used to extract funds from the private sector are of different kinds, and depending on their taxable base and relative size (rate) they will be more or less successful in this function. The success can be gauged by comparing sufficiency aspects (if the amount raised was enough to meet governments needs) with the various costs associated with the process: economic distortions and deadweight losses caused by administration and compliance costs, as well as evasion and avoidance, which are different forms of non-compliance.

The problem of compliance is as old as taxes themselves, and from the economic standpoint it can be viewed from many different angles: public finance, law enforcement, administration, design, ethics, or a combination of all of these.

Within the context of public finance, tax compliance has implications directly related to incidence, equity and efficiency. The tax system can be structured in such a way that the wealthy are taxed proportionally less than the poor (regressive), leading to an environment where high compliance is more easily achieved. In this case the tax incidence may lead to an efficient outcome but the system as written in the law is not equitable, and politically this might not be sustainable in the long run if democratic institutions work. On the other hand, if the system is such that the wealthy can evade a larger share of their taxes than the poor can, the final outcome is that the effective system will be less equitable than the legislated one. This system might be as inequitable as the previous, but much less prone to change. Furthermore, since both tax evasion and compliance costs (including tax planning) result in deadweight loss, this system might be less efficient than the previous. When a tax system doesn't raise enough resources due to evasion and avoidance, new tax instruments will most probably be introduced to meet revenue requirements. This could mean that higher and more distortionary taxes on reported incomes are introduced, while unreported incomes continue to escape taxation. Cheating affects incidence because it is easier to evade taxes on certain incomes than others. On the other hand, it is seldom a generalized practice, even when law enforcement is lax and penalties are low, which introduces the ethical variable to the debate.

With the growing interdependency between world economies, promoted by globalization, the question of compliance and how it is related to efficiency, equity and sufficiency has acquired a whole new dimension. The design and the administration of a tax system no longer depend solely on a country's sovereign decision. The increased mobility of factors, especially capital, implies that flows to different nations become very sensitive to tax treatment differentials, and the growth of economic activities taking place outside a country's frontiers may hinder its capacity to properly levy its taxes as it wishes.

This paper will discuss the relationship between the amount and the distribution of the tax burden and the level of taxpayer compliance, giving special attention to a context of growing economic integration.

### **TAX POTENTIAL**

The level of taxation is usually determined by a coefficient that relates the value of all tax revenues and the GNP, working as an indicator of relative capacity and a common denominator. This allows us to compare the tax burdens of different countries. Aside from this comparison, a simple percentage is not enough to indicate if the taxation level is high or low.

To assess if a country's level of taxation is proportionally or relatively high or low, one must compare tax level with the economy's potential tax paying capacity, not the GNP. Of a country's net production or income, a part is necessarily taken by basic consumption needs and another to insure minimum level of reproductive investment, at least to offset the effects of asset depreciation. Whatever is left constitutes a potential tax base.

In a rich country the part of the national income (or GNP) that is not committed to basic consumption or minimum investment is proportionally larger than in a poorer country, hence a higher tax potential. This means that if the two countries present the same level of taxation in respect to GNP, the poorer one is actually making a higher tax effort than the wealthier.

A country's tax potential is determined by many factors, and among the most important ones are the level of per capita income, the

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openness coefficient of its economy [(imports + exports)/GNP] and the importance of primary exports (agriculture and mining products), income distribution, and the level of urbanization.

The tax collection efficacy (Et) is determined by the relation between effective (T) and potential (Tp) tax revenues:

$$Et = \frac{T}{Tp}$$

When the amount of tax revenue actually raised (T) is close to the potential (Tp), it is said that the country presents a high tax effort. As a matter of fact, it is possible that some countries present a coefficient higher than one, which means that the actual revenues are higher than expected, given the country's characteristics. The estimation of the tax potential and hence of the tax effort is usually done through an econometric time series and cross-section exercises that correlate actual tax burdens or ratios (T/GNP or GDP) with a series of variables for many different countries over a period of time. This results in a "fitted curve" that indicates the expected tax burden of a country given its economic attributes or characteristics.

A recent study<sup>1</sup> estimates the tax effort index for a sample of 75 countries for the period 1985/95, at the central government level only. It incorporates the most recently available data and employs modern econometric techniques. The results suggest that per capita income, the ratio of trade to GDP, and the share of the agricultural sector in GDP are the most consistent explanatory variables of the tax ratios.

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<sup>1</sup> Piancastelli, Marcelo "Measuring Tax Effort of Developed and Developing Countries – Cross Country Panel Data Analysis, 1985-95". IPEA, TD 818, Rio de Janeiro, Brazil, September 2001.

**Tax Effort Indices – Selected CIAT Member Countries**

<b>Countries</b>	<b>Actual Tax Ratio</b>	<b>Fitted Tax Ratio</b>	<b>Tax Effort</b>
Netherlands	44.273	27.228	1.623
France	37.808	25.785	1.466
Italy	37.482	26.176	1.432
Uruguay	25.515	18.089	1.411
Portugal	28.667	24.307	1.179
Costa Rica	20.903	17.913	1.167
Spain	28.326	24.437	1.159
Brazil	17.103	16.273	1.051
Chile	18.801	19.451	0.967
Ecuador	14.836	16.819	0.882
Peru	10.728	12.223	0.878
Colombia	11.895	15.431	0.771
Mexico	13.742	18.431	0.746
United States	18.020	24.254	0.743
Argentina	11.401	17.434	0.654
Canada	18.008	27.743	0.649

Source: Piancastelli, Marcelo: "Measuring Tax Effort of Developed and Developing Countries"

Piancastelli's exercise was done considering only central government tax revenues, and that may cause distortions, especially in the case of federations where subnational tax revenues may be significant. This is probably what explains the relative position of countries like Canada and the US, where provinces and state raise a significant share of the countries' revenues. In the case of Brazil, where state governments are responsible for the country's most important tax<sup>2</sup>, the fiscal effort index is probably also underestimated. The fact remains that there is a large variation concerning the capacity countries have to extract revenues to finance their governments.

The characteristics of a country's tax instruments and administration, as well as the level, distribution and quality of government expenditures are important to explain why some countries present higher tax effort indices and are able to proportionally raise more tax revenues than others.

<sup>2</sup> *The Imposto sobre Mercadorias e Serviços (ICMS) is a subnational VAT and alone responsible for almost 1/4 of the tax burden.*

## EFFECTIVE TAX RATES

The tax burden measured as the ratio of total tax receipts to GDP is a very gross average that tells very little about the incidence of the various taxes that comprise a tax system. The nominal tax rates also tell very little since they are applied to different tax bases, and are directly influenced by the quality of the tax administration and enforcement. One way to have a better picture of the incidence of the tax burden is to use the effective tax rates on the different production factors and on consumption.

Calculations<sup>3</sup> done for EU countries, USA and Japan show that there are significant differences in tax incidence and that they are changing over the years. The effective tax rate on labor is calculated considering all social security and payroll taxes as well as personal income tax attributable to labor income as a ratio to the total labor costs. The effective tax rate on capital considers the ratio of personal income taxes attributable to capital, taxes on corporate income and property taxes in respect to a tax base proxy that is the adjusted gross operating surplus. Lastly, the effective tax rate on consumption is the ratio between indirect tax revenues to the value of final consumption, excluding wages paid by general government.

### Effective Tax Rates - 1999

Countries	Labor Effective Tax Rate	Capital Effective Tax Rate	Consumption Effective Tax Rate
European Union	37.6	23.6	20.8
United States	23.9	22.7	9.3
Japan	20.3	18.7	13.6

One can see that on the average the EU countries rely more heavily on taxes on labor, due mainly to the high social security benefits and an aging population. The US has a significantly lower consumption taxation than the others while Japan has the lowest effective taxation on both labor and capital. The differences within Europe are also significant. The capital effective tax rate varies from 16% in Germany to 34% in Luxembourg<sup>4</sup>. The labor effective tax rate varies from 24% in Ireland to 51% in Sweden. Moreover, the changes in the incidence pattern were significant over the last 20 years. The EU countries have experienced an average increase of 10 percentage points in their tax

<sup>3</sup> *European Economy, Directorate-General for Economic and Financial Affairs, Brussels, 2000.*

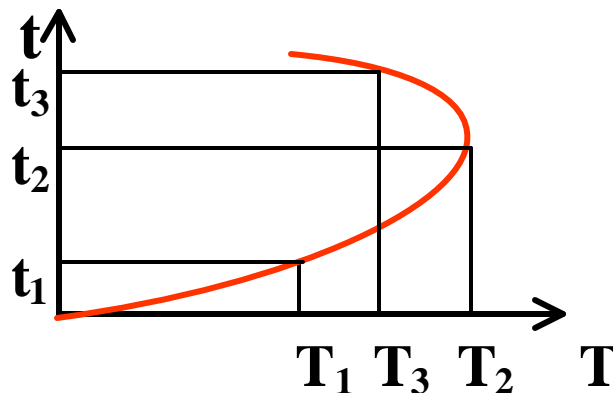
<sup>4</sup> *This refers only to domestic capital income, in contrast with special treatment of income from non-residents.*

ratio (revenues to GDP), of which about 7% in labor, 2% in capital and 1% in consumption. The US has experienced only an average 2.5 percentage points increase in the last 20 years, with a 4% increase in labor taxes but a 1.5% reduction in consumption taxes, and almost no variation in capital taxation. In a significant manner, this tax incidence distribution helps to explain why the US economy has gained competitiveness in respect to other developed nations.

### LIMITS TO TAXATION

The potentially taxable bases have finite dimensions, so any country's capacity to raise revenue has its limits. Depending on the level and the distribution of the tax burden, this capacity will vary, but there is a saturation point beyond which a high degree of tax aversion will come in place and further initiatives to raise tax revenue will inevitably fail.

Economists like to graphically show this taxing limitation with the Laffer Curve, which relates the increases in the tax rate with diminishing increments in the overall tax revenues, up to a point where no increases will occur. In fact, beyond this saturation point additional tax burden could reduce the revenue outcome.



### LAFFER CURVE

The shape of this curve will change from country to country as well as from time to time within each country. Depending on the choice of taxes that are used, how the tax administration is managed and how society perceives government expenditure, the tax-aversion behavior that leads to avoidance and evasion (non-compliance) will give distinct formats to the Laffer Curve.

Tax aversion is a consequence of a high tax burden in absolute terms, as well as a perception that it is unfairly distributed. This could happen if the taxes are “bad” or if they are poorly managed or enforced, allowing cheaters to unfairly compete with honest taxpayers. A good tax system should reasonably distribute the burden between different taxable bases such as income, consumption and wealth. The various taxes applied should be equitable, free from arbitrariness, create minimum interference in the economic system, result in reduced administrative and compliance costs, and render adequate revenue proceeds. If a satisfactory balance of well distributed, efficiently and fairly managed “good” taxes are not in place or the level of tax revenues surpasses the amount that the economy allows and society accepts to pay, one can expect rising non-compliance as a normal behavior.

### **TAX AVERSION, EVASION AND AVOIDANCE**

When inadequate taxing conditions prevail, citizens are averse to paying taxes. In the long run this could lead to tax reforms, but in the short run the response is reduced compliance through evasion. Of course, evasion happens under any circumstances, but is expected to be more intense when the tax burden is high, perceived as unfairly distributed, or there is no sustained social pact concerning proper government expenditure priorities. Enforcement, actual or perceived, is key to evasion. In highly competitive activities, if one player cheats and gets away with it, it is most likely that the others will pursue this alternative in order to maintain their competitiveness. It is always a matter of cost. Not paying taxes results in a benefit by reducing costs while on the other hand, fines, jail time and the probability of these sanctions result in costs. Taxpayers balance costs and benefits when deciding whether to cheat or not.

It is usually said that there are only two things unavoidable in life: death and taxes. Considering the latter, this is becoming less and less true. Tax avoidance, contrary to evasion, is a legal way to reduce the tax burden and increase net returns, so the balancing of costs and benefits is much more straightforward. Tax avoidance has to do with competition and opportunity. One does not have to estimate the cost of being caught cheating. Furthermore, in a competitive economic environment the inadequate taxing conditions that may lead to aversion and evasion probably do not have a significant influence in the decision to pursue tax planning to mitigate the tax burden.



Since tax avoidance is a legal procedure, it is made possible by breeches in the tax laws of a country or by the fact that different countries have different tax laws. Although the diverse legislation creates distinct opportunities for tax avoidance, it is within the income tax that tax avoidance most frequently occurs. This is because it is a direct tax and hence its avoidance schemes directly benefits those who promote and pursue it.

There are three basic principles<sup>5</sup> of tax avoidance within an income tax:

- 1) Postponement of taxes – given that the present value of a postponed tax could be significantly less than if it were paid now;
- 2) Tax arbitrage between individuals – if they are subject to different tax rates, leading to “tax induced transactions;”
- 3) Tax arbitrage across income streams subject to different tax treatments.

Among the most commonly known “tax planning” practices are borrowing to invest in assets yielding capital gains since the interest is usually deductible at ordinary rates and the gain, when taxed, is frequently subject to a favorable rate that, in any case, is due only upon realization. Without going into the multitude of ways that tax planning could avoid or mitigate tax liabilities, it is important to stress that with growing globalization and the increase of cross-border transactions and investments done by firms the possibilities are proliferating.

## **GLOBALIZATION AND ECONOMIC INTEGRATION**

Globalization is the result of the growing integration of economies and societies around the world. Integration has resulted from reduced transport costs, lower trade barriers, rising capital flows and faster communication of knowledge and ideas. Although it has generated economic opportunities the integration process does not come without risks and problems. The growing interdependency among national economies generates a smaller tolerance for divergence in domestic policies, which calls for stronger international coordination.

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<sup>5</sup> Stiglitz, Joseph E., “The General Theory of Tax Avoidance”, in *National Tax Journal*, vol. XXXVIII

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Particularly in tax matters, there is a potential conflict between greater transnational economic activity and the wish policymakers have to retain their sovereign ability to take whatever domestic decision they believe is proper. With increased economic integration it has become very difficult to separate domestic from international policies. Already in the present, and with more intensity in the future, national tax policies will have effects on other countries as well as be influenced by their tax policies.

A particularly well-known example is what happened in 1984 when the United States unilaterally decided to abolish the withholding income tax of 30% on foreign residents that earned portfolio interest income from sources within the US. This included interest on US government bonds, on bonds issued by US corporations and US bank accounts and certificates of deposit. This led to a classic “race to the bottom,” whereas one after the other, all the major economies abolished their withholding taxes on interest for fear of losing capital flows to the United States<sup>6</sup>. For Latin-American countries, the US portfolio interest exemption has resulted in a flight of an estimated<sup>7</sup> US\$ 300 billion from the region to the United States in a short period of time.

The economic interdependency has deep implications for tax issues, especially in three areas:

- 1) The important increase in the mobility of factors, particularly of capital, that affects the tax base and makes them very sensitive to different tax treatments.
- 2) The growing difficulty in determining and taxing activities taking place outside a country’s jurisdiction, especially in the case of intangible goods.
- 3) The increased complexity in the tax administration process that will demand new instruments and a greater level of information, requiring broad and intense cooperation between jurisdictions.

Capital mobility has increased dramatically with the advances in communication technology, the liberalization of exchange controls, and the development of new financial instruments. The competition between

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<sup>6</sup> Avi-Yonah, Rueven. “Globalization, Tax Competition and the Fiscal Crisis of the Welfare State”, in *Harvard Law Review*, Vol. 113, May 2000.

<sup>7</sup> Kant, Chander. “Foreign Direct Investment and the Capital Flight”. *Princeton Studies in International Finance*, No 80, 1996.

countries to attract capital has resulted in a race to reduce taxes to lower the cost of capital for investments, as well as to attract foreign savings while retaining the domestic savings. Ever more sophisticated tax planning mechanisms and financial instruments are put in place, increasing the possibilities of tax arbitrage and resulting in the growing erosion of the income tax base. The increase in transactions between associated or affiliated firms permits the determination of transfer prices in order to elude tax authorities and reduce revenues. Highly qualified professionals, key to a knowledge-based economy, are becoming more and more sensitive to different tax treatments and consider this in their decision to migrate.

Capital volatility and fiscal planning with the use of offshore financial centers, hedge funds and intra-firm transactions, resulting from the competition between nations, have caused the erosion of traditional tax bases such as income and foreign commerce. In effect, increased trade liberalization and international capital flows in the last two decades have resulted in a 4% reduction in income tax revenues and 10% in trade taxes of a representative number of Latin-American economies<sup>8</sup>. This has been compensated for by increased taxation of payroll by 5% and on consumption by 11%. A similar trend was observed in OECD countries, with negative implications for equity.

The defenders of tax competition between nations argue that this prevents the creation of Leviathans, countries with oversized and inefficient governments. Available international data shows that the level of taxation is still growing, but with a more unfair and inefficient distribution among taxpayers. The overall level of taxation is dictated by financing needs, but the distribution of the burden has to do with the tax instruments in use.

In a globalized and competitive environment the possibilities of tax avoidance and evasion are clearly enhanced since the lesser degrees of freedom to apply the adequate taxes, creates both the stimulus and opportunity for these practices.

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<sup>8</sup> Barreix, Alberto and Alvarez, Daniel, “Cambios en el Contexto Internacional y sus Efectos en la Tributación de América Latina y el Caribe”, XIII Regional Fiscal Policy Seminar, ECLAC, Santiago, Chile, 2001.

## CONCLUSIONS

It is clear that the level and distribution of the tax burden affects compliance in a globalized world economy. Higher tax levels tilt the balance that taxpayers consider when confronting costs and benefits before deciding on evasion or avoidance measures. The types of taxes that are used and their incidence also matter since some activities are easier to evade or avoid than others.

As exemplified by the Laffer Curve, taxpayers have different levels of tolerance when confronted with taxes. Increasing tax burdens result in growing aversion and leads to higher non-compliance. This takes the form of evasion and avoidance. Evasion is very much determined by the risk of being caught and the magnitude of the sanctions applied. Tax avoidance is more related to competition and opportunity. What really matters is that both reduce tax revenues and cause a redistribution of the tax burden among the other taxpayers that are unable or unwilling to evade or legally avoid taxes.

With the growing interdependency of economies and rising cross-border activities, the opportunities for both evasion and avoidance are increasing. To mitigate this problem and continue to sustain the desired levels of revenues, countries are changing their tax instruments and this results in the redistribution of the tax burden. Capital is one factor that is being less and less taxed at the expense of labor and consumption. This means that tax systems are becoming less equitable and are promoting more economic distortions. For this reason the quality of the tax systems is deteriorating in most countries.

This doesn't have to be this way. The main reason for the inability of most world economies to deal with this problem (this is being referred to as the "missing tax bases" or the "Fiscal Termites") is that very limited cooperative actions have actually been put in place in this field. International trade is a much older activity, and therefore countries have reached significant agreements on how to regulate it and avoid unfair or predatory competition. Taxation, as a symbol of national sovereignty, has advanced very little and most international agreements are bilateral and limited. The world doesn't have multilateral tax agreements or organizations to establish unified technical standards, promote coordinated

harmonization efforts, significant and automatic exchange of information, and internationally agreed and applied sanctions. We are still in a phase of technical cooperation, natural convergence and limited exchange of information.

Lets hope we can increase our pace and advance more rapidly in a worldwide agreement on tax matters. Otherwise we run the risk of entering the next century limited to collecting poll taxes.

Mr. Luiz Villela  
Tax Specialist, Fiscal Division  
Inter-American Development Bank - IDB  
E-mail: [luizvi@iadb.org](mailto:luizvi@iadb.org)

*Case study:*

*TOPIC 1.2.*

## **RELATIONSHIP BETWEEN THE AMOUNT AND DISTRIBUTION OF THE TAX BURDEN AND TAX COMPLIANCE**

**Carlos Silvani**

Deputy Director

(International Monetary Fund – IMF)

*CONTENTS: I. Introduction.- II. The Impact of Rates on Collection.-  
A. The Laffer Curve.- B. The Impact of Rates on the Collection of  
Income Tax.- C. The Impact of Rates in the Case of Taxes on Foreign  
Trade.- D. The Impact of Taxes in the Case of Cigarette Taxes.-  
E. The Impact of Rates in the Case of the Tax on Alcoholic  
Beverages.- F. The Impact of Rates in the Case of Taxes on Luxury  
Items.- G. The Impact of Rates in the Case of Small Taxpayers.-  
H. Government Expenditures and the Laffer Curve.- I. The Laffer  
Curve and Corruption.- J. Tax Rates and the Level of Tax Evasion.-  
III. Changes in the VAT Rate and Their Impact on the Tax's Yield.-  
IV. Conclusions.*

### **I. INTRODUCTION**

The purpose of this work is to analyze the relationship between tax rates and tax collection. This subject is frequently analyzed and discussed by those responsible for tax policy, particularly when authorities are faced with the need to increase tax revenues. When the need to increase revenues is discussed, the idea of increasing the current tax rates arises immediately. But other questions arise immediately as well. Will tax revenues increase and in what proportion? How will the taxpaying public react to an increase in rates? Will tax compliance decline? Will an increase in rates have an impact on the level of corruption in tax administration?

The answers to these and many other similar questions must be considered when evaluating the option of raising tax rates. In this paper we will review these subjects briefly. First we will discuss in Chapter II the general concepts supporting Laffer's ideas, which are illustrated in the curve that bears his name. Then we will discuss the validity of and empirical evidence for these concepts in terms of income tax, taxes on foreign trade and taxes on cigarettes, alcoholic beverages, and luxury items. We will also analyze the impact of tax rates in the case of small taxpayers, in the level of evasion and the Laffer curve in relation to government spending and corruption.

Secondly, in Chapter II, we will analyze the impact of a variation in the VAT rate in terms of the tax yield, which is defined as the volume of VAT collected as a percentage of Gross Domestic Product (GDP), divided by the VAT rate. To perform this analysis, we selected a sample of countries that have seen changes in the VAT rate over the last decade. Finally, in the last chapter we will summarize some general conclusions.

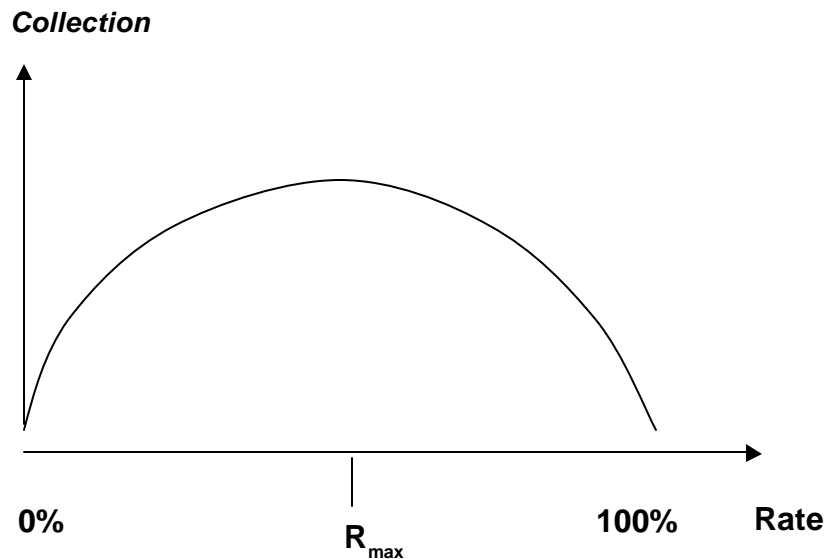
## **II. THE IMPACT OF RATES ON COLLECTION**

### **A. The Laffer Curve**

In the literature on economics there are authors who assert that there is a close relationship between tax rates and tax collection, and that this relationship reaches a point beyond which an increase in the rate results in a loss in taxes collected. This concept is summarized in what is known as the "Laffer curve." The assumption is that an increase in the rate can result in an increase or decrease in collection, depending on the level of the rate. This means that beyond a certain level, a decrease in the rate could lead to an increase in collection. In graphic terms, this concept is summarized in a curve where we see different collection results for different rates between 0 percent and 100 percent (see Graph 1).

According to various sources, Professor Arthur Laffer drew this curve on a napkin to convince President Reagan of the advisability of reducing the tax rate in the United States. According to this curve, maximum collection can be obtained at a specific tax rate level. When tax rates are higher or lower than this level, collection declines.

Figure 1. The Laffer Curve Concept



Laffer was referring to individual income taxes and did not assign values to either the horizontal or vertical axis on this graph. Thus, he did not specify the rate at which collection could be maximized, nor the rate at which collection could fall to 0 (which could certainly be less than a tax rate equal to 100 percent). The assumption behind this curve is that individuals adjust their behavior according to the rate level and it cannot be assumed that an increase in rates will result in an increase in tax revenues. The shape of the Laffer curve implies decreasing returns. This means that an increase in the tax rate is reflected in a proportionally lower increase in taxes collected.<sup>1</sup>

Laffer's original concept maintained that high marginal income tax rates strongly reduced people's incentive to work; thus, reducing income tax rates would encourage people to work more and earn more income, which could result in an increase in tax revenues. Consequently, a reduction in the tax on labor could increase the supply of labor and thus the taxable income derived from that labor. This concept later evolved and was given a broader interpretation. It was maintained that, in addition to what has been indicated above, a reduction in the rate could increase tax collection as a result of reduced incentives for evasion, avoidance and smuggling.

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<sup>1</sup> Ostaszewski, Krzysztof M. (2002).



Although Laffer's ideas were very influential in the industrialized countries in the early 1980s, these concepts are very old. "High taxes, sometimes by diminishing the consumption of the taxed commodities, and sometimes by encouraging smuggling, frequently afford a smaller revenue to the government than what might be drawn from more moderate rates" wrote Adam Smith in his famous book "The Wealth of Nations." Similarly, Dupuit wrote in 1844 that if a tax is gradually increased from 0 to a point where it becomes prohibitive, its collection is nil at the start, later increases in small steps until its maximum point is revealed, after which it declines until collection is again 0.

It should be pointed out that there is no single curve that could represent the relationship between tax collection and the tax rate for all countries. Different countries may have different Laffer curves, depending on many variables including the cultural and historical characteristics of each country and the value that people assign to the services provided by government. In addition, the Laffer curve cannot be considered static but rather it evolves over time according to the evolution of each country's economic circumstances, bearing in mind that human behavior adapts and responds to tax incentives and disincentives. As a result, a short-term Laffer curve could differ significantly from a Laffer curve for the long term.

### **B. The Impact of Rates on the Collection of Income Tax**

This subject became very popular in the 1980s during the Reagan administration when some economists proclaimed that a reduction in tax rates could mean more taxes collected. Following this line of economic thinking, income tax rates in the United States were reduced. However, revenues did not increase but tax deficits did, although this should not be attributed solely to a reduction in taxes. The results of the reforms made it clear that, at least at that time, the United States was not on the descending side of the Laffer curve. In effect, the rates increased again in the early 1990s and as a result the tax deficit disappeared.

Later studies, particularly those associated with the work of Lindsey<sup>2</sup> and Feldstein<sup>3</sup>, led to new theories that, although they follow the spirit of Laffer's theories, are more convincing and are supported by empirical evidence. The principal assumption of these theories is that increases in marginal income tax rates for high-income individuals do not succeed in increasing the collection of taxes paid by these individuals in proportion to the increase in the rates. The assumption is that high rates would not necessarily lead people to work less; they would, however, be a strong incentive for people to look for income that (either legally or in practice) would not be covered by income tax. Research has determined that when there is a change in the tax rate, people can alter their patterns of consumption, but they can also engage in a series of actions to avoid or evade the tax, in order to reduce the tax burden and thus avoid changing their patterns of consumption. This is particularly true in the case of high-income taxpayers. This means that the impact of a rate increase goes beyond consideration of a substitution effect in the labor supply, as originally conceived by Laffer. What is really important, as Slemrod indicates,<sup>4</sup> is to determine the elasticity of taxable income in relation to the tax rate, and not the elasticity of the labor supply in relation to the tax rate. This is the most important question to be examined, because it summarizes much of what we need to know with respect to taxation (See Table 1).

Various econometric studies have been carried out to verify these assumptions in practice. Goolsbee,<sup>5</sup> for example, analyzes the various tax reforms in order to observe the impact of rate changes in terms of taxable income reported by taxpayers. His conclusions confirm that in the tax reform of the 1980s it can be seen that taxable income reported grows at a higher percentage than the reduction in rates (elasticity >1), thus confirming Laffer's hypothesis. However, this conclusion can only be categorically maintained in the highest income brackets, where we also see the highest reductions in the rates.

Nonetheless, the conclusions regarding the tax reform of 1993, when the rates were increased, do not fully confirm what was seen in the reforms in the 1980s. Income reported in 1993 by the one million taxpayers with the highest incomes fell in comparison with income reported in 1992, but at a lower percentage than the increase in the rates established by the tax reform.

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<sup>2</sup> Lindsey, L. (1987).

<sup>3</sup> Feldstein, M. (1986).

<sup>4</sup> Slemrod, J. et al. (2000).

<sup>5</sup> Goolsbee, A. (1999).

## TOPIC 1.2

**Table 1. Number of Income Tax Returns, Total Income and Changes Observed 1/**

Income Bracket	Thousands of Returns	Reported Income (in thousands)	Thousands of Returns	Reported Income (in thousands)	Change in Returns (%)	Change in Reported Income (%)
	1985	1985	1989	1989	1985-1989	1985-1989
30,000 - 40,000	11,635	402,942	12,100	420,231	4.0	4.3
40,000 - 50,000	6,702	297,914	8,590	389,689	28.2	30.8
50,000 - 75,000	5,629	333,710	9,921	594,483	76.2	78.1
75,000 - 100,000	1,263	107,424	3,059	261,107	142.2	143.1
100,000 - 200,000	909	119,200	2,090	276,331	129.9	131.8
200,000 - 500,000	238	68,986	613	179,115	157.6	159.6
500,000 - 1,000,000	41	27,541	116	78,516	182.9	185.1
1,000,000+	17	40,100	68	151,465	300.0	277.7

Source: Internal Revenue Service, Statistics of Income (1985, 1989).

1/ In current dollars.

At any rate, it must be pointed out that any conclusion that one might want to establish regarding this subject is always limited, given that it is very difficult to isolate the “pure” effect of a rate change on reported income. Tax reforms include not only changes in the tax rates, but also other tax changes that go beyond rates. Bear in mind, for example, that the tax reform of 1986 established for the first time that the highest personal income tax rate would be lower than the corporate income tax. The result was that this created an incentive to transfer income from companies so that it would appear to be personal income.

The general conclusion is that, in the United States, according to the successive tax reforms that occurred during the 20th century, changes in income tax rates have resulted in changes in the taxable income that people report. In general, the changes have been proportionally moderately less significant than the rate changes, i.e., elasticity of reported taxable income in relation to rates is moderately less than 1.

On the other hand, some research studies tend to reject the notion of the existence, except in limited cases, of an inverse relationship between an increase in the tax rate and tax collection. Fullerton analyzes the case of the United States in 1982 and concludes that, in this case, general reductions in the tax rates on labor would not lead to an increase in taxes collected.<sup>6</sup> He notes that the Laffer curve could be divided into two parts. The first or “normal” part would be the ascending part of the curve. The second part would be the descending

<sup>6</sup> Fullerton, D. (1982).

or “prohibited” part that would exist because high rates suffocate economic activity, force people to barter, and encourage idleness. His conclusion is that, for 1982, the United States was not in the prohibited part of the curve because the elasticity of the labor supply and the marginal tax rates on labor were both sufficiently low to suggest that a reduction in tax rates on labor would not lead to a reduction in taxes collected. However, he points out that this conclusion does not invalidate the need to reduce taxes and revenues, if this is the general preference of the citizens.

### **C. The Impact of Rates in the Case of Taxes on Foreign Trade**

Most of the observations made up to this point referred primarily to income tax. We will now discuss some empirical evidence concerning taxes on foreign trade. An interesting study by Fisman and Wai<sup>7</sup> analyzes the relationship between import tax rates and tax evasion in the case of China. The approach to the subject is very interesting because it compares the figures for imports coming from Hong Kong as reported by China with the figures reported by Hong Kong for exports to China. The study analyzes data broken down by product, which makes it possible to reach conclusions on evasion or smuggling in terms of the various tax rates. The results are very revealing. The researchers found that the “evasion gap,” detected based on discrepancies between the figures reported for China’s imports from Hong Kong and the figures for exports from Hong Kong to China, correlates highly to the level of tax rates on imports (import duties + VAT). On average, the study concludes that an increase of 1 percent in the tax rates would be associated with an increase of 3 percent in evasion, which can take the form of undervaluation of the merchandise declared as imports, false identification of merchandise or simply smuggling. The relationship seen is not linear, and the elasticity of evasion would be higher at higher tax levels (See Table 2).

These relationships are maintained both when import duties are considered alone and when they are considered together with the VAT paid on imports. In conclusion, the results suggest that in China import tax rates are probably already on the descending side of the Laffer curve and any increase in the rates could produce a reduction in revenues instead of an increase. Even more, a reduction in the rates could lead to an increase in revenues from taxes on imports.

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<sup>7</sup> *Fisman et al. (2001).*

## TOPIC 1.2

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**Table 2. Effect of Rates on Foreign Trade and Tax Evasion: The Case of China  
(In figures)**

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Sensitivity 1/	2.82	2.59	3.08	2.85	2.76	2.78	3.44
Number of observations	2,043	1,974	1,760	1,368	1,710	1,337	1,16

1/ Estimate of the sensitivity of evasion to rates. In column (1) estimated sensitivity is 2.82. This means that if the rate increases one percentage point, the difference between imports and exports declared increases by approximately 3 percent. The remaining columns show the results for different groups of products.

The conclusions discussed above for China are also confirmed in Indonesia. In a study conducted by the University of Indonesia,<sup>8</sup> the same conclusion is reached: there is a high correlation between the level of taxes imposed on imports and the undervaluation of imported merchandise. However, in the case of Indonesia, the research is more limited and no precise quantitative relationship can be established between the level of import taxes and the undervaluation of merchandise.

### **D. The Impact of Taxes in the Case of Cigarette Taxes**

The relationship between the tax rate and tax collection become particularly significant in the case of specific taxes on cigarettes. Given that it is relatively easy to collect them and they are an important potential source of revenue, when faced with the need to increase revenues, governments often resort to increasing the rates. However, this can result in an increase in smuggling and consumption of counterfeit goods. In the case of Brazil, for example, according to figures published by the Ministry of Health, between 20 and 30 percent of the cigarettes consumed in 1998 came from the informal or “black” market and a high proportion of these were counterfeit.

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<sup>8</sup> *Cost Analysis and Benefit of the Change of the Import Risk Management System Towards Pre-Shipment Inspection,*” (2000) Public and Economic Investigation Institute Economic Faculty, Indonesian University.

As indicated earlier, the relative importance of taxes on tobacco is considerable, given that they represent approximately 2 to 4 percent of total tax revenues (See Appendix I). Although this range varies by country, in general terms it can be said that the relative importance of specific taxes on tobacco is higher in middle- or low-income countries. As for the potential impact of a rate increase on the collection of taxes, Sunley<sup>9</sup> made a tentative estimate of the increased collections that could result if the specific taxes on cigarettes were increased by 10 percent in a group of 70 countries. Assuming that in the medium- and low-income countries the consumption of cigarettes falls by a percentage close to the percentage increase in the price of cigarettes (elasticity  $-0.8$  for medium- and low-income countries and  $-0.4$  for high-income countries), he concludes that the increased collection could average about 7 percent. However, he warns that, depending on the price of cigarettes, we could eventually see a Laffer-type curve where after a certain point an increase in the tax could lead to a more than proportional reduction in demand, the result of which would be a decrease in revenues. It should be pointed out that in theory this decline in tax collections would not occur if the demand for cigarettes is sufficiently inelastic with respect to their price, as some authors maintain. Nonetheless, there would be a decline in taxes collected if tax and customs administration is not sufficiently effective to control smuggling and evasion when tax amounts exceed certain limits and create excessively high income for illegal activities. Some estimates of illegal trade in cigarettes<sup>10</sup> calculate that at least one-third (33 percent) of cigarettes “in transit” disappear and are diverted to illegal trade. This could mean that approximately 6 percent of the total number of cigarettes consumed in the world are smuggled. This study also indicates that the level of corruption in a country is even more important than the tax rate on tobacco as a determinant of smuggling.

In the Ukraine, prior to the introduction of the 1996 reform, the rates of the specific tax on cigarettes were 150 percent of customs value for imported cigarettes, 40 percent of the ex-factory price for filtered cigarettes produced in the country and 10 percent for unfiltered cigarettes produced in the country. The purpose of the reform was to encourage the production of low-cost domestic cigarettes to compete with the more recognized brands that held more than 90 percent of

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<sup>9</sup> Sunley, E., *et al* (2000).

<sup>10</sup> Joosens, L. *et.al*.

the market. The result was very low tax collection, caused by increased evasion, underreporting of customs value and smuggling. As a result, reforms were later introduced that definitively meant a reduction in the tax burden, and this is credited with reducing the percentage of cigarettes sold on the black market, which fell from 40 percent in 1996 to 15 percent in 1998. When adjusted for inflation, tax revenues from taxes on cigarettes increased by more than 500 percent between 1995 and 1999 and the collections on the VAT paid by cigarette manufacturers grew by 200 percent between 1996 and 1999.<sup>11</sup> In Russia, the reforms introduced and the experience were similar although less eloquent than in the case of the Ukraine. The increase in collections was on the order of 75 percent between 1995 and 1999.

#### **E. The Impact of Rates in the Case of the Tax on Alcoholic Beverages**

With taxes on alcoholic beverages, something similar happens as in the case of taxes on cigarettes: taxes that are too high can lead to a loss in taxes collected due to increased evasion and smuggling.

The case of England is discussed in a recent study<sup>12</sup> that concludes that the increase in tax rates on alcoholic beverages has led to a decline in collection. This is explained both by increased smuggling (particularly from France, where taxes are lower) as well as purchases of these products outside the borders of England. Taxes on alcoholic beverages currently represent about 60 percent of the retail sales price of liquor and about 42 percent of the retail sales price of beer and wine. The agency responsible for collecting the specific taxes on alcoholic beverages in England has estimated that in 1996 cross-border purchases meant a loss in revenues of 190 million pounds sterling, while smuggling of alcoholic beverages represented some 195 million pounds sterling, equal to 4 percent of the taxes on these products for the VAT and specific taxes. It should be pointed out that during the last five years the consumption of alcoholic beverages in England has increased, while the collection of taxes on these beverages has declined. The study concludes that a reduction in the rates could have a positive effect on tax collection in the medium term.

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<sup>11</sup> *International Tax and Investment Center (2000).*

<sup>12</sup> *International Conference on Excise Tax Policy and Administration, Research Centre for Economic and Financial Policy (OCFEB) of Erasmus University Rotterdam, University of Maastricht and the International Tax and Investment Center (Ministry of Finance, The Hague, The Netherlands: April 11–12, 2002).*

**F. The Impact of Rates in the Case of Taxes on Luxury Items**

The empirical evidence seen in some countries regarding the tax on luxury items also confirmed the idea that high tax rates can result in losses in taxes collected. In the United States, for example, starting in the year 1991, a 10 percent tax was established on certain goods considered luxury items.<sup>13</sup> The tax was imposed on the initial retail sale of autos, boats, airplanes, furs and jewelry if their value exceeded certain limits. The tax taxed at a rate of 10 percent the amount in excess of US\$30,000 for autos, US\$100,000 for recreational boats, US\$250,000 for airplanes (when their commercial use was less than 80 percent) and US\$10,000 for furs and jewelry. The lawmakers determined that only these five types of goods were affected by the “luxury tax” and, to simplify administration, items such as electronics were not subject to the tax. It goes without saying that the industries affected by the tax were highly critical of it. Their criticisms not only referred to the impact the tax could have on the demand for their products but also to the fact that the tax left them at a relative disadvantage compared to other industries. The result was a decline in the level of activity in the industries producing these goods. In the case of the recreational boat industry, the Labor Department estimated that the workforce in these industries in the State of Florida fell by 30 percent as a result of the decline in the level of activity. In summary, the luxury tax resulted in a reduction in state and federal taxes collected on the sale of these items.<sup>14</sup> In 1993, the federal “luxury” tax was repealed with the exception of the tax on passenger vehicles, which was significantly reduced. Starting on January 1, 2002, the vehicle tax is imposed at a rate of 3 percent on the value in excess of US\$40,000.

**G. The Impact of Rates in the Case of Small Taxpayers**

As we know, tax compliance is determined not only by the rate of taxes but depends on many other variables as well. To a large extent, the other variables are related to the effectiveness of tax administration, i.e., the likelihood that evasion will be detected and effectively punished. In the United States, the Internal Revenue Service estimates that income tax non-compliance among salaried employees is less than 1 percent while the average is about 18 percent in other groups. However, in the case of the self-employed or single person companies, average non-

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<sup>13</sup> *Omnibus Budget Reconciliation Act (1990).*

<sup>14</sup> *DiRe, E. (1991).*



compliance is about 40 percent. The disparity in compliance in this case has to do with the likelihood of detection and punishment of evasion by the tax administration and cannot be explained by the level of tax rates. Nonetheless, a study conducted with a sample of 9,000 relatively low-income taxpayers (reported income in 1988 of less than US\$52,000), which includes as a variable the likelihood that taxpayers will be audited, proves that evasion is sensitive to rates.<sup>15</sup> When the behavior of the taxpayers in the sample is analyzed, tax non-compliance grows from a minimum of 39 percent for the lowest rates to a maximum of 72 percent for the highest rates. It should be noted that the likelihood that a taxpayer will be audited that the study considers is the “objective” likelihood of being audited, i.e., the number of taxpayers audited compared to the total number of taxpayers with similar characteristics. In the groups of small taxpayers studied, the likelihood of being audited was approximately 5 percent, with slight variations for each of the different taxpayer groups according to the type of income reported. The methodology used is an approximation of what could be an ideal model, which should not take into account the “objective” likelihood that a taxpayer will be audited, but rather the likelihood of being audited as “perceived” by the taxpayers. Obviously, the objective likelihood can be quite different from the perceived likelihood. However, a taxpayer’s behavior will be determined by the taxpayer’s perceived likelihood of being audited.

#### **H. Government Expenditures and the Laffer Curve**

Although the theoretical concept of the Laffer curve only relates to the potential revenue that could be obtained for each tax rate, it cannot be considered in isolation. In practice, rates alone do not determine the amount of tax revenue; government use of those funds is also a determining factor. In other words, tax collection also depends on the make-up of government expenditures. This is due not only to taxpayers’ potential predisposition to paying their taxes according to whether they feel the resources collected will be put to good use or poor use (wasted), but also to the different macroeconomic impact of government expenditures, depending on whether they are consumer expenditures or capital expenditures.

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<sup>15</sup> Joulfaian, D., et al. (1996).

Thus, the nature of government expenditures could also determine the shape of the Laffer curve. Some authors indicate that the downward part of the curve (when a rate increase decreases tax revenue) occurs when government expenditures take the form of money transfers to persons.<sup>16</sup> Assuming that the government follows a balanced budget policy, if the revenue collected from an increase in income tax rates is used to grant consumer subsidies, that measure will offset (counteract) the income effect produced by an increase in the income tax rate. Accordingly, with rate increases, the labor supply will drop; this means that at some point, the downward slope of the Laffer curve would be reached, where there is an inverse relationship between the rate change and the change in tax revenue.

However, the downward part of the curve would not exist if tax revenue were used to provide public goods and make capital expenditures. That is because the income effect produced by an increase in the income tax rate, in general, would not be offset by the utility effect of the provision of a public good financed with the taxes collected through a rate increase. In other words, when the funds from a rate increase are used to provide a public good, the income effect would not be offset. This in turn would prevent a drop in the labor supply; therefore, in this case, there would be no downward part to the Laffer curve.

Therefore, conceivably one might wonder whether the drop in revenue in the United States from lowering tax rates in the 1980s can be explained in part as a consequence of the changes made in that period to the make-up of expenditures.

### **I. The Laffer Curve and Corruption**

The level of corruption in the tax administration could also affect the shape of the Laffer curve. In a tax administration with a high degree of corruption, a rate increase would trigger a reaction among taxpayers and tax administrators that could decrease tax revenue.<sup>17</sup> For corrupt employees in such a tax administration, a higher tax rate represents the possibility of negotiating a larger bribe. Furthermore, taxpayers who are taxed at a higher rate have greater incentive to evade the tax. The net effect of these administrator and taxpayer reactions to an increase in the tax rate could be lower revenue. What's more, in an administration with a high degree of corruption, an increase in auditing could also lead to a drop in revenue.

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<sup>16</sup> *Gahvari, F. (1989).*

<sup>17</sup> *Sanya, A. et al. (2000).*

The findings of rigorous research conducted in one country on the impact of audits on taxpayers' attitude towards evasion were very revealing. After analyzing the responses that audited taxpayers gave to a survey, the conclusion was reached that it was more advisable to suspend all audit activity (of course, the survey was designed and conducted so as not to reveal the purpose of the research to the respondents). According to the research findings, instead of improving taxpayers' attitude regarding evasion, the audits worsened it. Audited taxpayers reported that the auditor detected only a small fraction of the evasion, for which they generally paid a bribe; so the penalty actually paid for evasion was extremely light. As a result the perception that audited taxpayers had of the tax administration after an audit was significantly worse; therefore their incentive to comply fell. In such a situation, it is advisable to suspend audit activity until it can be reorganized. Otherwise, an increase in audit activity, if not restructured, could lead to deterioration in taxpayer compliance.

The general conclusion is that, in a context of high corruption, there are a wide variety of situations that could lead to a loss in revenue in response to rate increases, and a rate cut could possibly increase revenue.

## **J. Tax Rates and the Level of Tax Evasion**

Feinstein performs an econometric analysis of this topic with data on taxpayer compliance for income tax in the United States in 1982 and 1985 and concludes that the probability and magnitude of evasion rise as income tax rates increase. However,<sup>18</sup> it is difficult to completely isolate the effect of rates from the effect that the income bracket could have on evasion, since the two variables are closely associated. Increased evasion could be the result of an increase in persons' income, not just an increase in the tax rate. Propensity towards evasion is also determined by socio-economic characteristics. For example, empirical evidence indicates that individual entrepreneurs and farmers evade taxes more than the average taxpayer.

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<sup>18</sup> Feinstein, M. (1991).

Allingham and Sandmo's<sup>19</sup> classic theoretical analysis of income tax evasion concluded that the government has the following three tools at its disposal to combat evasion: rates, penalty rates, and the resources earmarked for audits, which determine the probability of an evader being detected. The efficiency of each of these tools is not clearly defined, but increased or intensive use of one tool could somehow be offset by less vigorous use of another.

In the case of the VAT,<sup>20</sup> a study of 20 countries concluded that it is not possible to state that a higher rate corresponds to increased evasion. In addition, the broad differences observed in percentages of evasion by economic sector,<sup>21</sup> even though the same VAT rates applied, bolsters this conclusion. This could be an indication that sound tax administration could overcome the disincentives to voluntary compliance created by high rates. Indeed, there is an inverse correlation between the level of development of the countries and the level of evasion. For the VAT, the size of the tax base was a more important determinant of compliance than the rate level. The larger the base and the lower the exemptions are, the higher the level of compliance.

In conclusion, the effectiveness of the tax administration appears to be one of the most important determinants of evasion. A study that analyzes data from 17 OECD countries<sup>22</sup> argues that, in general, higher VAT rates correspond to higher levels of evasion. However, the level of evasion would also be determined by the amount of resources allocated to the tax administration, and an increase in those resources could reduce evasion. An increase of US\$1 in the administration's expenditures could yield a US\$12 increase in revenue collected. In the case of Chile, for every additional US\$1 spent on VAT audit-related activities, there could be a US\$31 jump in VAT revenue.<sup>23</sup>

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<sup>19</sup> Allingham, *et al.* (1972).

<sup>20</sup> Silvani, C. *et al.* (1993).

<sup>21</sup> *Estadísticas Tributarias* (1998).

<sup>22</sup> Agha, *et al.* (1996).

<sup>23</sup> Engel, E. *et al.*

## II. CHANGES IN THE VAT RATE AND THEIR IMPACT ON THE TAX'S YIELD

The purpose of this section is to analyze whether there is any relationship between changes in VAT rates and changes in the tax's yield. The yield of the tax is defined as the amount of VAT collected as a percentage of gross domestic product (GDP), divided by the VAT rate.<sup>24</sup> In other words, the yield of the VAT is VAT revenue as a percentage of GDP obtained for each percentage point of the VAT rate.

To analyze the relationship between rate changes and VAT yield, we have selected 20 countries that changed their VAT rate after 1993 – except Chile, where we consider rate changes made at the end of the 1980s, because that country experienced a drop followed by a rise in VAT in that period that would be desirable to analyze. The results of the analysis are only tentative and indicative of general trends, because the information available is limited, which restricts the validity of the conclusions.

The first simplification will be calculating VAT yield with respect to its "general rate." Since most countries have more than one VAT rate, it would have been ideal to have calculated a rate representing the weighted average of the rates, but this is not possible, because the necessary data are not available. The second simplification will be calculating yields assuming that the tax base has not changed. Obviously, if there were other changes in the tax base in addition to the rate change, this could have had an impact on the tax's revenue and hence on its yield.<sup>25</sup> Nonetheless, according to the experience acquired in the countries, such cases would have only had a marginal impact. Therefore, despite the limitations indicated, we believe the conclusions are generally valid.

Table 3 presents data from the selected countries in four groups. The first group, made up solely of Chile, presents data for the case of a drop in the general VAT rate. No other examples could be included in this group, because very few countries have lowered their VAT rate and have adequate data available. The second group includes

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<sup>24</sup>  $VAT\ yield = (VAT\ revenue/GDP)/rate.$

<sup>25</sup> *In addition to the change in the VAT tax base, other changes could affect its yield. Therefore, this section's conclusions are valid assuming that only the VAT rate has changed and that the remaining characteristics remained constant.*

countries that raised the VAT rate by one percentage point. The third group contains countries that had a VAT rate increase equal to or greater than two percentage points, but equal to or less than three percentage points. Group four includes countries with general VAT rate increases over three percentage points. For each country, the first columns indicate the base year for the calculation, the general VAT rate, VAT revenue as a percentage of GDP, and the tax's yield for the base year. The same data are also included for the new year after the change in the VAT rate, which is used as the new basis for the calculation. The data considered correspond to a full year after the new VAT rate was introduced, in order to fully detect the impact of the rate change.

Finally, the last columns present the changes observed in the tax's yield, indicating the averages for each group of countries. Table 4 and Charts 2 and 3 also present data on the impact of VAT rate changes on its yield.

Analysis of the data shows that a change in the VAT rate has an impact on yield. Roughly 57 percent of the variance in the change in the tax's yield is the result of rate changes. On average, for each percentage point that the VAT rate increases, yield falls 0.0136 in absolute terms and 3.6 percent in relative terms (see Appendix II).

Although these conclusions make it possible to state that, other things being equal, an increase in the VAT rate will lower the tax's yield, the variation is relatively small. Therefore, notwithstanding the foregoing, when faced with the need to increase tax revenue it might be advisable to increase the VAT rate, because of the resulting increase in revenue in absolute terms.

Conversely, although lowering the VAT rate would increase yield, it would also result in an immediate drop in revenue. Only if the rate is extremely high could a rate cut increase revenue. Nonetheless, there is no empirical evidence indicating that once the VAT rate reaches a certain level an increase could result in lower tax collection. For example, countries like Denmark and Sweden have VAT rates of 25 percent applied over a very large tax base, yet they still probably record the lowest levels of evasion in the world.

**Table 3. Changes in the VAT Rate and Their Impact on Yield 1/**

	Base year calculation				New rate calculation			Effects on productivity			
	Base year	Standard VAT rate (base rate)	VAT Rev/ GDP 1/	Revenue productivity ratio 2/	Year of rate change	Standard VAT rate (new rate)	VAT revenue/ GDP 1/	Revenue productivity ratio 2/	VAT rate change	Change in productivity	Change in productivity (percent)
<b>Group 1 (reduction in rate)</b>											
Chile (i)	1987	20	8.3	0.43	1989	16	7.8	0.48	-4	0.046	9.0
<b>Group 2 (rate increase 1%)</b>											
Belgium	1995	20	6.8	0.35	1997	21	6.9	0.34	1	-0.011	-3.0
Germany	1997	15	3.3	0.22	1999	16	3.4	0.21	1	-0.009	-4.3
Kenya (ii)	1997	15	5.6	0.37	1999	16	5.7	0.36	1	-0.015	-4.1
Norway	1996	22	8.7	0.40	1999	23	9.3	0.40	1	0.009	2.2
Portugal	1995	16	7.4	0.46	1997	17	7.6	0.45	1	-0.016	-3.5
Spain	1996	15	4.4	0.29	1999	16	4.6	0.29	1	-0.004	-1.4
Turkey	1996	15	5.0	0.34	1999	16	5.3	0.33	1	-0.007	-2.1
Uruguay	1994	22	5.3	0.24	1996	23	5.9	0.26	1	0.015	6.0
Group average	17.4	5.8	0.33			18.4	6.1	0.33	1.0	-0.005	-1.3
<b>Group 3 (rate increase 2 to 3%)</b>											
Chile (ii)	1989	16	7.8	0.48	1991	18	8.1	0.46	2	-0.020	-2.1
Colombia	1995	14	4.1	0.29	1997	16	4.8	0.30	2	0.010	3.4
Dominican Rep.	1994	6	2.6	0.43	1996	8	2.5	0.32	2	-0.111	-25.9
France	1994	19	7.5	0.40	1996	21	8.0	0.39	2	-0.013	-3.3
Jamaica	1996	13	4.9	0.39	1999	15	6.3	0.42	2.5	0.026	6.7
Argentina	1994	18	6.8	0.20	1996	21	6.9	0.19	3	-0.016	-12.1
El Salvador	1994	10	4.9	0.49	1996	13	5.9	0.45	3	-0.037	-7.7
Guatemala	1996	7	3.6	0.51	1999	10	4.6	0.46	3	-0.053	-10.3
Group average		12.8	5.3	0.40		15.2	5.9	0.37	2.4	-0.027	-6.4
<b>Group 4 (rate increase over 3%)</b>											
Costa Rica (i)	1994	8	4.0	0.50	1996	15	5.5	0.37	7	-0.129	-26.0
Costa Rica (ii)	1995	10	4.1	0.41	1997	15	5.2	0.35	5	-0.068	-16.5
Honduras 3/	1997	7	3.8	0.54	1999	12	6.1	0.51	5	-0.033	-3.8
Mexico	1994	10	2.7	0.27	1996	15	2.9	0.19	5	-0.081	-29.9
Nicaragua	1994	10	2.9	0.29	1996	15	2.9	0.19	5	-0.096	-33.4
Group average		9.0	3.5	0.40		14.4	4.5	0.32	5.4	-0.082	-21.9

IMF Sources: FAD, Tax Policy Division, World Economic Outlook, Government Finance Statistics, Recent Economic Development reports.

1/ Calculations were based on a full year after new rate was introduced.

2/ Revenue Productivity = (VAT Revenue/GDP)/VAT Rate.

Table 4. Changes in VAT Rates and Its Effect in Productivity 1/ 2/

Country	Change in the VAT Rate	Change in productivity (percent)	Change in productivity (value x 100)
Chile (i)	-4	9.0	3.9
Belgium	1	-3.0	-1.1
Germany	1	-4.3	-0.9
Kenya (ii)	1	-4.1	-1.5
Norway	1	2.2	0.9
Portugal	1	-3.5	-1.6
Spain	1	-1.4	-0.4
Turkey	1	-2.1	-0.7
Uruguay	1	6.0	1.5
Chile (ii)	2	-2.1	-1.0
Colombia	2	3.4	1.0
Dominican Rep.	2	-25.9	-11.1
France	2	-3.3	-1.3
Jamaica	2.5	6.7	2.6
Argentina	3	-12.1	-4.5
El Salvador	3	-7.7	-3.7
Guatemala	3	-10.3	-5.3
Costa Rica (ii)	5	-16.5	-6.8
Honduras 3/	5	-3.8	-3.3
Mexico	5	-29.9	-8.1
Nicaragua	5	-33.4	-9.6
Costa Rica (i)	7	-26.0	-12.9

IMF Sources: FAD, Tax Policy Division, World Economic Outlook, Government Finance Statistics, Recent Economic Development reports.

1/ Calculations based on one full year after the change in the VAT rate was introduced.

2/ Productivity = (VAT revenue / GDP) / VAT rate.



Figure 2. VAT Rate Changes and its Effect on Productivity (in percent)

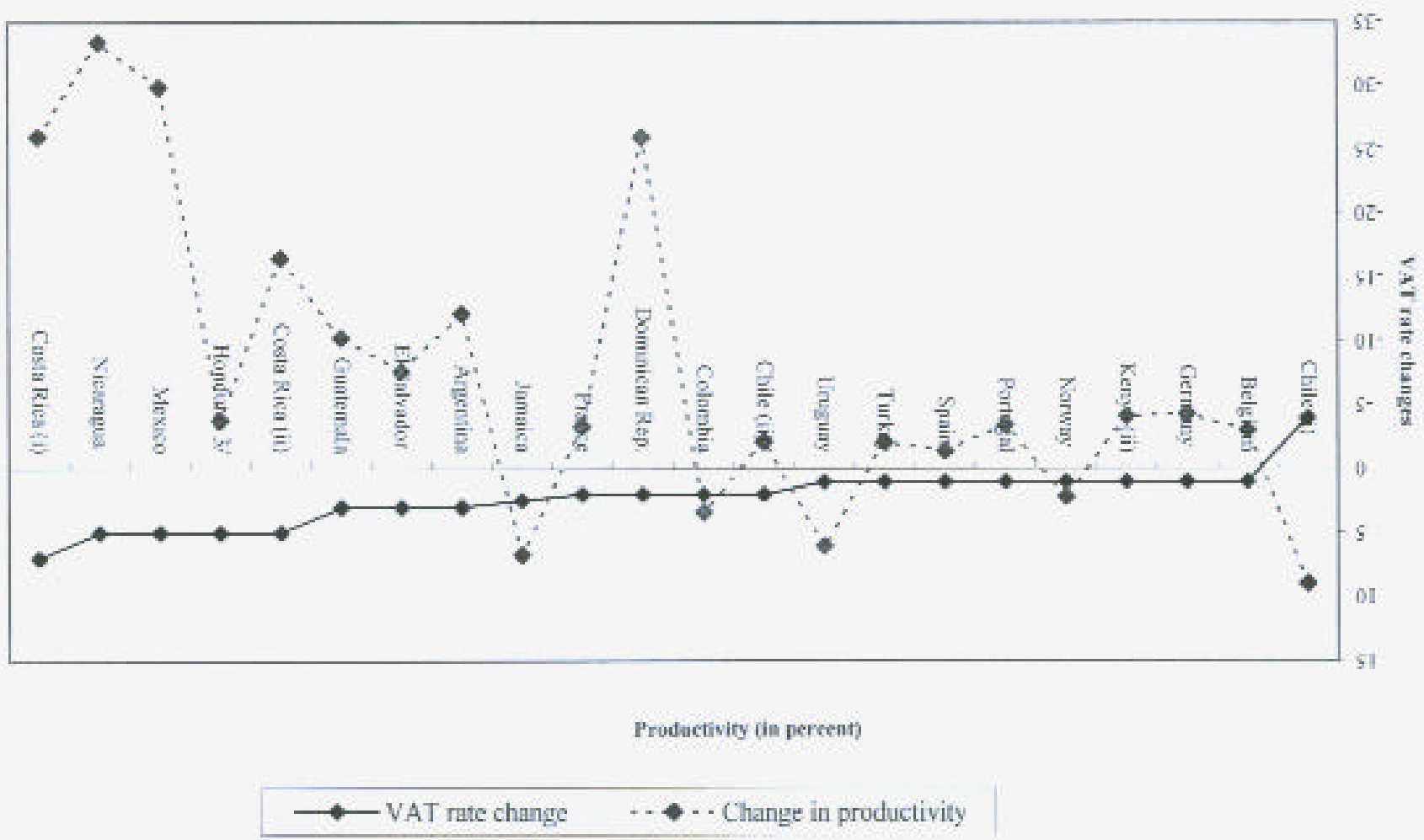
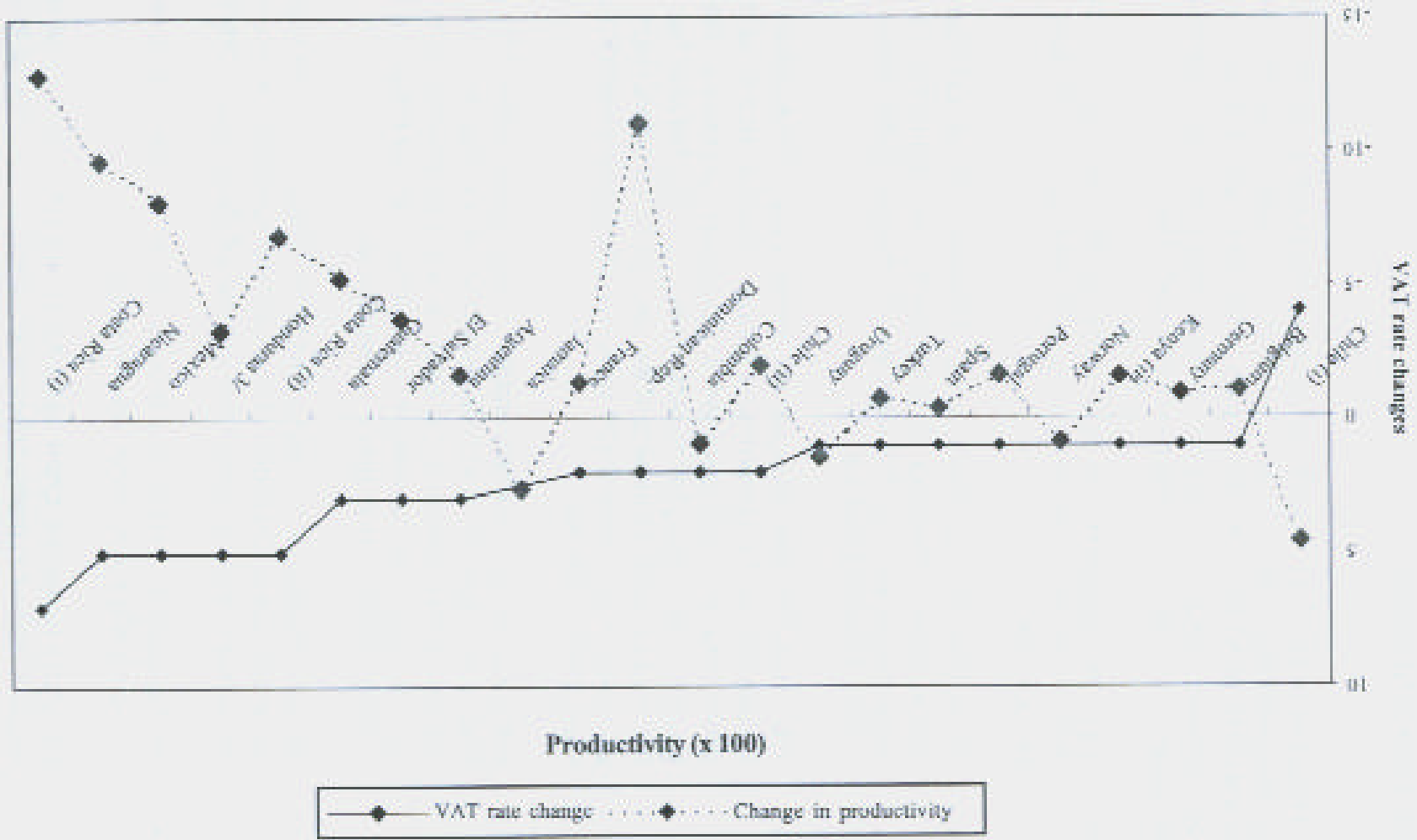


Figure 2. VAT Rate Changes and Its Effect on Productivity



#### IV. CONCLUSIONS

This paper examines the relationship between tax rates and their impact on tax collection. Categorical statements cannot be made, because it is very difficult to separate the impact of the rate level or a rate change on revenue, since tax revenue is also determined by many other variables. However, it is possible to conclude that:

- Tax rates have diminishing returns. In other words, an increase in the rate results in an increase in revenue that is less than proportional.
- In the case of the United States, lowering income tax rates did not increase revenue. Furthermore, rate increases led to increases in revenue that were less than proportional, particularly in high-income brackets.
- The impact of rate changes on revenue cannot be observed in isolation. How the government spends revenue also impacts tax collections, not only because of taxpayers' perception that the government is using tax revenue well or poorly, but also because the macroeconomic impact of the expenditures differs depending on whether the government executes consumer expenditures or capital expenditures.

An increase in the tax rate would produce an increase in revenue that is less than proportional. However, if the rate increase and the respective revenue increase is used to finance consumer expenditures, the increase in revenue will be lower than if it were used to finance investment expenditures.

- In a tax administration with a high level of corruption, an increase in the tax rate could reduce revenue, because it raises incentives for evasion and increases the income of the corrupt persons.
- In the case of China and Indonesia, an increase in taxes on foreign trade could lower tax revenue.
- Cigarette taxes are often used as an important source of revenue; however in many cases rate increases were found to lower tax revenue.

- A similar trend is exhibited for taxes on alcoholic beverages. In many cases, rates that are too high have resulted in a drop in revenue, because they have made evasion and smuggling exceedingly profitable.
- The experience observed in the United States with respect to the tax on luxury articles was negative. It eliminated practically all of these, because of the drop in recorded sales of taxable products and the negative impact this had on the collection of other taxes.
- The impact of rates is also observed among small taxpayers; tax evasion in that group rises clearly along with rate levels.
- In general, a clear correlation cannot be found between the VAT rate level and evasion. The size of the VAT base and the effectiveness of the tax administration would be more important determinants of VAT evasion.
- Changes in the VAT rate have an impact on the yield of the tax, which is defined as VAT revenue as a percentage of GDP, divided by the VAT rate. An increase in the tax's rate would result in a relatively small drop in yield. Therefore, since an increase in the VAT rate would increase revenue in absolute terms, when there is a need to increase tax revenue it might be advisable to increase the VAT rate, even though its yield would fall.
- Even though a drop in the VAT rate could increase yield, it would produce an immediate reduction in tax revenue.



## APPENDIX II

### Specific Tax on Tobacco, by Country

#### Revenue from the Specific Tax on Tobacco

	As a percentage of total tax revenue	As a percentage of specific tax revenue
<b>High income</b>		
Australia	3.38	28.00
Austria	0.16	2.58
Denmark	2.03	18.84
Finland	2.03	12.26
France	0.37	5.18
Germany	1.38	11.89
Japan	0.02	0.34
Korea	3.46	27.54
Holland	1.44	21.30
Norway	1.76	10.37
Spain	2.37	24.69
Sweden	1.63	12.23
Switzerland	1.69	73.61
England	3.23	25.38
United States	0.44	12.50
<b>Upper middle income</b>		
Argentina	4.34	36.89
Brazil	7.37	66.23
Chile	4.10	40.82
Croatia	0.82	6.76
Greece	8.69	35.31
Hungary	0.02	0.21
Mexico	1.41	13.10
San Marino	3.35	10.58
Poland	3.26	28.27
South Africa	1.15	22.38
Uruguay	2.64	23.27
<b>Lower middle income</b>		
Bulgaria	3.63	36.58
Colombia	0.91	17.73
Costa Rica	1.58	12.67
Egypt	1.34	6.58
Estonia	1.29	14.87
Indonesia	3.38	68.57
Lithuania	0.16	1.42
Romania	0.20	4.73
Turkey	0.21	1.90
Venezuela	2.30	56.93
<b>Low income</b>		
China	2.79	15.22
India	2.43	6.53
Kenya	0.09	0.63
Nepal	6.37	75.68
Pakistan	0.11	0.43
Zambia	0.04	0.23
Zimbabwe	1.17	22.81

Sources: Unpublished data, IMF, PAHO, World Bank study on tobacco, and Sunley et al. (2000).

TOPIC 1.2

Regression 1: Change in Yield (%) with Respect to the Change in the VAT Rate

Dependent Variable: LPROD

Method: Least Squares

Date: 04/17/02 Time: 07:39

Sample: 1 22

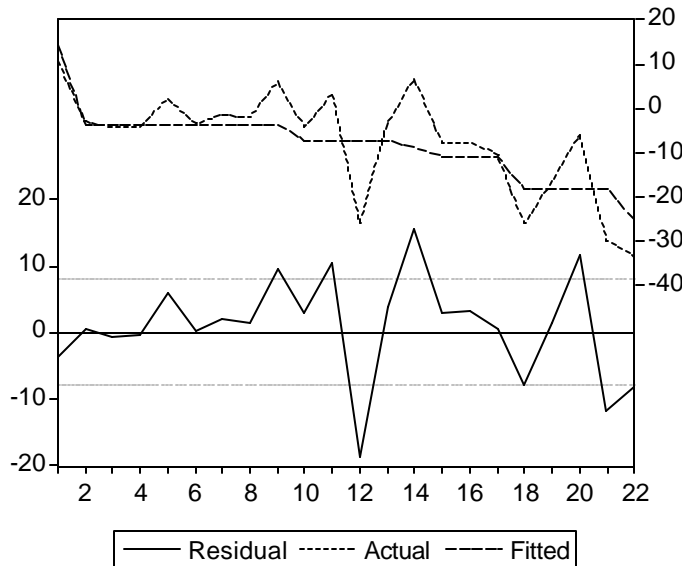
Included observations: 22

Variable	Coefficient	Std. Error	t-Statistic	Prob.
VAT	-3.602475	0.530444	-6.791431	0.0000
R-squared	0.565269	Mean dependent var		-7.313636
Adjusted R-squared	0.565269	S.D. dependent var		11.99362
S.E. of regression	7.907888	Akaike info criterion		7.017988
Sum squared resid	1313.229	Schwarz criterion		7.067580
Log likelihood	-76.19786	Durbin-Watson stat		2.125179

Approximately 56 percent of the variance in the change in yield is due to changes in the VAT rate. The variable is very significant.

On average, for each percentage point the VAT rises (in absolute terms) the tax's yield falls 3.6 percent.

The adjustment is reasonably good. The greatest deviations were the cases of the Dominican Republic, Jamaica, and Mexico.



Regression 2: Change in Yield (in Absolute Terms x 100) with Respect to the Change in the VAT Rate

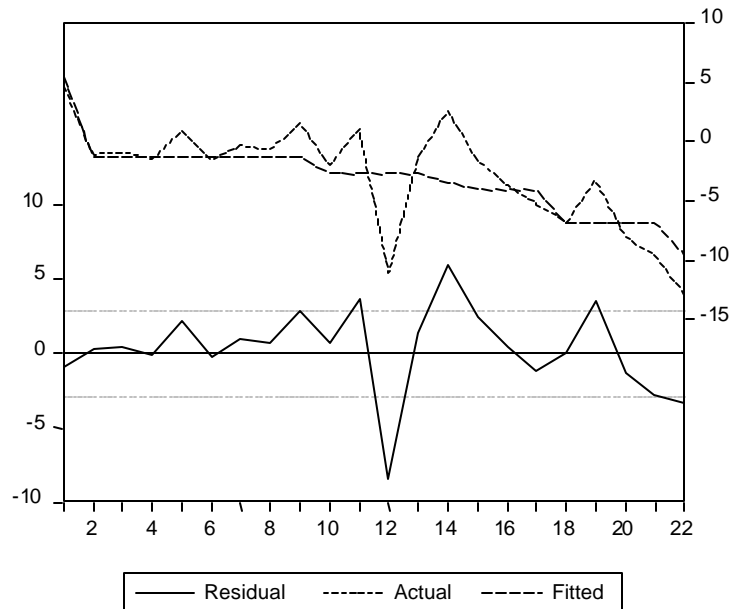
Dependent Variable: PROD  
 Method: Least Squares  
 Date: 04/17/02 Time: 07:40  
 Sample: 1 22  
 Included observations: 22

Variable	Coefficient	Std. Error	t-Statistic	Prob.
VAT	-1.366029	0.195993	-6.969800	0.0000
R-squared	0.576368	Mean dependent var		-2.786364
Adjusted squared	R-0.576368	S.D. dependent var		4.489172
S.E. of regression	2.921868	Akaike info criterion		5.026712
Sum squared resid	179.2835	Schwarz criterion		5.076305
Log likelihood	54.29383	Durbin-Watson stat		1.984481

Approximately 57 percent of the variance in the change in the yield of the VAT, in absolute terms, is due to changes in the VAT rate. The variable is very significant.

On average, for each percentage point the VAT rises (in absolute terms), the tax's yield falls 0.0136 (in absolute terms).

The adjustment is reasonably good. The greatest deviations were the cases of the Dominican Republic and Jamaica.







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TOPIC 1.2

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Mr. Carlos Silvani  
Assistant Director  
International Monetary Fund  
E-mail: [csilvani@imf.org](mailto:csilvani@imf.org)

*Case Study:*

*TOPIC 1.3*

## **COOPERATION OF BUSINESS AND PROFESSIONAL ORGANIZATIONS**

**William V. Baker**  
Assistant Commissioner  
Canada Customs and Revenue Agency  
(Canada)

*CONTENTS: Introduction.- Background.- Objectives of interacting with business and professional organizations.- CCRA Initiatives to improve compliance.- Fostering Relationships.- Responsible Enforcement.- Conclusion.*

### **INTRODUCTION**

The main theme of the 36<sup>th</sup> CIAT General Assembly is Opportunities For Improving Tax Compliance Through Interaction And Cooperation. The purpose of this paper is to discuss the many important ways in which a tax administration can interact and cooperate with business and professional organizations to improve compliance. As such cooperation has been an integral part of the Canada Customs and Revenue Agency's (CCRA) compliance strategy for many years, I will also share some of our own experiences in this regard.

## **BACKGROUND**

No other public organization touches the lives of more Canadians on a daily basis than the CCRA. Of all the public interactions with the Government of Canada, it is the CCRA that is most frequently contacted. Our ability to manage this relationship wisely and achieve healthy and sustainable levels of compliance with tax, trade, and border laws is a critical factor in shaping public attitudes toward the government in general. Our corporate values of integrity, professionalism, respect, and co-operation guide us in our dealings with Canadians and in our partnerships with others.

Our responsibilities include revenue collection; the administration of tax laws for the Government of Canada and for most provinces and territories; customs services at the border; the administration of international trade legislation; and the delivery of various social and economic benefit programs. In fulfilling these responsibilities, we service hundreds of thousands of Canadians and visitors to our country every day.

The CCRA does not take these responsibilities lightly. We understand that by ensuring consistency in the application of the laws we administer, we are facilitating the competitiveness of business in Canada by providing a level playing field for all. As well, in maintaining sustainable levels of compliance, we know that we must not become an impediment to business. We must minimize the compliance burden and assist business by helping to create an environment in which they can succeed, both domestically and in global markets.

Our approach to compliance is best described in our mission statement.

“Our mission is to promote compliance with Canada’s tax, trade, and border legislation and regulations through communication, quality service, and responsible enforcement, thereby contributing to the economic and social well-being of Canadians.”

Our overall approach to compliance is based on self-assessment and voluntary compliance. Voluntary compliance is a cornerstone of our self-assessment system where taxpayers determine what they owe and pay it voluntarily. To help our clients meet their

obligations, and to inform them of their rights and entitlements, we provide information and assistance in applying tax and customs rules. To ensure the fairness of the system, we maintain an enforcement capacity to take appropriate corrective action when people do not abide by the laws and regulations that we administer on behalf of all Canadians. We also have effective redress at both the administrative and judicial levels.

For individuals and companies alike, voluntary compliance begins with the understanding of their entitlements and responsibilities under our country's tax laws. For CCRA, this means providing "user friendly" guides, information brochures, inquiry services, tax clinics and individualized help to assist in the preparation of tax and other returns. It also means identifying particular areas of non-compliance, the root cause of that non-compliance, and ensuring that education is used where applicable, to help resolve these problems.

Consequently, communication is a key element of our compliance strategy and we put a great deal of emphasis on the maintenance of excellent communication and partnership mechanisms. These mechanisms provide a number of benefits for both the CCRA and our clients. On the one hand, they permit us to distribute information about tax law and our administration of the law to the people who are affected by it. On the other, they allow our clients to tell us about irritants in tax administration, and to suggest how we can improve.

The CCRA publishes extensive material designed for a wide variety of audiences. It ranges from one-paragraph inserts and pamphlets to detailed guides and papers that target the most complex and technical areas of tax law. Most of this information is available both in paper and in electronic form over the Internet. Published material covers the vast majority of the questions that we commonly receive, and it is constantly updated to remain current.

But published material has its limitations. It is one-way only. It does not provide a way for taxpayers, their advisors, or the public to make their views known to us. Feedback like this requires a structured way of identifying and meeting with representative groups of our clients. In these meetings, we hear what is working and what is not, we explore, together, possible solutions to problems, and



we solicit opinions about our ideas for future changes to tax administration. In many ways, these meetings are the most interesting part of our work, and this paper sets out some aspects of our relationships with business representatives at the national, regional and local level. Interaction between CCRA and business and professional organizations is an effective way to improve compliance with the laws we administer.

Before discussing some of the ways in which the CCRA interacts and cooperates with business and professional organizations to improve tax compliance, it is worth noting that the CCRA is guided by the recognition that any one business can be part of a large number of overlapping groups. For instance, it has interests in common with other residents of its neighborhood, city or region – a geographical relationship. A business has shared interests that are unique to the other participants in its industry – a sector relationship. Finally, businesses in different industries can engage in a similar activity as part of those businesses, such as payroll administration, clearing goods at the border or conducting scientific research that involves interaction with the tax authorities. In all these aspects of its relationships, a business has varying interests in exploring how a tax administration can best serve its needs. And so we at the CCRA must ensure that we have various communication channels and partnership mechanisms open to all of these aspects of a business.

But what advantages are there to cooperating and building partnerships? How do we do it? To begin with, by partnering with the CCRA, business is able to minimize the compliance burden and ensure that programs to counter non-compliance are effective and efficient. In addition, the CCRA benefits from the expertise and wealth of information possessed by the industry and business associations to assist in its understanding of the industry and thus improve compliance through the design of appropriate enforcement activities.

In order to build partnerships, we must foster an environment of mutual trust and respect. The CCRA and industry and professional organizations have developed such an environment and consequently, have worked together to institute program changes, implement program delivery and consult on new and emerging issues. And we have had a number of excellent successes, a few of which are described below.

**OBJECTIVES OF INTERACTING WITH BUSINESS AND PROFESSIONAL ORGANIZATIONS****(A) Analysis of causes of non-compliance**

An important aspect of our compliance strategy is issue analysis. Thorough and thoughtful analysis enables the CCRA to determine the nature and magnitude of the non-compliance. By identifying the underlying cause of a problem, we can target our efforts in the most effective manner and take appropriate action.

Business and professional associations have proven to be invaluable in helping the CCRA analyze the root cause of non-compliance and develop strategies to find solutions. The following is an example of how industry helped analyze and develop a solution for the deductibility of meal and entertainment expenses at “special work sites”:

**Special Work Sites:**

Industry was having a problem concerning the deductibility of meal and entertainment expenses incurred by their employees at “special work sites”, which are defined as work locations that are at least 30 kilometres from the nearest urban area that has a population of at least 40,000 people. Businesses that claim a deduction for tax purposes for such expenses are limited by law in the amount that they can deduct, except if the employees worked in a “special work site”. In those circumstances and subject to certain other specified conditions, the expense is fully deductible. Employers, many of who were members of various industry associations, found it difficult to determine if a particular site was in fact a “special work site” and thus comply with the law. For example, municipal boundaries, which are used as the base for the 30 kilometres distance calculation, are usually very irregular in shape and were often disputed by the employers and the CCRA. Working in partnership, the CCRA, industry associations and other government departments studied the issue and developed an interactive electronic search map, which determines whether a named location is a “special work site” in

relation to nearby urban areas. The information on which the site map is built is maintained by Statistics Canada, which also provides a greater level of independence and credibility to the determination. The site for this search map is found on the CCRA website and is available to all Internet users at <http://www.ccradrc.gc.ca/tax/business/smallbusiness/searchmap-e.html>. Now the problems encountered in the past have been virtually eliminated.

## **(B) Education**

Educating our clients on their rights and responsibilities is a key part of our communication strategy. Working with individual taxpayers, business associations and professional organizations, the CCRA provides information, offers a technical inquiry service, and provides special sessions on topics of particular concern. Employees of the CCRA are often invited to address annual meetings of industry associations, take part in round table discussions at national industry conferences or private sector sponsored professional training sessions, and participate in business trade fairs. Other educational activities include presentations at schools, colleges, and universities. One example of a successful communication project with business is our community visits initiative.

### **Community Visits**

Community visits were initiated as an efficient way to help deal with the underground economy. Its strength is not just its education of taxpayers, but it also provides important feedback to the CCRA on its programs, publications, and other services. CCRA auditors visit businesses in large and small communities across Canada. These visits, offered as an education and service activity, and designed with input from the business community, help to educate businesses on their tax responsibilities. They help and encourage businesses to voluntarily comply with tax obligations. These visits also enhance our visibility and demonstrate to the public

that CCRA is taking action to combat non-compliance and to ensure a level playing field for all businesses. Since 1994, we have reached more than 37,000 businesses in 216 communities, and the informal feedback received from businesses at the time of the visits has been positive.

### **(C) Minimize compliance burden**

If we are to achieve and maintain sustainable levels of compliance, the burden of complying must not be too cumbersome or restrictive. Otherwise, our clients will give up in frustration. Consequently the CCRA works in partnership with business and professional organizations to find ways to make it as easy as possible for business to comply with its obligations. The following example involves life insurance companies and illustrates how the CCRA works with its stakeholders to keep the compliance burden to a minimum.

#### **Insurance Industry**

When filing their income tax returns, life insurance companies must include a form on which they detail the differences between income per their financial statements and income as reported on their tax return. This reconciliation is very detailed and complex, often requiring arbitrary calculations for which the information is often not readily available. Due to changes in the law, the form needed to be updated. The Industry asked our Insurance Industry Specialists if a major overhaul of the form could be made at the same time in order to get rid of some of the reporting requirements that were difficult to provide and were often arbitrary calculations. A committee was formed by the Canadian Life and Health Insurance Association, along with our Industry Specialists, to study the matter. As a result of this partnership, the committee recommended that the form be completely rewritten and much of the information previously required, including the arbitrary calculations, be removed. We are in the process of developing a less burdensome form that will, as well, be able to be

filed electronically. In this case, the CCRA worked with the industry to obtain a result that helped industry significantly reduce the time and effort to complete and file their income tax returns while still maintaining the integrity of the information requirements of the CCRA.

#### **(D) Program improvement and redesign**

Industry and professional organizations have played an important role in the improvement and redesign of our programs, often providing a critical yet constructive perspective. They are generally on the receiving end of our programs, whether it be the receipt of an incentive, such as the Scientific Research and Experimental Development (SR&ED) tax credit, or an audit. If there are difficulties with the delivery of the program, who better to be aware of the shortfalls than the user. One of our more dramatic success stories in cooperating with business involves the SR&ED program.

#### **Scientific Research and Experimental Development**

The Scientific Research and Experimental Development Program (SR&ED) is a major element in the Canadian government's strategy to improve competitiveness, given the strong link between investments in science and technology and economic growth. The SR&ED Program is the largest single source of federal funding for Canadian industrial R&D. The objective of the Program is to deliver SR&ED incentives in a timely, consistent, and predictable manner, while encouraging companies to assess their own claims in compliance with tax laws, policies and procedures.

To respond to industry concerns about the effectiveness and efficiency of the claims process, an Action Plan was developed with the full and active involvement of industry in order to redirect the program to a more client-centered focus and to provide enhanced predictability, certainty and timeliness. Industry and professional organizations played an important role in the

implementation of the action plan. Through wide ranging partnerships forged with industry, CCRA has created a rich source of information and guidance about the Program. By streamlining paperwork and simplifying the claim process, companies find it easier to access and benefit from the program.

### **(E) Assistance in developing administrative procedures and guidelines**

In order to properly administer complex legislation, administrative procedures and guidelines are developed to make compliance easier. The CCRA has obtained the assistance of industry and professional organizations on a number of occasions to assist in the development of such procedures and guidelines. The following are two recent examples of the CCRA working with its stakeholders on such matters.

#### **Technical Advisory Groups**

In response to recommendations put forward in 1998 by the Minister's Advisory Committee on Electronic Commerce, four Technical Advisory Groups (TAGs), composed of private sector tax experts and representatives of industries involved in electronic commerce, were formed. The four topics addressed by the groups include: consumption taxes; interpretation and international co-operation; compliance and administration; and taxpayer service. These groups provided valuable advice to the CCRA on a variety of policy, technical, administrative and compliance matters related to the electronic commerce environment.

The consultations have proven to be effective and have resulted in advice on electronic service delivery, input into the CCRA's draft electronic commerce compliance strategy, as well as the development of position papers on the interpretation of legislation involving income tax and tax treaties relating to electronic commerce. In addition, the consultations have helped the CCRA participate in international discussions on electronic

commerce with partners such as the Organization for Economic Cooperation and Development.

**Third Party Penalties (TPP)**

With the proliferation of tax shelters and tax planning arrangements in recent years, the need for penalty provisions for dubious conduct concerning the promotion of tax shelters and the filing of returns became apparent. However, early in the legislative process it was recognized that third party penalties was a sensitive issue that would have a significant impact on the tax community. It was therefore decided to involve tax practitioners and their associations in the development of policies and administrative guidelines for the application of the penalties.

The CCRA consulted the tax community to get their views with respect to the content of the guidelines. We consulted 26 professional and industry organizations that were likely to be impacted by the TPP. During this process, a number of information sessions were also held with some of the organizations to keep them informed about the status of the process. As a result of this communications and partnership initiative, the tax community became an integral part of the solution. They were invited to, and did, voice their concerns. But they also provided us with excellent suggestions during the process of how we could make the guidelines as clear, and the application as transparent, as possible.

We believe that we have a much better product because of the involvement of these stakeholders and we published our final Information Circular on the Application of the Third-Party Civil Penalties on September 18, 2001 on the CCRA's Internet site. But we won't stop there. We also intend to update the tax community on a regular basis about our experience with the application of the TPP.

**(F) Private sector participation in program delivery**

Partnerships between the CCRA and the private sector help to strengthen program delivery and are advantageous to all parties. A dramatic example of the benefits that can be derived from a cooperative effort between tax administrators and the private sector is the *Get It In Writing!* Campaign conducted in partnership with the Canadian Home Builders Association (CHBA).

***“Get It In Writing!” Campaign***

At issue is the non-compliance of building contractors who deal in the underground economy. By not reporting their revenues and thus not paying their fair share of taxes, they put honest businesses at a competitive disadvantage and reduce revenues for governments thereby putting important government programs such as health and national security at risk.

The campaign is designed to inform consumers of the risks inherent in dealing with businesses operating in the underground economy. Legitimate contractors are experts in their profession and take pride in the quality of their work. Unlike illegitimate businesses, they are fully insured and offer legally binding warranties.

The objective of the campaign is to level the playing field and help honest businesses be competitive thereby increasing their profitability and improving compliance with tax laws.

This approach serves to complement traditional compliance activities as it involves stakeholders, independent of the tax administration, who have an intimate knowledge of the industry. Having the campaign delivered by their own industry association provides a greater level of credibility to the message than would otherwise be available if delivered only by the tax administration. In addition, by involving individual members of the industry in the campaign, we are able to put more resources to the initiative as well as reach a much larger audience.



The proof of the effectiveness of this partnership is the interest by both parties to see it continue and improve. The initiative began with a *Get It In Writing!* pamphlet, which was produced jointly by the CHBA and the CCRA and distributed by the CHBA to its members, associates and the public. The positive reaction to the pamphlet led to a second phase, consisting of 39 seminars delivered by local CHBA associations to over 1400 contractors. These seminars taught individual contractors how to effectively deliver the campaign's message about the risks in dealing with illegitimate contractors to their clients. Businesses found the seminars so effective that they wanted to expand the program, and a new *Get It In Writing!* consumer awareness campaign was launched, supported by the CCRA and again to be delivered by the CHBA.

#### **(G) Private sector insight through interchange assignments**

In looking at all opportunities to benefit from the private sector's insight on compliance issues, the CCRA has found that hiring private sector executives through short to medium term interchange assignments can also be an effective way to tap into private sector experience and expertise. Two examples of such interchange assignments are as follows:

##### **Scientific Research and Experimental Development Program**

As noted earlier, in response to industry's concerns regarding the effectiveness and efficiency of the Scientific Research and Experimental Development (SR&ED) tax credit program, the Minister of National Revenue announced a number of measures to improve service for companies claiming these investment tax credits. A key step in gaining the full support and trust of the industry, and in partnering with them to implement the resulting Action Plan, was to enter into an interchange agreement with one of the affected professional organizations. Specifically, we hired a Vice President from the Information Technology Association of Canada to carry out the duties of the Director

General, SR&ED Directorate and to partner with industry to redirect the focus of the program. This interchange, which ended recently, proved to be very successful in providing the CCRA with the private sector's insight into research and development compliance issues, and in fully implementing the Minister's Action Plan.

### **Advice on Review Committees to Address Sensitive Issues**

The CCRA has also engaged, for a period of approximately two years, the part time services of a tax lawyer from the private sector to serve as a member of a number of CCRA review committees, including the *General Anti-Avoidance Rule* and *Third Party Penalties* review committees. We believe this assignment will be mutually beneficial. It will provide the CCRA with a private sector perspective on the resolution of some sensitive issues, and hopefully provide the private sector lawyer with a greater appreciation of some of the compliance issues faced by the CCRA.

### **(H) Transformation of CCRA's core business – Future Directions Initiative**

The CCRA has launched a Future Directions initiative with the objective of transforming its programs and services in a manner that keeps pace with changes in technology, business and management practices and the expectations of the public at large. Our focus for the future is to become more innovative in everything we do. This will make us more effective and efficient in achieving compliance and contributing to the social and economic well being of Canadians.

The CCRA's Future Directions initiative is focused on a massive transformation of our core business and internal management processes to achieve modern, integrated, harmonized, and client centered services to Canadians. It will help position us to respond to future service needs, expectations and priorities of Canadians in the most effective and efficient way possible. The ultimate goal is to make it easier for Canadians to comply with their tax obligations by streamlining operations and reducing the compliance burden.

Future Directions is a process of engagement through which clients, stakeholders and staff are being given the opportunity to assist in this transformation. Their views on how the CCRA should chart a course for the next five to ten years will be invaluable. With a clearer understanding of the nature and range of services and activities that Canadians envision for the future, the CCRA will be able to focus its investments and efforts to make the best overall contribution to the ongoing success of the organization.

We have started the process by establishing four working groups of CCRA employees to examine our current programs and services. The four working groups are; charities; small and medium enterprises; individuals and benefit recipients; and large business. These groups are conducting a process based on consultation, research and dialogue with their respective clients. The results of this process will be used to develop an action plan to guide the CCRA's efforts over the next decade.

The work being undertaken by these groups is quite extensive. For example, the Large Business Working Group is developing a strategic vision for the CCRA's relationship with its large business clients. This means identifying the best range of activities and initiatives that maximize compliance while providing the highest level of service possible. All aspects of our relationship with the large business community are open to critical review.

We began last fall by consulting with our own employees. Some 55 sessions were held across the country with about 1,000 staff participating. As one might expect, there were a wide range of opinions, many of which concerned day-to-day operational issues faced by our employees. A key theme that emerged was that, given the complexity and competitiveness of the large business sector today, our staff recognizes the need for continuous learning and professional development for them to continue to perform successfully.

The results of the internal consultations are currently being validated and will be augmented with the results of our consultations with external stakeholders, including business and professional organizations. These consultations have been wide-ranging and comprehensive. We are consulting with:

- established CCRA consultative groups such as the International Tax Advisory Committee and the Large Business Advisory Committee;
- national business organizations like the Canadian Tax Foundation;
- regional consultative bodies and industry associations;
- direct, one-on-one interviews with some 400 large businesses;
- provincial tax administrations;
- other federal government departments; and
- foreign tax administrations.

The external consultations phase of the Large Business Future Directions initiative is nearing completion. The next step will be to take stock of the proposals and coordinate them with those of other working groups, particularly the Small and Medium Enterprise group. An integrated action plan will be developed which will set the strategic direction of the CCRA's upcoming Corporate Business Plan.

### **CCRA INITIATIVES TO IMPROVE COMPLIANCE**

Understanding the importance and effectiveness of interacting and cooperating with business associations and professional organizations, the CCRA has implemented several ongoing mechanisms, most notably the Industry Specialists program and a suite of Advisory Committees, which have the scope and potential to address all the objectives outlined above.

#### **Industry specialist program**

The CCRA has seventeen "industry specialists" whose main function is to develop communications at the most senior level with associations in a particular industry to identify ways to work more constructively with that industry.

An industry specialist is a person with extensive expertise and knowledge of a particular industry sector from an overall business point of view, and an in-depth knowledge of the accounting and tax issues of that industry. The industry specialist's role is to use that expertise to act as a single point of contact between the industry and the CCRA so that concerns of each

party can be identified and strategies and solutions developed to resolve these matters. Industry specialists regularly meet with associations representing businesses in their industry, other CCRA staff who deal with that industry, and other federal, provincial and foreign government institutions. These meetings are an important source of information and problem identification.

For example, our Banking Specialists worked with the banking industry, through the Canadian Bankers Association, to develop procedures to ensure that formal requests for information are issued to the banks only when necessary, are made to the proper person at the bank, contain information needed by the bank to be able to honor the request, and are replied to in a standard fashion.

In the Oil & Gas Industry, our Industry Specialists worked with the Canadian Association of Petroleum Landmen to develop a standardized form to be used by the industry to document the sale of oil and gas properties. This joint effort resulted in the reduction of the time and effort required to complete and review the necessary documentation.

### **Advisory Committees**

In addition to our contacts with existing associations, CCRA has established more than 30 advisory committees, including ones for seniors, large and small business, collections, appeals, international issues, and electronic commerce, to name a few.

Two such committees are the Large Business Advisory Committee (LBAC) and the Small Business Advisory Committee (SBAC). These committees consult with representatives of Canada's business community on an ongoing basis to ensure that CCRA is addressing the specific needs of that sector.

Each Committee is composed of about 25 members representing business sectors from all regions of Canada, and senior officials from CCRA. Members are appointed by the CCRA. They do not represent particular associations or companies, but rather they act in their own right to provide advice in the interest of industry in general. Typically, members are appointed for staggered terms of two and three years to ensure continuity. Committee meetings are held annually or semi-annually in Ottawa and generally last one day. When required, subcommittees are established and meet as often as necessary

Committee members provide the CCRA with advice and comments on administrative matters which reflect the business perspective; assist the CCRA in identifying opportunities for closer, more efficient working relationships with the business community; provide the CCRA with the opportunity to communicate its plans and initiatives to business executives; and assist the CCRA in the development of policies, procedures, and forms impacting on business operations.

Another committee is the International Tax Advisory Committee (ITAC). This Committee's purpose is to provide advice on current and emerging international tax issues. The Committee assists CCRA officials in identifying opportunities for closer, more efficient working relationships with businesses and industry involved in international transactions, their professional associations and their professional advisors. The Committee also assists CCRA in the development of policies, procedures and forms that have an impact on entities undertaking international transactions.

## **FOSTERING RELATIONSHIPS**

In Canada we have an excellent relationship between government and business. There is an extensive network of industry associations created and operated by their members that, among other things, manage and focus industry's dialogue with the CCRA. This network

has been built up over many years of mutual effort and goodwill. The CCRA regularly consults with over a hundred associations at the national and local levels.

As a tax administration, we cannot force businesses to form associations so that we can talk to them. Businesses form associations for their own benefit, not ours. Associations lobby governments, they negotiate with suppliers or customers on behalf of their members, they incur research or advertising costs that would be beyond the reach of individual members, and so on. A mature economy will always contain a rich population of associations representing the interests of their members.

Tax affairs are not usually the most important reason they exist.

The CCRA's approach is to build relationships with existing business associations, and encourage the formation of associations where none exist. An effective way to do this, in our experience, is to approach businesses to suggest a particular opportunity for cooperation. For instance, if audits in the trucking industry frequently cause contentious discussions about how to deduct license fees, several truckers could be called and a suggestion made that they get together to work with the CCRA in setting out some mutually agreeable guidelines on deducting the fees, which can be made available to both CCRA auditors and all truckers. If this is fruitful, the group of truckers might coalesce into an association.

Some points to consider when working with associations are as follows:

- For businesses to work together, they have to disclose some details of their operations to each other. Disclosure is minimal when talking about the designing of a new form, whereas it is considerable when discussing a complex issue such as transfer pricing. Disclosure of information is a sensitive issue for any business, and discussions should be framed in a manner that minimizes their concerns.
- Tax administrations must also be aware of the extent to which a particular association can speak on behalf of a particular industry. For example, if we adopt a position after discussions with an industry association, and a major

industry participant who is not a member of that association complains because the position is harmful to it and it was not part of the consultations, then there is a problem. It is important to try and ensure that the association is representative. Since membership is usually voluntary, not every industry participant will be a member. In some cases, there is a need to deal with the association plus some additional participants or even other associations in the same business.

An ongoing relationship with an association, as with anyone, requires that it benefits both sides. We, as tax administrators, want the additional efficiency and effectiveness created by a common understanding of issues. In return, we need to listen to the association's concerns and suggestions, and take them back to our own organizations to address. It is only if the association can show its members that the relationship creates benefits for them, that it will want to continue to cooperate with and create benefits for us.

## **RESPONSIBLE ENFORCEMENT**

While most of this paper talks about communication, CCRA recognizes that communication alone cannot ensure compliance. Responsible enforcement must also be an integral part of any compliance strategy. Responsible enforcement acts not only to deter non-compliance but also serves to remind taxpayers that the CCRA is working to maintain the fairness of the tax system by ensuring that all pay their fair share. It means making voluntary compliance as easy as possible for all taxpayers, businesses and individuals alike. And it means staying ahead of change by being able to predict new trends and adapting compliance strategies to meet them, often working in partnership with groups who share similar objectives.

Risk assessment is an integral part of responsible enforcement. The CCRA monitors trends in revenues, examines compliance patterns, conducts studies of the factors affecting compliance including the impact of education and program redesign,



to mention a few. By meeting with industry and professional associations, we can learn more about that particular industry and, consequently, be better informed to be able to risk assess businesses in that industry and be able to better interpret and utilize the results of our analysis.

## **CONCLUSION**

The CCRA operates in a complex environment characterized by rapid change. Ensuring compliance, voluntary or otherwise, in this environment is an ongoing challenge requiring communication, quality services, and credible enforcement strategies. For the CCRA to be successful, it must not only continue but also enhance its partnerships with business and professional organizations. Many of the benefits of these partnerships discussed in this paper are readily apparent, others less so, but all are important in achieving our ultimate objective of improved tax compliance.

Mr. William V. Baker  
Assistant Commissioner  
Canada Customs and Revenue Agency  
E-mail: [Bill.Baker@ccra-adrc.gc.ca](mailto:Bill.Baker@ccra-adrc.gc.ca)

Case study:

TOPIC 1.3

## **COOPERATION OF BUSINESS AND PROFESSIONAL ORGANIZATIONS**

**Deborah Nolan**

Deputy Commissioner, Large & Midsize Business  
Internal Revenue Service  
(United States of America)

*CONTENTS: Achieving Sound Tax Administration.- Creating a Customer-Focused Organization.- Understanding the Customer's Point of View.- Stakeholder Relationship Management.- Leveraging Resources through Effective Partnerships.- External Liaison Activities with Outside Stakeholders.- Tailoring Business Practices to Better Meet Customers Needs.- Conclusion.- Annex.*

The ability of tax administrations to improve tax compliance is strengthened by its proactive relationship management with the private sector. Cooperation of business and professional organizations can be crucial in getting taxpayers to support tax systems that are primarily based on voluntary compliance. Additionally, with the usually limited funding available for tax administration efforts, the cooperation of external stakeholders can provide an opportunity for tax administrations to leverage the resources of these private sector groups. The Internal Revenue Service of the United States has recently completed a restructuring and modernization of our organizational structure into four operating divisions, each based the unique needs of different segments of taxpayers. Our ability to accomplish this transformation to a tax administration that can provide more of a compliance and customer service focus has been facilitated through key external relationships. Several aspects of the necessary linkages between tax administrations and private sector organizations will be discussed:

Achieving Sound Tax Administration  
Creating a Customer Focused Organization  
Understanding the Customer's Point of View  
Stakeholder Relationship Management  
Leveraging Resources through Effective Partnerships  
External Liaison Activities with Outside Stakeholders  
Revamping Business Processes Based on Customer Needs

### **ACHIEVING SOUND TAX ADMINISTRATION**

The public today has a legitimate expectation that tax administrations will do their job in a manner that is no less effective than high-quality private sector organizations. After all, every taxpayer is also a customer of many other businesses and institutions, many of which provide consistently high quality service to customers while also providing excellent results for shareholders and other stakeholders.

The IRS Restructuring and Reform Act of 1998 (RRA '98) gave clear direction to the IRS: it said that we must do a better job in meeting the needs of taxpayers. As required by the RRA '98, this direction is expressed in the new IRS mission statement:

*Provide America's taxpayers top quality service by helping them understand and meet their tax responsibilities and by applying the tax law with integrity and fairness to all.*

This mission statement accurately describes the role of the new IRS, as well as the public's expectations as to how the IRS should perform it. In the United States, the Congress passes tax laws and requires taxpayers to comply with them. It is the role of taxpayers to understand and meet their tax obligations, and most do since roughly 98 percent of the taxes collected are paid without active intervention by the IRS. It is the role of the IRS to help the large majority of taxpayers who are willing to comply with the tax law, while seeing to it that the minorities who are not willing to comply are not allowed to burden their fellow taxpayers. The IRS must perform this role to a top quality standard, which means that all of its services should be seen by the people who receive them as comparable in quality to the best they get elsewhere.

Some observers have questioned whether the new mission statement underemphasizes the obvious need to collect taxes. On the contrary, the mission statement calls for the IRS to be more effective in all aspects of its mission, including application of the law to those who are unwilling to voluntarily comply.

Just as the best companies produce excellent shareholder returns by providing high-quality products and services to customers, it will also be expected that successful execution of this new IRS mission will produce tax revenues for the Treasury in accordance with the tax law without political or corrupt influence.

This new mission statement does not, in any sense, negate the intent of the previous one; rather it builds on it and sets a broader and higher performance standard. Only an institution that has been successful at one level can aspire to a higher level of performance.

Establishing a new mission for the IRS and clarifying the public's expectations have been essential and meaningful steps in meeting those expectations. However, achieving this mission requires fundamental change in many aspects of an institution that has been built over many years. This change must produce success in the new mission, while retaining the essential elements that created success in the past. Further, this change must take place while the IRS continues to administer a very large, complex and ever-changing tax system. Since the IRS will strive to perform at a level of quality achieved elsewhere in the economy, a major part of this change is guided by proven private sector best practices.

### **CREATING A CUSTOMER-FOCUSED ORGANIZATION**

The IRS' modernized structure is similar to one widely used in the private sector: organized around customers' needs, in this case taxpayers. Just as many financial institutions have different divisions that serve retail customers, small to medium businesses and large multinational businesses, the taxpayer base falls naturally into similar groups. This concept has been closely studied since it was first proposed in early 1998. In fact, IRS designs teams who were primarily responsible for designing the new organizational structure, worked closely with external business and professional organizations. Not only were their insights useful, but their involvement at this pivotal time allowed them to become familiar with what the modernized organization would eventually look

like, and it gave them a stake in its success. Extensive consultations were held with the Tax Executives Institute (TEI), one of our major external stakeholders and with two of our federal advisory committees: the Internal Revenue Service Advisory Council (IRSAC) and the Information Reporting Program Advisory Committee (IRPAC). Each of these advisory committees is comprised of representatives from the private sector. More information on our use of advisory committees will be covered later in this paper.

The key operational units that emerged are four operating divisions, each charged with full end-to-end responsibility for serving a set of taxpayers with similar needs. The needs and problems of the taxpayers served by each of these operating divisions are very different, and consequently serving them effectively and efficiently requires different services and different ways of delivering that service.

The first of the four operating divisions serve some 88 million filers. This group represents 116 million individual taxpayers, including those who file jointly, with wage and investment income only, almost all of which is reported by third parties. Most of these taxpayers deal with the IRS only once a year, when filing their return, and most receive refunds. Collection problems are limited since they pay only \$46 billion in cash directly to the IRS, the balance of their liability being paid through withholding by their employers. Compliance issues are focused on a relatively limited range of issues, concentrated on dependent exemptions, credits, filing status and deductions. Roughly 60 percent of these taxpayers file their own returns, depending directly on the IRS or volunteer groups for education and assistance.

The second group of taxpayers includes fully or partially self-employed individuals and small businesses. This includes about 45 million filers. This group has much more complex dealings with the IRS than the wage and investment taxpayers. They have four to 60 transactions with the IRS per year and pay the IRS directly over \$915 billion in cash, representing approximately 44 percent of the total cash collected by the IRS. This amount includes personal and corporate income taxes, employment taxes, excise taxes and withholdings for employees, each of which has filing and technical requirements. Since business income and a range of taxes are involved, compliance issues are also complex. The possibilities for errors, resulting in collection and compliance problems, are greatest in this group because of lack of withholding or information reporting and the large amount of cash paid. The result is much more frequent dealings with IRS compliance functions.

Large and mid-size businesses, comprising only about 140,000 filers, pay the IRS close to \$700 billion in cash. This group includes corporations with assets over \$10 million. While collection issues are rare, many complex issues such as tax law interpretation, accounting and regulation, many with international dimensions, frequently arise. At least 20 percent of these taxpayers interact with IRS compliance functions each year, and the largest taxpayers deal with the IRS continuously.

The tax-exempt and government entities sector, including pension plans, exempt organizations and governmental entities, represents a large economic sector with unique needs. Comprising 2.4 million filers, this sector ranges from small local community organizations to major universities and huge pension funds. Although generally paying no income tax, this sector pays over \$220 billion in cash in employment taxes and income tax withholdings and controls about \$6.7 trillion in assets. The IRS is charged with administering detailed and complex provisions of law that are generally not intended to raise money, but rather to ensure that these entities stay within the policy guidelines that enable them to maintain their tax-exempt status.

The benefits of this new organization structure as compared to the old structure are apparent. The modernized organization is built around specific groups of taxpayers with relatively similar needs. It is an inherently customer-focused organization, with each operating division responsible for creating and executing business practices and strategies to meet those needs.

The modernized organization sets forth clear, end-to-end responsibility and authority for a top official, supported by a small top-management team, to serve a set of taxpayers. Equally important, since the taxpayers served are reasonably homogeneous in their needs, we expect managers at all levels to be knowledgeable in the substantive problems and issues that arise in administering the tax law in their division.

In the modernized organization structure, much of our complex tax law will not be relevant or important for the particular issues in each division, allowing the managers to focus on that which is important for their taxpayers. For example, the management of the Wage and Investment Division, although responsible for serving 75 percent of all taxpayers, will generally not have to be concerned with the 83 percent of the tax code that ordinarily does not apply to the taxpayers for which it is responsible. Therefore, we can expect managerial accountability for

understanding the problems in their area of responsibility and for taking effective action to reach our strategic goals. The Commissioner, Deputy Commissioners and the national office staff, in turn, are better able to perform their proper role of helping the operating units set appropriate strategic goals and overseeing their performance in meeting them, rather than engaging in detailed operational issues.

### **UNDERSTANDING THE CUSTOMER'S POINT OF VIEW**

One of the IRS' new guiding principles is:

*Understand the customer's point of view and use this understanding to prevent and solve problems and provide quality service.*

This principle is especially important at this point as it represents a significant shift in emphasis. This shift, from an internal focus to a customer focus, is one that many organizations undertook in the last 15 years and has powerful and pervasive implications. Working with business and professional organizations gives tax administrations a more streamlined and efficient way of obtaining this very necessary understanding of taxpayers needs. As the IRS began to adopt this focus in recent years, practical examples of this principle have already had important effects.

For example, the IRS phone service improved a great deal, with level of service rising substantially in one year, without actually answering significantly more calls. How? By recognizing that taxpayers typically call at certain times of the day or week and by adjusting the schedules of customer service representatives to be available at those peak times. Previously, call schedules were arranged mainly on internal convenience.

IRS Problem Solving Days are another example of this principle. They have been very highly rated by taxpayers and have cleared up many long-standing problem cases by understanding the customer's point of view. Some taxpayers needed to meet face to face with an IRS representative and needed convenient times to do this and oftentimes the taxpayers' issues crossed IRS functional boundaries. By providing all the necessary expertise in one place at one convenient time, these taxpayers' needs were met.

Even the IRS quality measures for answering calls are changing to better reflect the taxpayers' points of view. Instead of rating the quality of answers against a test list of IRS-developed tax law questions, quality of actual taxpayer calls is rated.

Nearly every IRS activity and every employee's way of doing his or her job has been affected by adopting this principle. It is guiding internal IRS activities as well. For example, those within the IRS organization who provide information systems services, facilities services or accounting services have internal customers, and it is vital to understand their needs to solve their problems.

While this principle has much potential to improve service to each particular taxpayer, it can also improve overall compliance. Since the IRS intervenes directly with only a very small percentage of taxpayers, gaining a clear understanding of what causes compliance problems in particular circumstances and situations has proven essential to address those problems effectively. Partnering with business and professional organizations gives tax administrations an efficient and effective way of obtaining this important understanding of taxpayers issues and requirements. For example, our work with the Tax Executives Institute (TEI) and the American Institute for Certified Public Accountants (AICPA) revealed to us the need on the part of our taxpayers to receive information and training on alternative dispute resolution techniques. Accordingly, we will offer several training sessions this summer on this subject.

## **STAKEHOLDER RELATIONSHIP MANAGEMENT**

The IRS has maintained excellent relationships with stakeholders for decades. To capitalize on past efforts, and to positively influence the public's perception of the IRS, Commissioner Rossotti and IRS leadership developed a Servicewide strategy, known as Stakeholder Relationship Management (SRM). SRM defines a new, proactive partnership approach for actively coordinating IRS outreach programs with external stakeholders. Some external stakeholders include: tax professionals and practitioner organizations, Congress, federal statistical agencies, state and local governments, major corporations, trade associations, non-profit organizations, advisory groups, etc.



SRM is a set of behaviors and practices used in the private and public sectors to help organizations manage their constituents. SRM may be an unfamiliar term, but the concept is not new. We do it every day at work, with our customers and co-workers, and at home with our friends and neighbors.

SRM is much more than customer-service. It is a strategy that enables IRS and its stakeholders to work together to resolve issues before they become problems. It is the bridge that provides a two-way exchange of ideas, emerging issues, and feedback. SRM is a type of account management, emphasizing a proactive approach to reaching out to stakeholders and getting to know their business needs and industry characteristics.

There are four overall goals of the SRM strategy:

- Leverage stakeholder relationships to help the IRS achieve its tax administration objectives;
- Support the IRS' Strategic Business Plan;
- Add value to external stakeholders;
- Assist stakeholders and improve the overall consistency and quality for stakeholder interactions.

Relationship Management is nothing new to the many IRS employees who have made it a part of their jobs for years. In fact, the SRM strategy has expanded upon the relationship building activities previously in place at IRS. When conceiving SRM, Commissioner Rossotti envisioned a strategy of Lead and Participant Relationship Managers. These relationships have been assigned to specific employees via a spreadsheet that lists every stakeholder group in our country. Lead Relationship Managers play a pivotal role in dealing with outside stakeholders, while Participant Relationship Managers play a more supportive role. To date, we have received much positive feedback from stakeholders. The specific duties of all relationship managers include:

- Identifying stakeholder needs and values,
- Contacting stakeholders regularly,
- Participating in stakeholder meetings and conferences,
- Notifying stakeholders of new IRS programs and products,

- Soliciting feedback from stakeholders,
- Referring case-related issues to appropriate case managers,
- Following through on issues delegated to other IRS staff,
- Notifying IRS leadership of stakeholder issues and trends,
- Assisting stakeholders in navigating the new IRS,
- Creating a forum for an on-going open exchange of ideas,
- Gathering information about emerging issues in the tax community, and
- Leveraging stakeholder networks to disseminate vital tax information.

When these activities are practiced on a consistent and on-going basis, trust is built and partnerships are developed. Creation of these mutually beneficial stakeholder partnerships is consistent with the new direction that the IRS is taking.

One specific example of a Lead Relationship Manager would be our executive Industry Director for Heavy Manufacturing and Transportation. One of the many stakeholder groups for which he is assigned lead relationship manager duties is the Air Transport Association of America. As the lead relationship manager for this stakeholder all communications between the IRS and this group are to be coordinated by him. He worked extensively with this stakeholder group last fall in the aftermath of “9/11”.

### **LEVERAGING RESOURCES THROUGH EFFECTIVE PARTNERSHIPS**

There are many organizations and groups that are actively involved in tax administration and deal regularly with taxpayers. Among the most notable are tax practitioners of many kinds, industry associations, international associations (such as the National Foreign Trade Council “NFTC”, the International Fiscal Association “IFA”, and the Organization for International Investment “OFII”), small business associations, vendors of tax services and products, hundreds of community and volunteer groups, services for low income and disadvantaged taxpayer services, large businesses and institutions offering tax filing assistance to their employees, State revenue agencies, and other federal agencies.

Historically, the IRS worked with many of these organizations to share information about IRS programs and taxpayer concerns and, in the case of States, to exchange information for compliance purposes. The IRS also has some joint electronic filing programs with States.

IRS now places far greater emphasis on working in partnership with all of these groups to reach solutions on taxpayer issues, and especially to improve taxpayer education and assistance. Many of these groups have established communications channels to millions of taxpayers and are enthusiastic about working with the IRS to help their members avoid tax problems. Many taxpayers are also more likely to listen to and trust information that comes to them from organizations with which they regularly deal and depend on rather than from the IRS directly. Examples of partnership programs that provide information to taxpayers include the following:

- The American Bar Association and IRS produced an interactive education module for teens for use in high schools called "TAXi" and made it available on the Internet through the IRS Digital Daily website.
- The Banks, Post Office and Library (BPOL) program facilitates distribution of publications and forms through participating banks, post offices and libraries.
- The Small Business Resource Guide CD-ROM, designed as a reference guide for the entrepreneur, is produced and distributed free to the public.
- Through its Community Based Outlet Program, the IRS made forms and publications available to 14.8 million employees through the Intranet sites of over 2,200 companies.
- The Copy Center Program encourages copy centers to distribute free tax forms. Over 2,900 copy centers participate nationwide with support from large chains such as Office Depot, Office Max and Sir Speedy.
- Other partnership programs focus on outreach to taxpayers in under-served communities such as the Newspaper Supplement Program that distributes tax information through local newspapers and a pilot program in the Austin area that provides laminated tax forms for copying by grocery store customers.

The IRS has much to learn about specific taxpayer problems and concerns from the groups that are intimately knowledgeable about the taxpayer's point of view. Such an approach is very much in keeping with our guiding principle of "understanding and solving problems from the taxpayer's point of view." It is also a way of improving productivity, since a small investment of time and money in supporting a partnership with an organization of thousands of members is much more efficient than attempting to communicate directly to individual taxpayers.

The states offer special opportunities for using resources and improving service to taxpayers. Since most taxpayers deal with at least one state as well as the IRS, there is a great deal of overlapping information providing significant opportunities for reducing the burden on taxpayers.

The IRS and the Montana Department of Revenue are testing a Simplified Tax and Wage Reporting System (STAWRS). Upon successful completion of the test, Montana employers will be able to take advantage of combined federal and state filing. STAWRS reduces taxpayer burden on small businesses by combining into one tax return the information now contained in the IRS employment tax return (Form 941), the Montana withholding return and the Montana unemployment insurance return. State government partnership programs will enable us to meet our joint mission as tax administrators to reduce employer burden while improving the efficiency and effectiveness of government operations.

In order to implement improvements in business practices, the principle of effective partnership must be integrated into the basic structure of the organization and be given sufficient management attention and support.

## **EXTERNAL LIAISON ACTIVITIES WITH OUTSIDE STAKEHOLDERS**

### **Federal Advisory Committees**

Advisory committees have played an important role in shaping programs and policies of the Federal Government from the earliest days of the Republic. Since President George Washington sought the advice of such a committee during the Whiskey Rebellion of 1794, the contributions made by these groups have been impressive and diverse.

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Through enactment of the Federal Advisory Committee Act (FACA) of 1972 (Public Law 92-463), the U.S. Congress formally recognized the merits of seeking the advice and assistance of our Nation's citizens. At the same time, the Congress also sought to assure that advisory committees:

- Provide advice that is relevant, objective, and open to the public;
- Act promptly to complete their work; and
- Comply with reasonable cost controls and record keeping requirements.

With the expertise from advisory committee members, Federal officials and the Nation have access to information and advice on a broad range of issues affecting Federal policies and programs. The public, in return, is afforded an opportunity to participate actively in the Federal Government's decision-making process.

Under the Federal Advisory Committee Act, advisory committees can be created only when they are essential to the performance of a duty or responsibility conveyed upon the Executive Branch by law.

Federal advisory committee members are drawn from nearly every occupational and industry group and geographical section of the United States and its territories. The FACA requires that committee memberships be "fairly balanced in terms of the points of view represented and the functions to be performed."

As a result, members of specific committees often have both the expertise and professional skills that parallel the program responsibilities of their sponsoring agencies. In balancing committee memberships, agencies are expected to assure that major-and sometimes strongly opposing-viewpoints are represented to provide a foundation for developing advice and recommendations that are fair and comprehensive.

Advisory committee meetings, while generally required to be open to the public because of the Government in the Sunshine Act of 1976 (Public Law 94-409), may be closed or partially closed to the public. Examples of meetings that may be closed under the FACA are:

- Those including discussions of classified information;
- Deliberations involving considerations of personnel privacy; and
- Reviews of proprietary data submitted in support of Federal grant applications

Today, an average of 1,000 advisory committees with more than 40,000 members advise the President and the Executive Branch on such issues as the disposal of high-level nuclear waste, the depletion of atmospheric ozone, the national fight against Acquired Immune Deficiency Syndrome (AIDS), efforts to rid the Nation of illegal drugs or to improve schools, highways, and housing, and on other major programs.

IRS has established the following advisory committees, each with its' own unique mission. Members of each of these committees represent a diverse cross-section of IRS partners, customers and stakeholders, most of which come from private-sector business and professional groups. Each of these groups, in it's own way, conveys the public's perception of IRS activities to the Service.

- **Internal Revenue Service Advisory Council (IRSAC).** The IRSAC focuses on broad policy matters. It makes recommendations with respect to policies, organizational structure, operations, programs, procedures and emerging tax administration issues. IRSAC participated extensively with IRS design teams in the formulation of IRS' new organizational structure. They also advised us on our new Issue Management Strategy and assisted us with the implementation of it.
- **Information Reporting Program Advisory Committee (IRPAC).** The Omnibus Budget Reconciliation Act of 1989 suggested that the IRS formulate this advisory committee to make recommendations relating to reducing the burden involved in third party information reporting and improving the related processes and procedures. IRPAC provided input to IRS design teams regarding the formulation of IRS' recent reorganization. Additionally, they advised us on the implementation of electronic payee statements for taxpayers in lieu of the traditional paper statement sent through the mail.

- **Electronic Tax Administration Advisory Committee (ETAAC).** The RRA '98 established this advisory committee for the purpose of providing continued input to the development and implementation of the IRS strategy for electronic tax administration. ETAAC has recently been actively involved in advising the IRS on ways to increase the number of electronically filed tax returns.
- **Art Advisory Panel.** This advisory committee is a 25-member group of art dealers and museum directors who review and recommend acceptance or adjustment of taxpayers' claimed values for major paintings and sculptures. Since this committee deals with private taxpayer information their meetings are not open to the general public.
- **Citizen Advisory Panels (CAP's).** These four advisory committees, which are organized geographically, fall under the jurisdiction of the Taxpayer Advocate Service which reports directly to the Department of the Treasury. Their mission is to: (1) provide citizen input into enhancing IRS customer service by identifying problems and making recommendations for improvement (2) elevate identified problems to the appropriate IRS official and monitor the progress to effect change, and (3) refer individual taxpayers to the appropriate IRS office for assistance.

### **IRS Office of Electronic Tax Administration Outreach Initiatives**

Over the years, taxpayers' needs have changed. Technology has increased the expectations of our customers and we have been faced with increasing demands for easier submittal, faster processing, and automatic banking. In addition, the IRS was required by Congress to reach a goal of receiving 80% of all tax and information returns electronically by 2007 and to cooperate with and encourage the private sector to increase electronic filing of such returns. In order to meet public demands and this Congressional mandate, the IRS established the Office of Electronic Tax Administration (ETA). ETA has established numerous projects and initiatives designed to meet these objectives. Three of these initiatives deal intensively with private sector groups such as business and professional organizations. ETAAC has already been discussed, but information about the other two initiatives follows.

- **IRS National Account Managers (NAMs).** A handful of high-level positions were created to provide the highest level of service possible to tax related businesses and large practitioner organizations who either file the largest number of returns and information returns electronically, or potentially stand to have the largest impact on electronic filing practices in this country.
- **Nationwide Tax Forums.** Initially, these six-to-eight annual seminars were established by ETA, primarily for the purpose of providing information on electronic filing initiatives to businesses, practitioner associations, and the general public. These forums have now evolved into a Servicewide activity, in which the public can receive information and training on a multitude of IRS programs. Business and professional groups are actively included in the planning and execution of these seminars.

#### **Other Outreach Initiatives**

One last outreach initiative of significance includes the Annual and Periodic Liaison Meetings in which various business and professional organizations are invited to meet directly with the IRS Commissioner. The benefit of this program is that issues and problems are raised to the highest level of the organization without having to go through lower level staff intermediaries.

- **Annual Liaison Meetings.** Certain key organizations are invited once per year to have a one-on-one meeting with the IRS Commissioner. These meetings are dedicated exclusively to the issues of a single organization. The groups participating in these meetings include: the American Bar Association (ABA), the American Association of Retired People (AARP), the American Institute of Certified Public Accountants (AICPA), the National Association of Enrolled Agents (NAEA), the National Association of Tax Practitioners (NATP), and the National Society of Accountants (NSA).
- **Periodic Liaison Meetings.** In addition to meeting individually once per year with the IRS Commissioner, these same groups are invited twice per year to meet with him as a group.



## **TAILORING BUSINESS PRACTICES TO BETTER MEET CUSTOMERS NEEDS**

Just as companies develop particular products and marketing programs to reach customers with differing needs, most IRS business practices offer the opportunity for dramatic improvement by tailoring them to address particular taxpayer needs and problems. These needs and problems vary enormously, as just a few examples illustrate:

- Individual taxpayers with income reported predominantly by third parties have a much more limited set of reporting and payment problems than those with business income, but prompt payment of refunds is very critical to them.
- College students, whose returns can often be filed by telephone, have different service needs and preferences than senior citizens with retirement income.
- Large businesses, with extensive international activities, have a different set of tax problems that require much different service than small, start-up businesses.

An IRS working group recently studied taxpayers with only wage and investment income and identified groups of individual taxpayers with particular circumstances and needs. To serve these taxpayers effectively, it is essential to understand their particular needs and circumstances and to meet them with appropriate services and programs.

Tailoring IRS services to particular groups of taxpayers is a cornerstone of how we can dramatically improve our service to taxpayers as well as increase productivity within the organization. Virtually all IRS services can be improved using this principle. Pre-filing assistance programs, such as customer education, telephone and Internet assistance and publications and forms design, all represent obvious opportunities for more clear and effective communications. Filing-related programs, such as electronic filing, telephone account assistance and notices also need to be tailored to suit the needs of individual, small business and large business taxpayers. In addition, post-filing compliance programs offer major opportunities to allocate resources more effectively based on knowledge of specific issues affecting taxpayers in particular industries or business situations. In turn, the post-filing knowledge gained from working with taxpayers in examination and collection can

be used to develop improved guidance and education programs to prevent future problems, thus reinforcing the problem prevention strategy.

Understanding taxpayer problems and needs and tailoring and improving programs to meet these needs is so fundamental to meeting IRS strategic goals that it must be a key organizing principle for the way the IRS is managed.

One of the overriding themes in improving IRS business practices is to shift from addressing taxpayer problems well after returns are filed to addressing them as early in the process as possible, and in fact prevent problems wherever possible.

Malcolm Sparrow of Harvard's Kennedy School of Government, and one of the world's leading analysts of government compliance programs, said it simply:

*Speed of reaction after the fact is considered second best; prevention is considered better, but is harder to quantify.*

This approach follows the well-established quality principle that it is far better for the customer and far less expensive to eliminate defects than to fix them. In making cars, for instance, it is very expensive to issue a recall because of a defect; it is less expensive to fix a defect before the car leaves the factory; and it is best of all to improve the design and manufacturing process so no defect occurs. So it goes with tax returns. As a rule, if a taxpayer files a correct return, no further costs are incurred by the taxpayer or the IRS. If the taxpayer makes an error, it is highly beneficial for both the IRS and the taxpayer to find and fix the error as soon as possible. If the taxpayer fails to pay the correct amount due, the sooner the issue is addressed, the lighter the burden on the taxpayer and the greater the likelihood that the IRS will receive payment. Interacting with taxpayers is a three-part process:

1. Pre-filing: services provided to a taxpayer before the return is filed to assist in filing a correct return.
2. Filing: services provided to a taxpayer in the process of filing returns and paying taxes.
3. Post-filing: services provided to a taxpayer after a return is filed, to identify and correct possible errors or underpayment.

Historically, the balance of IRS resources was heavily weighted to intervention after problems occurred while relatively little was devoted to preventing problems. Formerly, 73 percent of the budget was allocated to post-filing activities. In fact, nine times as much was spent addressing problems after the fact than was spent in preventing them.

Experience at the IRS and elsewhere shows that there are many opportunities to improve service and compliance and increase productivity by pursuing more aggressive use of techniques to prevent errors and address recurring and systematic compliance problems.

An example of a new business practice that my own division of the IRS—Large and Mid-sized Business (LMSB) is working on is listed below.

### **Industry Issue Resolution (IIR)**

The goal of our issue management strategy is to resolve disputes with taxpayers earlier, or eliminate the controversy earlier in the process thereby resulting in interactions that are less time-consuming, expensive, and contentious. Issue resolution positions resulting from this program are reducing burden on taxpayers and IRS, and provide consistency and certainty on previously confusing issues across the country. Initially, this was a pilot program (see attached notice), but because of its enormous success, it is now in the process of being made permanent.

The IIR Pilot Program involved seven issues affecting a broad array of industry segments. The issues selected included:

- Clarification of the conformity election by banks for bad debts.
- Taxable value of the use of demonstrator vehicles provided to employees.
- Depreciation of certain costs of golf course construction.
- Reporting payments to employees who own heavy equipment used by their employers.
- Tax treatment of local impact fees associated with the low income housing credit.
- Determination of recoverable reserves of oil and gas for cost depletion purposes.
- Tax treatment of restaurant small-ware packages (see attached notice).

All seven of these issues have been resolved and collectively the related guidance removes tax issues that would otherwise need to be worked in thousands of tax examinations on a case-by-case basis. Various business and professional organizations have already been requested to solicit additional issues for the next phase of the IIR program. IRS expects to select at least ten issues in this next phase for resolution.

## **CONCLUSION**

In conclusion, our work with business and professional organizations over the years has enabled us to improve voluntary compliance by improving tax products and processes to better meet the needs of taxpayers. These partnerships with external groups have given outside stakeholders a voice in determining tax policy and operations and, accordingly, has motivated them to voluntarily comply with the tax laws of this country. Our liaison activities with business and professional organizations have benefited us tremendously in the United States and these relationships become more important to us every day. We highly encourage tax administrations in other countries to develop such partnerships and to actively utilize them.

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**ANNEX**



## **Part III**

### **Administrative, Procedural, and Miscellaneous**

26 CFR 601.204: Changes in accounting periods and methods of accounting. (Also Part I, §§ 162, 263(a), 446, 481; 1.162-3, 1.263(a)-1, 1.446-1, 1.481-1.)

#### **Rev. Proc. 2002-12**

##### **SECTION 1. PURPOSE**

This revenue procedure provides taxpayers engaged in the trade or business of operating a restaurant or tavern (as defined in section 4.01 of this revenue procedure) with a safe harbor method of accounting for the cost of “smallwares” as defined in section 4.02 of this revenue procedure) (“smallwares method”). This revenue procedure also provides a procedure for such taxpayers to obtain automatic consent of the Commissioner to change to the smallwares method.

##### **SECTION 2. BACKGROUND**

.01 The trade or business of operating a restaurant or tavern requires the use of many items in the preparation, service, and storage of food and beverages. Pots and pans, dishes, and glassware are common examples of these items, known as “smallwares” in the restaurant industry. Generally, an “opening package” of smallwares is purchased before a restaurant or tavern opens its doors to customers. Although an opening package is made up of hundreds or thousands of items, it is typically purchased as one unit from the same vendor. Replacement items are thereafter purchased on an ongoing basis. Industry data shows that the average cost of an opening package of smallwares ranges from \$10,000 to \$50,000, and that smallwares have an average useful life of slightly over one year.

.02 Section 162(a) of the Internal Revenue Code allows a deduction for ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Under § 1.162-3 of the Income Tax Regulations, the cost of materials and supplies (other than incidental materials and supplies) may be deducted only to the extent that the materials and supplies are actually consumed and used in the taxpayer’s business during the taxable year.



.03 Section 263(a) provides that no deduction is allowed for the cost of new buildings or of permanent improvements or betterments made to increase the value of any property or estate. Section 1.263(a)-2(a) provides examples of capital expenditures, such as the cost of acquisition, construction, or erection of buildings, machinery and equipment, furniture and fixtures, and similar property having a useful life substantially beyond the taxable year.

.04 Except as otherwise provided, under §§ 446(e) and 1.446-1(e), a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to change a method of accounting. Section 481(a) generally requires those adjustments necessary to prevent amounts from being duplicated or omitted to be taken into account when a taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year.

.05 To resolve disputes concerning whether the cost of smallwares should be accounted for as currently deductible expenses under § 162 or capital expenditures within the meaning of § 263(a), and to simplify the record keeping requirements with respect to smallwares, the Internal Revenue Service will permit a taxpayer engaged in the trade or business of operating a restaurant or tavern that complies with the requirements of this revenue procedure to account for the cost of smallwares using the smallwares method provided in section 5 of this revenue procedure.

### SECTION 3. SCOPE

This revenue procedure applies to the cost of smallwares incurred by taxpayers engaged in the trade or business of operating a restaurant or tavern. It does not apply to the cost of smallwares that are start-up expenditures as defined in § 195. Thus, a taxpayer that is not already engaged in the trade or business of operating a restaurant that opens a new restaurant may not use the smallwares method provided in section 5 of this revenue procedure to account for the cost of smallwares paid or incurred before the new restaurant opens.

## SECTION 4. DEFINITIONS

.01 Trade or Business of Operating a Restaurant or Tavern. For purposes of this revenue procedure, a taxpayer is engaged in the trade or business of operating a restaurant or tavern if the taxpayer's business consists of preparing food and beverages to customer order for immediate on-premises or off-premises consumption. These businesses include, for example, full-service restaurants; limited-service eating places; cafeterias; special food services, such as food service contractors, caterers, and mobile food services; and, bars, taverns, and other drinking places. For purposes of this revenue procedure, the trade or business of operating a restaurant or tavern also may include food or beverage services at grocery stores, hotels and motels, amusement parks, theaters, casinos, country clubs, and similar social or recreational facilities.

.02 Smallwares. For purposes of this revenue procedure, smallwares consist of the following ten categories of items: (1) Glassware and paper or plastic cups; (2) Flatware (silverware) and plastic utensils; (3) Dinnerware (dishes) and paper or plastic plates; (4) Pots and Pans; (5) Table Top Items; (6) Bar Supplies; (7) Food Preparation Utensils and Tools; (8) Storage Supplies; (9) Service Items; and (10) Small Appliances that cost \$500 or less. Categories 5 through 10 include, but are not limited to, the items listed below:

- (5) Table Top Items include items placed on customer tables, such as salt and pepper shakers, cheese shakers, ash trays, teapots, cruets, sugar caddies, tablecloths, napkins, menu holders, menus, vases, candles, and candleholders.
- (6) Bar Supplies include mixing glasses, bar strainers, cutting boards, liquor pourers, jiggers, corkscrews, bottle openers, storage bottles, wine and champagne stoppers, bar caddies, wine coolers, decanters, salt and sugar glass rimmers, slow pourers, and malt shakers.
- (7) Food Preparation Utensils and Tools include hand utensils (spoons, spatulas, wisks, peelers, etc.), pastry and grill brushes, skimmers, knives, kitchen shears, cutting boards, strainers, colanders, shakers, dippers, measuring cups and spoons, thermometers, gloves, goggles, timers, scales, shaker baskets, salad spinners, lettuce crispers, sifters, pastry bags and tubes, mixing bowls, pot holders, kitchen towels, cheesecloths, and kitchen staff uniforms.

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- (8) Storage Supplies include food containers, flatware sorters, dish containers, and spice racks.
- (9) Service Items include pepper mills, cheese graters, bread boards, pitchers, squeeze dispensers, coffee pots, napkin receptacles, flatware, plate, glass, and mug storage racks, wait staff and self-serve trays, soup and salad bar trays and containers, bus tubs, tray carts, booster seats, and wait staff uniforms.
- (10) Small Appliances include iced tea dispensers, can openers, condiment pumps, individual food warmers, heat lamps, slicers, glass washers, electric knife sharpeners, blenders, juicers, and nonindustrial mixers. Small appliances do not include appliances that cost in excess of \$500.

For purposes of this revenue procedure, smallwares do not include office supplies, general purpose cleaning supplies, or general purpose maintenance tools. In addition, smallwares do not include extraordinary items, such as collectibles or other items of significant artistic or intrinsic value, items that are accounted for separately for tax or financial purposes, or items that generally are listed as scheduled property for insurance purposes. Examples of extraordinary items are flatware or dinnerware made of precious metals, and antique vases used for centerpiece or display purposes.

### SECTION 5. SMALLWARES METHOD

.01 Taxpayers within the scope of this revenue procedure are permitted to account for smallwares in the same manner as materials and supplies that are not incidental under § 1.162-3.

.02 Under § 1.162-3, the costs of materials and supplies that are not incidental are deductible in the year in which the materials and supplies are actually consumed and used in a taxpayer's business.

.03 For purposes of this revenue procedure, smallwares are consumed and used in a taxpayer's business, within the meaning of § 1.162-3, in the taxable year in which they are received at the restaurant and are available for use. For purposes of this revenue procedure, "received at the restaurant and available for use" does not include smallwares purchased and stored at a warehouse or facility other than the restaurant where the smallwares will be used.

**SECTION 6. CHANGE IN METHOD OF ACCOUNTING**

.01 Limitations, Terms, and Conditions. A change in a taxpayer's treatment of the cost of smallwares to the smallwares method provided in section 5 of this revenue procedure is a change in method of accounting to which §§ 446 and 481 apply. A taxpayer that wants to change its method of accounting for the cost of smallwares to the smallwares method provided in section 5 of this revenue procedure must follow the automatic change in method of accounting provisions of Rev. Proc. 2002-9, 2002-3 I.R.B (or its successor) with the following modification: the scope limitations in section 4.02 of Rev. Proc. 2002-9 do not apply. However, if a taxpayer is under examination, before an area appeals office, or before a federal court with respect to any income tax issue at the time that a copy of the Form 3115, Application for Change in Accounting Method, is filed with the national office, the taxpayer must provide a copy of the Form 3115 to the examining agent, appeals officer, or counsel for the government, as appropriate, at the same time the copy of the Form 3115 is filed with the national office. The Form 3115 must contain the name(s) and telephone number(s) of the examining agent, appeals officer, or counsel for the government, as appropriate.

.02 Audit Protection. If a taxpayer complies with the requirements of this revenue procedure and changes its method of accounting for the cost of smallwares to the smallwares method provided in section 5 of this revenue procedure, the treatment of those costs will not be raised as an issue in any taxable year before the year of change and, if the treatment of the cost of smallwares has already been raised as an issue in a taxable year before the year of change, that issue will not be further pursued.

.03 Section 481(a) Adjustment. A taxpayer changing its method of accounting under this revenue procedure for the cost of smallwares must take the entire net amount of any § 481(a) adjustment into account in computing taxable income for the year of change.

**SECTION 7. EFFECTIVE DATE**

This revenue procedure is effective for taxable years ending on or after December 31, 2001.

## DRAFTING INFORMATION

The principal author of this revenue procedure is Angella L. Warren of the Office of Associate Chief Counsel (Income Tax and Accounting). For further information regarding this revenue procedure, contact Ms. Warren at (202) 622-4950 (not a toll-free call).

## **Part III—Administrative, Procedural, and Miscellaneous**

### **Industry Issue Resolution Pilot Program**

#### **Notice 2000-65**

#### **1. INTRODUCTION OF A PILOT PROGRAM**

This Notice announces the *Industry Issue Resolution Pilot Program*. The objective of the program is to provide guidance to resolve frequently disputed tax issues that are common to a significant number of large or mid-size business taxpayers. This effort is part of the IRS's strategy to resolve issues in a manner other than the traditional post-filing examination process. The Large and Mid-size Business Division (LMSB) of the IRS will undertake much of the operational responsibility for the projects in the program.

We invite taxpayers as well as industry associations and other groups representing taxpayers to suggest issues and possible options for resolution. Parties submitting suggestions may be asked to meet with government representatives and to provide additional information. After analysis and review, the IRS and Treasury intend to select issues to address in this pilot program. Taxpayers or groups may contact Richard Druk of LMSB's Pre-filing and Technical Guidance Office at (202) 283-8387 (not a toll-free number) to ask questions or to discuss this program.

The form of resulting guidance may vary depending on the issue. However, the most likely form of guidance will be a Revenue Procedure that permits taxpayers to adopt a recommended treatment of the issue on future returns. In many cases, this may require filing a request for a change in method of accounting. Examples of the types of Revenue Procedures that could be issued under this program include: Rev. Proc. 2000-38, 2000-40 I.R.B. 310, on the treatment of mutual fund distributor

commissions; Rev. Proc. 99-26, 1999-24 I.R.B. 38, on employee benefits secured by letters of credit; Rev. Proc. 97-44, 1997-2 C.B. 496, on the LIFO conformity requirement for automobile dealers.

The principal focus of the program is to resolve issues arising in future years. However, depending on the circumstances, resolution also may be provided for certain issues for prior years.

Suggestions for issues for the pilot program should be forwarded as provided in section 3 of this Notice by February 28, 2001. LMSB, the IRS Office of Chief Counsel and the Treasury Office of Tax Policy will evaluate the suggestions with a view to selecting approximately five issues, drawn from diverse industries, for the pilot program. In reviewing potential issues for the program, the selection criteria will include the suitability of the issue for the program, the likelihood that timely guidance can be provided, and the availability of appropriate staffing and other resources.

Projects selected for this program will be handled in a manner similar to items listed on the Treasury and IRS Guidance Priority List.

Parties whose topics are included in the pilot will be notified and may be asked to provide additional information and legal analysis of the issue. The issues selected for the pilot program will be announced publicly. After completing the pilot, the IRS and Treasury will evaluate the program and may then continue the program on a permanent basis.

We believe that the Industry Issue Resolution program offers significant and timely benefits for taxpayers as well as the IRS, and invites interested parties to participate.

## **2. ISSUES APPROPRIATE FOR THE PROGRAM**

The objective of this program is to provide guidance to resolve frequently disputed tax issues that are common to a significant number of large or mid-size taxpayers. Therefore, issues most appropriate to the program generally will have the following characteristics:

- There is uncertainty about the appropriate tax treatment of a given factual situation.

## TOPIC 1.3

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- The uncertainty has resulted in frequent, often repetitive examinations of the same issue.
- The issue impacts a significant number of taxpayers within an industry group, many of which are larger businesses (those with gross assets in excess of \$5 million).
- Factual determination is a major component of the issue.

For purposes of the pilot, the following issues would not be suitable:

- Issues unique to one or a small number of taxpayers.
- Issues under the jurisdiction of the Commissioner, Tax Exempt and Government Entities Division (e.g., employee plans).
- Issues regarding transactions that lack a bona fide business purpose or have as their principal purpose the reduction of federal taxes.
- Issues involving transfer pricing or international tax treaties.

### **3. REQUESTING CONSIDERATION UNDER THE PROGRAM**

No particular format is required for submissions in response to this Notice.

However, submissions should briefly describe the issue recommended for the pilot and explain why there is a need for guidance. Submissions may include an analysis of how the issue may be resolved. In addition, submissions should state the number of taxpayers estimated to be affected by the issue. All submissions will be available for public inspection and copying in their entirety. Therefore, comments should not include taxpayer-specific information of a confidential nature.

Letters should include the name and telephone number of a person to contact should further clarification be needed.

The address to submit an issue for consideration under the pilot program is:

Internal Revenue Service  
Att'n: Richard Druk  
Large and Mid-size Business Division LM: PFTG  
Mint Building, 3rd Floor M-3-321  
1111 Constitution Avenue NW  
Washington, DC 20224

*Alternatively, submissions may be faxed to 202-283-8427 or e-mailed to [pftg2@irs.gov](mailto:pftg2@irs.gov).*

#### **4. ADDITIONAL INFORMATION ABOUT THE PROGRAM**

**Project staffing.** The IRS and Treasury intend to staff each project with a team (the IIR team) that will analyze such information as may be appropriate and propose a resolution. This resolution will require the approval of those officials normally responsible for approving the type of guidance to be issued.

An IIR team will be composed of appropriate personnel from the IRS field, the IRS Office of Chief Counsel, Appeals, the LMSB Office of Pre-filing and Technical Guidance, and the Treasury Office of Tax Policy. A Technical Advisor (formally referred to as an Industry Specialist) also may be a team member. In some circumstances, the IRS may find it necessary to hire outside experts.

**Communication with requesting taxpayer or group and other interested parties.** As part of its efforts to formulate a recommendation for a resolution position, the IIR team may meet with the submitting taxpayer or group, and possibly with other interested parties. It is anticipated that the submitting party and other interested parties will be given the opportunity to present factual data and legal analysis. The IIR team may seek additional factual development or legal analysis from the submitting party or other sources.

Any solicitation of input from affected persons will be done within the requirements of the Federal Advisory Committee Act (FACA). The IRS does not intend to form advisory committees during this process. Input is welcome from interested parties, but they will not be invited to enter into negotiations or to participate in the decision making process with respect to the proposed resolution of the issue.



**Potential inspection of books and records.** An IIR team may consider the inspection of an individual taxpayer's records desirable as part of the factual research necessary to develop its position. Although a team may request such inspection, any such inspection will be voluntary. Any inspection of a taxpayer's records under this program, whether at the initiative of the taxpayer or the team, will not preclude or impede (under section 7605(b) of the Internal Revenue Code or any IRS administrative provisions) a later examination or inspection of records with respect to any tax year, nor subject the IRS to any procedural restrictions (such as providing notice under section 7605(b)) that otherwise might apply before beginning such examination or inspection.

**Disclosure of information provided by interested parties.** Interested parties are encouraged to provide whatever information is necessary to permit the IRS and Treasury to reach an appropriate resolution of an issue. However, this information may be subject to disclosure under the Freedom of Information Act (FOIA).

## **5. COMMENTS**

The IRS invites interested persons to comment and provide feedback on this program. Comments should be sent to the address provided in section 3 of this Notice.

## **6. FURTHER INFORMATION**

For further information regarding this Notice, contact Richard Druk of the LMSB Pre-filing and Technical Guidance Office at (202) 283-8387 (not a toll-free number).

Ms. Deborah Nolan  
Deputy Commissioner, Large & Midsize Business  
Internal Revenue Service  
E-mail: [deborah.m.nolan@irs.gov](mailto:deborah.m.nolan@irs.gov)

**TOPIC 2**

**WHAT IS THE APPROPRIATE LEVEL OF INTERACTION  
BETWEEN POLITICAL INSTITUTIONS AND PUBLIC  
AUTHORITIES TO IMPROVE TAX COMPLIANCE?**

*Lecture:*

*TOPIC 2*

**WHAT IS THE APPROPRIATE LEVEL OF INTERACTION BETWEEN  
POLITICAL INSTITUTIONS AND PUBLIC AUTHORITIES TO  
IMPROVE TAX COMPLIANCE?**

**Alain Jolicoeur**

Deputy Commissioner

Canada Customs and Revenue Agency  
(Canada)

*CONTENTS: Six Principles for Encouraging Compliance.- Nature of Canadian Economy.- The Canadian Experience in Tax Administration.- The Minister of National Revenue.- The Minister and the Taxpayer.- The Minister's Accountability to Parliament.- Consultation on Taxes. Canada Customs and Revenue Agency and Accountability.- The Auditor General – Accountability Ensured.- The Auditor General – Accountability Ensured.- Taxpayers' Rights of Redress.- Fairness and Taxpayers.- Consultations with the Business Community, with Taxpayer Groups, and Other Parties.- CCRA's Future Directions.- Provincial Partners – Coordinating Tax Policy and Administration.- Benefit Programs and the Tax System.- Confidentiality of Taxpayer Information.- Conclusion.*

For thousands of years, Quebec was home to the Iroquois and Algonquin tribes. It is also, in 1665, where the country's first professional tax collector, Jean Talon established himself.

As *Intendant* in the colony of New France, Talon joined executive, legislative and judicial functions in his position. Such an arrangement was workable at the time. In the modern reality of responsible, accountable government and modern economics, it is one which would now be impossible.

It is worth noting that Jean Baptiste Colbert, France's Comptroller General of Finances and the man who appointed Jean Talon, was the man who defined the art of taxation as consisting in "so plucking the goose as to obtain the largest amount of feathers with the least amount of hissing." This statement, I believe, could only come from a bureaucrat/politician who knew how many feathers were needed and knew he would be the one who would have to do the plucking.

A tax system that is efficient and inexpensive – and in M. Colbert's words, "produces" the least amount of hissing" – inevitably means a system of governance that is efficient, effective and based on voluntary compliance rather than government intrusion.

As you know, Canada has a very high level of voluntary tax compliance. Over 95% of our revenues are collected without our having to resort to any sort of enforcement action.

The subject that I have been asked to discuss today is an effort to get to the heart of the challenge of all tax administrators: *What is the appropriate level of interaction between political institutions and public authorities that would contribute to tax compliance?*

What are our observations, as Canadian tax administrators, on the nature of this interaction in achieving this high level of voluntary tax compliance in Canada?

## **SIX PRINCIPLES FOR ENCOURAGING COMPLIANCE**

I would propose for your consideration six principles we have followed which, I believe, are the basis for our level of compliance. These are principles that have been derived slowly and through iteration, but their practical effectiveness has only increased our commitment to them.

I will briefly describe each one, and then discuss their application within the Canadian political and public administrative context.

### **Principle 1: A tax system based on open dialogue and consultation encourages compliance**

The system of taxes themselves must be the result of active consultation with stakeholders and public discussion. This includes discussion with

taxpayer and business groups, with those who represent special interests, and with elected officials. The Cabinet, and especially the Minister of Finance and the Minister of National Revenue, must be publicly and actively involved in this process. This is necessary in order to maintain a consensus on the legitimacy of tax measures, and the perception that they are fair and balanced.

**Principle 2: Compliance is promoted when there is no political interference in individual tax cases**

No uninvited elected political figure may have anything to do with the administration of an individual citizen's tax affairs. All individual taxpayers should be free from partisan scrutiny of their affairs.

**Principle 3: Clear accountability for the administration of taxes increases confidence in the tax system and enhances compliance**

The government of the day, and in Canada's case, the minister responsible for tax administration, must be – and be seen to be – answerable and accountable for the just and competent functioning of the tax system. Effective oversight provisions, responsive redress mechanisms, and functioning political accountability are necessary ingredients for public support, and hence voluntary compliance.

**Principle 4: Taxes and benefits as part of an integrated wealth redistribution system promote tax compliance**

Integration of tax administration and beneficial government programs supports compliance. The citizen can see the blended administration as an exchange of benefits and obligations: the citizen's duty to the state (taxes) and the state's duty to the citizen (social and redistributive programs).

**Principle 5: Cohesive coordination of intergovernmental tax policy and administration encourages tax compliance**

There are several levels of government, but there is only one taxpayer. Faced with inconsistent, uncoordinated, or capricious tax measures

from competing jurisdictions reduces the incentive to comply. This applies in the domestic and the international environment.

**Principle 6: A commitment to taxpayer confidentiality increases taxpayer confidence and taxpayer compliance**

Our experience in Canada suggests that taxpayers must be confident that information provided in connection with tax administration is not used wantonly or arbitrarily for other purposes. That level of confidence is central to tax compliance.

**NATURE OF CANADIAN ECONOMY**

Before I begin to address how we have applied these principles in Canada, I want to give you the economic and political context that affects the way the CCRA operates as a tax administration.

In fact, our job as a tax administrator is actually made easier by the structure of the Canadian economy. While Canada is a large country geographically, our population is proportionally rather small (about 32 million) and it is largely urban. Canada is also a relatively prosperous country. Our GDP exceeds one trillion dollars (Canadian), and personal disposable income is about 21 000 dollars *per capita*.

The major sources of federal government revenues are individual income taxes; corporate income taxes; excise taxes; and a Value-Added Tax on goods and services.

The Canadian personal income tax base consists of a large number of salaried employees. These employees are subject to regular income tax deductions from their paycheques, which are remitted to the CCRA by their employers. Most employers are large businesses. This direct remittance makes it practically impossible for employees to be part of the underground economy.

There are many government-run social programs that are available to employees as a consequence of their employment. An insurance program protects them against the loss of employment. There is a national pension plan which complements private pension plans. Workers' insurance protects employees against earning losses if they are injured on the job. These programs heavily influence the decision as to whether an employer can pay his employees 'under the table'.

Large businesses themselves also incur deductible expenses that are easily traceable to their suppliers. This in turn makes it difficult for suppliers to be part of the underground economy. Since most employers and their suppliers are heavily integrated into the above-the-board economy, Canada has a high level of compliance in Income Tax, VAT tax, and Excise Taxes. This compliance at the federal level also benefits provincial-level tax revenues.

Many compliance issues remain, of course. We have challenges with transfer pricing between multinational enterprises. Derivative financing instruments add complexity. Electronic Commerce requires that we work together in the international arena to combat an erosion of our respective tax bases.

An underground economy does exist in Canada. We have systemic problems in the areas of jewellery sales, the hospitality industry, auto repairs and home renovation. These underground enterprises are usually small one-person operations featuring cash transactions which are therefore difficult to trace. While the underground economy is not large, we believe we have to address this problem to maintain respect for the principle of 'everyone paying his or her fair share'.

This brief overview of the Canadian economy clearly suggests that tax compliance is not merely a question of laws or institutional arrangements, but may be determined primarily by economic structure. Let's keep this in mind as I discuss the six principles that I believe support tax compliance in Canada.

## **THE CANADIAN EXPERIENCE IN TAX ADMINISTRATION**

The first principle that sustains tax compliance that I set out was that the tax system had to be based on open dialogue and consultation, while another principle addresses clear accountability for the administration of taxes. Both these principles are embodied by the Canadian parliamentary process.

The Canadian system of government derives from the British or Westminster model of responsible government. That model traces its lineage back to the *Magna Carta* in 1215. From the *Magna Carta* arose a representative assembly, or Parliament, whose purpose was to advise and approve the spending and taxing plans of the King, or executive. As such, the *Magna Carta* was a first and extremely important step in

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broadening participation in the decision-making processes of government – in the Westminster context, 1215 marked the end of the right of the monarchy (or any subsequent government) to argue the legitimacy of sweeping decisions made without dialogue and consultation.

In Canada, the approval of spending and taxing continues to be a primary responsibility of Parliament. In Canada “Parliament” is composed of an appointed upper chamber, the Senate, and an elected lower chamber, the House of Commons. The party enjoying a plurality in the lower chamber forms the Government.

The Government of Canada is directed by a Cabinet composed of a Prime Minister and ministers selected by the Prime Minister. Most members of Cabinet are elected members of the lower house, but occasionally senators are named to Cabinet.

The Government is responsible to Parliament which debates and passes into law the government’s legislative program, and approves Government spending plans and all tax measures.

In the Canadian system, these Cabinet ministers comprise the executive of the Government. For the most part, the vast majority of powers and authorities created by legislation are vested with a minister, not with a government department or agency. The various organisations that together comprise the Canadian government bureaucracy exercise powers given by Parliament to a certain minister, and which are in turn delegated by that minister to government officials.

There are two ministers with particular responsibility for taxation matters. The Minister of Finance is one of the most senior ministers of Cabinet, and is responsible for setting the country’s fiscal goals, determining tax policy, and for shepherding new tax measures through Parliament.

It is the second minister, the Minister of Revenue, who is the national tax collector. The Minister of National Revenue directly delegates the authority for collecting taxes to the Canada Customs and Revenue Agency.

The authority for these tax collection powers devolves from the *Income Tax Act*, the *Excise Act* and the *Excise Tax Act*. These pieces of legislation provide the foundation for Canada’s tax collection system, but in fact the CCRA administers all, or part of, over 180 different acts.



## **THE MINISTER OF NATIONAL REVENUE**

In many respects the Minister of National Revenue has a more complex balance of accountabilities than does any other minister of the Canadian Cabinet.

By convention, the minister has no involvement in the actual administration of an individual taxpayer's file, notwithstanding the statutory powers. In Canada it has been long recognised – and accepted – that for a system of tax administration to be seen as credible and having integrity, there can be no involvement by elected political office-holders in the affairs of an individual taxpayer. This practice, as you may recall, embodies the second principle I set out: no political interference in individual tax cases.

## **THE MINISTER AND THE TAXPAYER**

This is not to say that the minister has no relationship with the citizen as tax-payer. On the contrary. The minister is accountable to that taxpayer for fair and just treatment. The minister may be asked to involve herself in a particular case – but only by the taxpayer.

The relationship is clear: the minister must be seen to be responsive, but will act in matters affecting an individual only on the appeal of that individual. This practice reflects the third principle I set out – if there is clear accountability for the administration of taxes, there must be responsive redress mechanisms and functioning political accountability.

## **THE MINISTER'S ACCOUNTABILITY TO PARLIAMENT**

The minister of National Revenue is accountable to Parliament, as I said before.

This means that she must be prepared to account for the operation of the tax system to the House of Commons, Parliamentary Committee, and to individual Members of Parliament. Again, this accountability gives substance to the third principle I proposed – clear accountability for the administration of taxes.

Indeed, members of Parliament of all political convictions and flavors have the opportunity to query the Minister of National Revenue during

a daily question period while Parliament is sitting. These questions can relate to tax administration issues raised directly by constituents with their representative, or can arise from issues reported in the media. As well – and I'll enlarge on this a little later – the Minister is also called to appear before Committees of the House of Commons to give evidence and answer questions relating to tax administration issues.

The Minister of National Revenue must, as do all other Ministers, report to Parliament on the forward plans, activities and results of the organization for which she is responsible. The Minister annually tables a business plan in Parliament for the CCRA, and tables an annual report detailing the Agency's performance against its plans. The CCRA has taken special pains to ensure that its annual report is prepared in a way that illustrates its performance (good and bad). The document is written in a manner that provides an uncomplicated guide for Parliamentarians to easily assess performance and to provide guidance to the Agency on its future activities.

I should note that this Annual Report is carefully scrutinized by the Auditor General, who is required by the CCRA Act to render judgement on the fairness and accuracy of the contents.

## **CONSULTATION ON TAXES**

Parliament also is the forum in which the process of dialogue and consultation – my first principle – is played out. Each year, generally in mid to late February, the Minister of Finance tables a budget in Parliament. This document presents the Government's view of the economy, sets out new spending programs, and spells out how government revenues will be generated.

Before the budget is presented, however, committees of Parliament hold public hearings on the economy and receive advice on fiscal policy including tax measures. They receive submissions and hear testimony from a variety of invested parties – small business, manufacturers, financial industries, associations, academics and think tanks etc. These committees issue reports expressing their views that may reflect the representations they have received.

The Minister of Finance also conducts a wide range of meetings with various business and representatives of public interest groups. These groups almost always make representations on tax policy issues.

Government caucus and individual members of Parliament present suggestions to the Minister, including suggestions on tax policy.

The full cabinet is also involved – its members, as well as all government members, take responsibility for ensuring that once the budget has been tabled in Parliament, the public across the country is well informed as to the content, the purpose and the benefits there for them.

The officials of the Ministry of Finance, assisted by legal counsel of the Department of Justice and with input from the officials of the CCRA, actually do the drafting of the budget, which involves many policy decisions. I should add that because of the potential impact of the Budget on Canadian economic markets, the specific details of the Budget document are highly secret until it is tabled in Parliament by the Minister of Finance, even if the budget consultations and media reports (not to mention the declared political platform of the governing party) give a sense of overall policy direction.

Apart from the Budget-tabling process, draft legislation is often published for public comment. The Minister and the drafters take submissions into account before the bill is tabled by the Minister. The extent to which tax policies result from a consensus or at least are seen to be acceptable has a direct influence on tax compliance.

## **CANADA CUSTOMS AND REVENUE AGENCY AND ACCOUNTABILITY**

The principle of clear accountability underlies the creation of the Canada Customs and Revenue Agency.

In 1999, the Department of National Revenue, a conventional government department, was given a new structure. As a new, more autonomous organisation, it became the Canada Customs and Revenue Agency.

The Canada Customs and Revenue Agency remains a public service institution, but it has a unique governance structure that reflects the principle of clear accountability for tax administration. This structure allows it to operate at increased arm's length from government while maintaining a direct, legislated relationship with the Minister. Created by an Act of Parliament, the CCRA has specific, legislated roles and responsibilities for its Board of Management and its Commissioner or CEO.

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The overall result is increased management flexibility and improved accountability to taxpayers, to other government departments as well as to provincial governments on whose behalf the Agency delivers tax and benefit programs.

Under the *Canada Customs and Revenue Agency Act*, the Minister of Revenue remains accountable to Parliament for the administration and enforcement of program legislation. This guarantees that she has the ability to take action to ensure that the Agency operates within the government framework, and to ensure the Agency treats clients with fairness, honesty and integrity.

The Agency's Board of Management, comprised of members drawn from the private sector and largely nominated by the provinces and territories, has the authority to oversee the management of the Agency to ensure accountability in human resources and administrative areas.

The Agency's Commissioner is responsible for the day-to-day administration and enforcement of program legislation under the Minister's delegated authority, and day-to-day management of the Agency under the Board's direction on management matters. As well, he is accountable to provincial ministers for the administration of legislation or programs contracted to the Agency. Under the CCRA Act, the Commissioner is required to offer to meet with provincial ministers each year to discuss the Agency's performance and future direction.

I would like to stress the consultative approach that underlies the operation of the CCRA. It has a Board of Management with representatives outside the government structure. Its creation depended heavily on a private sector Advisory Board which influenced greatly the design and eventual legislation. And now, as the CCRA moves towards continuous improvement in what we have termed our "Future Directions" initiative, round-tables with business representatives and other stakeholders are being held across the country.

### **THE AUDITOR GENERAL – ACCOUNTABILITY ENSURED**

The principle of accountability is further buttressed by the role that the Auditor General of Canada plays in ensuring a just and functionally effective tax administration system.

Parliament, the government and the public service are the recipients of public funds entrusted to them for delivering programs and services to benefit Canadians. We believe that an important element of tax compliance is directly related to the confidence and belief that people have that public funds are spent wisely and effectively. There must be value for money spent, and public monies should not be spend without the necessary authority.

To ensure that this spending is carried out properly, the Auditor General conducts independent audits of federal government operations. These audits provide members of Parliament with objective information to help them examine the government's activities and hold it to account for its stewardship of public funds. Several times a year, the Auditor General reports on its review of government operations. Generally these reports include some element of CCRA's many activities. A special committee of Parliament has the authority to hold public hearings on the Auditor General's final report. This openness instils confidence in the integrity of tax administration.

### **TAXPAYERS' RIGHTS OF REDRESS**

The need for responsive redress mechanisms is part of the principle of clear accountability I proposed. That mechanism is readily available to Canadian taxpayers. A number of formal and informal avenues are available that allow taxpayers to challenge decisions and positions taken by the CCRA. The most basic and obvious approach is that they can always speak to the tax official's 'supervisor'. This 'supervisor' can include myself, the Commissioner and/or the Minister.

To ensure consistency in the administration of programs and policies that could have a significant impact on taxpayers and to mediate disputes that could arise, we often establish committees of internal experts. For example, Canada introduced a provision to respond to aggressive and inappropriate tax avoidance strategies. This provision was named the General Anti-Avoidance Rule (GAAR).

After significant consultation with various interest groups, it was determined that a central committee of senior tax officials should examine the application of this provision. One objective was to ensure national consistency in its application.

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Prior to recourse to the Canadian court system, the taxpayer has the opportunity for an independent review of the facts and or interpretation of the law with our Appeals function. While the Appeals Branch is part of the CCRA, we have taken great steps ensure its autonomy.

We also have an additional way to avoid the need for redress. Through an advanced rulings program, taxpayers can obtain a ruling, legally binding on us and them, on tax implications which may arise from a complicated transaction.

As an example, advanced rulings are obtained to facilitate corporate mergers and acquisitions, or in estate planning by high-income individuals. As long as all the elements of the planned transaction are disclosed, the ruling by the CCRA assures the taxpayer that no unforeseen tax liabilities will arise from the transaction.

If the taxpayer did not obtain a ruling, or if the dispute was not settled through the informal dispute resolution procedures I have just described, taxpayers appeal the decision of the CCRA to the Tax Court of Canada.

For those who wish to avoid a formal legal process, the Tax Court allows individuals to select an informal route where they can represent themselves and therefore minimize the cost of retaining a lawyer.

Both the government and the taxpayer have the right to appeal decisions of the Tax Court to the Federal Court of Appeal. A final appeal can be taken to the Supreme Court. However the Supreme Court reserves the right to consider only those cases which have national implications and can thus refuse to hear cases.

It is important to note that individuals and small businesses who challenge positions taken by CCRA do not have to pay income tax amounts that are in dispute until they have had a formal review by the CCRA or, if they have filed an appeal, until the Tax Court of Canada issues its decision. Large corporations are required to pay half of the amount in dispute. However, interest charges apply during any period that an amount in dispute is not paid.

I would just like to add that in the process of redress, the CCRA does not always emerge as the winner. The fact is that the independence of the review process and of the Canadian judicial system does indeed give taxpayers a reasonable expectation of successfully challenging CCRA rulings, particularly when they fall in 'gray' areas of policy or practice. The fact that we lose cases further supports the principle that the tax system must be, and must be seen to be fair and balanced.

### **FAIRNESS AND TAXPAYERS**

Similarly, the CCRA has Fairness provisions that provide common-sense ways to help clients who, because of extraordinary circumstances, are unable to meet their tax or customs duty obligations. Measures to ensure fair treatment were added to the *Income Tax Act*, *Customs Act*, and *Excise Tax Act* in the early 1990s. More recently, these provisions were revisited to ensure that they are relevant, and that they are appropriately supported within the CCRA by knowledgeable and trained staff.

To the CCRA, "fairness" means applying legislation impartially, justly and consistently. Fair treatment also requires being open, clear, courteous, responsive, timely and accessible.

The CCRA also has a Voluntary Disclosures Program which promotes voluntary compliance with the *Customs Act*, *Customs Tariff*, *Income Tax Act*, and *Excise Tax Act*. This program allows individuals and/or businesses meeting specific conditions to come forward and correct deficiencies without being penalized or prosecuted.

Clients can correct inaccurate or incomplete information, or disclose information they did not previously report. For example, clients may not have met their tax obligations if they claimed ineligible expenses, failed to remit source deductions or the GST, or did not file the correct customs accounting information. Clients who make a voluntary disclosure only have to pay the taxes and duties owing, plus interest. They will not be penalized or prosecuted.

Both the Fairness Provisions and Voluntary Disclosure reflect the principle that effective redress mechanisms are essential to sustain tax compliance.

## **CONSULTATIONS WITH THE BUSINESS COMMUNITY, WITH TAXPAYER GROUPS, AND OTHER PARTIES**

I discussed earlier the extensive consultations that go into the preparation of the Federal Budget and the development of tax policy. Canadian tax administration also benefits greatly from consultation with the client groups with which it deals on a regular basis: tax professionals, tax executives of large corporations, academics, seniors, small business, payroll associations, customs brokers, senior citizens, the disabled, and government officials of other departments. In adhering to the principle of dialogue and consultation, I believe that new tax-related initiatives enjoy a higher level of success and acceptance than they would otherwise.

I cannot stress enough the role of the Minister in these consultations. As the political figure responsible for the CCRA, she ensures that those who have views and suggestions as to the direction and management of tax administration in Canada have a forum and are provided with an opportunity to voice their views.

Obtaining public views and assistance in designing programs helps to reduce or eliminate administrative burden on their clients or groups they represent. They can encourage their clients to cooperate, which improves compliance at a lower cost to the taxpayer and the Agency.

Electronic Commerce is likely to represent a major challenge to tax administrations in the next few years. We have been fortunate to have the leading tax practitioners in Canada volunteer to be participants on technical advisory committees to examine the International and Interpretive Issues facing Income Tax, Consumption Tax Issues, Compliance Issues and Taxpayer Service Issues. This participation has helped us to analyse the many challenges of electronic commerce and to focus our attention on the remedies. Their contribution is also invaluable when we meet in international venues to work together as tax administrators.

## **CCRA'S FUTURE DIRECTIONS**

The commitment to the principle of consultation is reflected in our approach to the tax administration of the future. With technology, the global economy, and our own society evolving so rapidly, we must actively transform CCRA's services to keep pace with those changes and to respond to the expectations of Canadians.



Our *Future Directions Initiative* is key to meeting this challenge. *Future Directions* is a process of engagement. We are inviting staff and their unions, our clients and the public to provide their perspective and input on what the CCRA should and must be, and to contribute to defining how those changes will be achieved.

Four working groups are examining the CCRA's current services and programs affecting four key groups of clients: small and medium enterprises, large businesses, individuals and benefits recipients, and charities. Through consultation, research, and dialogue, together with feedback received from CCRA staff and management, we will develop a plan to guide the CCRA into the future.

Ultimately, the *Future Directions* initiative will ensure that we have a business transformation program in place enabling the CCRA to respond to future service needs, expectations and priorities of Canadians. More effective and efficient methods will make it easier for Canadians to comply with their tax obligations by reducing their compliance burden.

### **PROVINCIAL PARTNERS – COORDINATING TAX POLICY AND ADMINISTRATION**

The fifth principle I set out – that there has to be cohesive coordination of intergovernmental tax policy and administration – has strong support in Canada. The Government of Canada and the CCRA actively cooperate and partner with the provincial and territorial governments of the country.

The need for coordination is crucial in this country. I referred earlier to the decentralized nature of Canada's governing processes that make it the loosest federation in the world. The ten provinces and three territories that make up Canada have more governmental autonomy than any sub-national government in any other country.

Provinces have exclusive jurisdiction in important areas affecting Canadians. Health care and education, to name but two, are among the largest components of the national public sector budget that are within provincial control.

Provinces also have unrestricted taxation powers. There is no area of taxation not open to provinces. All provinces have their own personal and corporate income tax regimes, and all but one have distinct provincial consumption taxes.

Through regular consultation, and merged administration in many areas, federal and provincial tax policy and tax administration is well coordinated. Indeed, great efforts are made to avoid competitive taxation.

In Canada, the public debate over the role and powers of the federal government versus provincial governments is lively and indeed, some would argue that it is unending.

In the area of tax administration, however, there is a high degree of cooperation. The CCRA administers income taxes for nine of ten provinces. Quebec, which has its own ministry for tax administration, administers the federal consumption tax, the GST, on behalf of the federal government.

The federal government has agreements with all ten provinces governing the reciprocal collection of taxes. These agreements set out respective responsibilities and accountabilities for issues such as payments, remittances, audits and reporting. In general, it is the CCRA who acts as agents on behalf of the provinces in tax collection. However, it is interesting to note that tax collection agreements can work in the other direction too: by agreement, the Province of Quebec collects the federal VAT in Quebec (in Canada we call it the *Goods and Services Tax*) on behalf of the Government of Canada.

## **BENEFIT PROGRAMS AND THE TAX SYSTEM**

Another principle I proposed – that compliance is promoted by having Taxes and Benefits as part of an integrated wealth redistribution system – is actively realized in Canada.

The federal government and provinces administer a number of benefit programs that provide payments or other benefits to Canadians. Many of these programs – Employment Insurance, Social Security programs, Child Benefit programs, education savings programs, Workmen's Compensation Benefits, and workplace accident insurance – are administered through the tax system or depend on information drawn from the tax system.

There are two advantages for integrating benefits into the tax system. The first is efficiency and convenience. A comprehensive tax administration must collect and maintain an information system covering

just about every household in the country. Such a database is invaluable for the administration of programs that distribute benefits. It is only natural to take advantage, to the extent feasible and appropriate, of this valuable information resource.

The second advantage to integrating benefits distribution into the tax collection system is in many ways more important, and touches directly on the issue of tax compliance.

The tax system is not only a means of collecting revenue to support the cost of running national and provincial governments; it also represents a system of income redistribution. In Canada, we have progressive taxation. That means that embodied in the tax system itself is a first element of redistribution. There are many other programs, moreover, that involve redistribution of income and conferring benefits to the eligible that are not tax measures but which are highly integrated with our tax system.

At some time or other, all Canadians pay taxes, and all are recipients of some of these benefits. Integrating the process of levying taxes with the distribution of benefits underscores the relationship between these two government functions, and reinforces the civic compact between citizen and state. Because the tax administration system confers benefits to almost every Canadian, there is a powerful incentive to each Canadian from early adulthood to participate in the tax system. By engaging citizens in the benefits distribution aspect of our system, we automatically improve compliance.

## **CONFIDENTIALITY OF TAXPAYER INFORMATION**

The final principle I set out – compliance is promoted by ensuring taxpayer confidentiality – is a cornerstone of Canadian tax policy and administration.

In Canada, information on an individual taxpayer collected under the authority of tax legislation is highly protected. It cannot be shared with any other party or used for any other purpose unless that other use is explicitly authorised by legislation, or the taxpayer has given consent.

To give an example of how seriously we treat taxpayer confidentiality, our *Income Tax Act* specifies that any official responsible for the unauthorized release of taxpayer information is liable to criminal

penalties. I have stressed the term “criminal” because unauthorized disclosure is not dealt with by some mild bureaucratic sanction.

Taxpayer information is, of course, very valuable. It is the most comprehensive source of up-to-date household information in the Canadian economy. Its potential use for government and non-government purposes is considerable.

Even where information sharing is permitted by law, for the sole reason of supporting voluntary compliance, we place great restrictions on sharing this information. For the CCRA, consideration of a new use of taxpayer data is tested primarily against this yardstick – the effect on public perception and hence compliance.

This does not mean we do not share information – only that the individual taxpayer must agree: For instance, the names and addresses of taxpayers who consent are shared with the agency that organizes and carries out Canada’s federal elections. Not all addresses are shared, but the information that is provided lowers the cost of maintaining voter lists.

Taxpayer information is also a valuable tool for effective tax administration, particularly in the area of international cooperation. As our economy evolves to include the important opportunities presented by E-commerce, we also know that it will challenge our tax administration. I believe that important work in the area of exchange of information will benefit us all. I know that CIAT is presently making excellent progress on a Model Agreement for Multilateral exchange of information between member countries. This agreement, while respecting the confidentiality of information, will allow each of us to verify that multinational corporations pay their fair share.

## **CONCLUSION**

The experience of the Canadian political and public administration clearly suggests that the six principles I listed earlier are in no small part responsible for our tax compliance success.

In the Canadian context, I have to conclude that tax compliance requires interaction between political institutions and public authorities that is constant, clear and sensitive. The checks and balances that we have evolved in our political and administrative systems suggest that there

cannot be isolation between policy makers and policy implementers. Having said that, accountabilities and powers cannot be arbitrarily assumed or abandoned. Tax compliance is based on taxpayer faith and trust: while it may be difficult to achieve that trust, its loss is even more disastrous.

In closing, I would like to emphasize three *caveats* that you should apply to what I've said this morning.

First, the Canadian experience is valid only within the Canadian political context. Our solutions may not work in other jurisdictions having different political, legal, economic and social frameworks.

Second, we do not presume to know all the answers. We are still working at our compliance challenges, and even a small change in our political or social matrix could result in a decline in our compliance rates.

Third, what works today may not work tomorrow – we can never rest on our laurels. The global economies and political processes are evolving far too quickly for us to relax. We all live in a world where we either improve or we fail. And none of us will ever be able to say that we are perfect.

With the complexities of the world today, we can never delegate to one individual or integrate into one organization the span of control that Jean Talon exercised here in this very town 335 year ago. As *Intendant*, he was responsible for finance, health, sanitation, justice, police, defence, and even the first census in Canada. Indeed, Talon made his mark in the New World. I think, as a public administrator *par excellence*, he would have appreciated the challenges that we as tax administrators face in our work. And I don't doubt that his active mind would find great value in discussing with us the tax administration challenges of twenty-first century.

I can assure you that we at the CCRA find gatherings such as this CIAT General Assembly to be tremendously rewarding. We truly value learning from each and every one of you about your experiences, just as we learn from our own.

Meetings such as this one convince me more and more that the management of a tax administration is not one that any of us can approach lightly. We cannot experiment blindly; we cannot undertake risky pilot projects when we are responsible and accountable for the

## TOPIC 2

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finances of our governments. I believe that gatherings such as this one make all of us more capable of fulfilling our mandates.

I would like to thank you for your attention to this presentation today. I will look forward to your comments and questions now and over the next few days as we look at the challenges that lie before us, collectively and individually.

Mr. Alain Jolicoeur  
Deputy Commissioner  
Canada Customs and Revenue Agency  
E-mail: [Alain.Jolicoeur@ccra-adrc.gc.ca](mailto:Alain.Jolicoeur@ccra-adrc.gc.ca)

*Case Study:*

*TOPIC 2.1*

**MECHANISMS OF COORDINATION AND COOPERATION  
BETWEEN GOVERNMENT AGENCIES  
(THE ADEQUACY OF THE DATA BASES AND  
INFORMATION SYSTEMS FOR INTERNAL COOPERATION  
BETWEEN PUBLIC ORGANIZATIONS)**

**Matthijs H. Jacob Alink**

Deputy Director International  
Ministry of Finance  
(The Netherlands)

*CONTENTS: 1. General Frameworks and Examples of Areas of Cooperation.-  
2. The Risk-selection Model in The Netherlands.- 3. Three Important  
Aspects with Respect to Cooperation.- Base registrations.- The 'Al  
Capone bias'.- Procedural aspects.- 4. Example of an Action Plan.*

**1. GENERAL FRAMEWORKS**

Cooperation is, above all, surrendering some of one's own autonomy: cooperation means that the interests of other parties must be taken into account. You must consult with other parties on what you are going to do, when you are going to do it and how you are going to do it. Many government organizations in the Netherlands nevertheless work together, so they apparently feel that the benefits surpass the aforementioned disadvantages. In the next pages, I will seek to objectify and specify the benefits as experienced by these organizations.

First of all: what working together means?

Working together in this context means any type of cooperation related to enforcement, focusing on:

- Policy, legislation and evaluation
- Prevention
- Control
- 

Cooperation activities may be performed in the fields of knowledge-sharing, file comparisons, exchange of information and joint investigations. The basic principle is the intention to stimulate forms of cooperation at all levels within the organization if they are efficient and effective. This also includes the monitoring of existing forms of cooperation, in the sense that it is reviewed to what extent they meet the requirements and have the intended effect. There must also be an internal cohesion between the specific forms of cooperation.

In the Netherlands, the Tax Administration mostly works together with implementing bodies in the field of social security (in particular, policy, prevention and control) and with the Ministry of Justice (in particular, investigation). In addition, the administration works together with all other ministries in the implementation of rules and regulations related to the concept of income or in the implementation of rules and regulations focusing on target groups such as entrepreneurs.

The cooperation is better in cases where the mission, the strategies and the operational objectives of the other organizations coincide with those of one's own organization. In this context, it concerns issues such as the description of the problem, the selection method with respect to items to be dealt with, control methods, the publicity regarding the joint action (both in advance and afterwards), etc.

The existing forms of cooperation: Ministries of Finance and Social Affairs and Employment (or SZW).

The existing joint ventures have been classified below according to the different links in the enforcement chain: policy/legislation/evaluation, prevention, control and investigation. Each item includes a brief description of what the cooperation includes.



### **Policy/legislation/evaluation**

- Harmonization of legal terms

SZW and Finance are seeking to harmonize the legal terms, e.g., in the field of the wage concept and the concept of the entrepreneur.

- Base Enterprise Register

The Tax Administration and the UWV (implementing social security bodies) actively contribute to the establishment of a base enterprise register (under the auspices of the Ministry of Economic Affairs - EZ).

- The policy regarding identity fraud

SZW and Finance jointly draw up proposals to formulate any actions to counteract irregularities with respect to tax and social insurance numbers.

### **Prevention**

- Manual for entrepreneurs

The Manual for Entrepreneurs including an extensive summary of the rights and obligations of entrepreneurs and an explanation on the generally applicable statutory provisions, is drawn up by the Tax Administration and the UWV and handed out free of charge to starting entrepreneurs.

- Adoption of Collective Bargaining Agreements (or CAO)

The Tax Administration assesses, in consultation with the UWV, the relevant fiscal aspects of any recently concluded CAOs.

- Development of sector-related documentation

As regards some sectors, information is exchanged between the Tax Administration and the UWV in order to develop the sector-related documentation.

- Joint active media approach

The target group that is the subject of a joint action is actively approached via the media.

## **Control**

- Cooperation and exchange of information between Tax Administration and the UWV

The control reports of all wage controls are mutually exchanged. In addition, it must be further examined, in consultation with the Tax Administration and the UWV, in what other fields the exchange of information may have an added value.

- Joint controls

Annually, some 40 joint controls are planned and performed at a number of large enterprises (the parties involved are the large-enterprises units of the Tax Administration and the UWV). Ideally, the Tax Administration and the UWV harmonize their general control policy whereby special attention is drawn to certain sectors in a given year.

- Regional control platforms

Local control activities by the Tax Administration, the UWV, the Employment Inspectorate (or AI) and the Aliens Police. In several regions, so-called control platforms are set up organizing the joint control activities, the exchange of information and such.

- Development of computerized audit tool for salary administrations (Clair/audit file)

Further to the Audit file/Clair audit tool, the Tax Administration and the UWV are developing a joint audit tool to support the audit of salary administration.

- Cooperation in the control of persons working illegally in the Netherlands

The parties involved exchange information for the benefit of the implementation of the Foreign Nationals Employment Act (*Wet arbeid vreemdelingen*), the tax levy and the social security contributions.

- Regional interdisciplinary fraud teams

In around 8 regions, several control and investigative bodies including local authorities, the Tax Administration, the UWV and the AI work together. This cooperation concerns the outline of fraud structures, the additional tax assessments, the collection of contributions and discontinuing of benefits wrongly granted.

- Local target group-oriented joint ventures

Local teams have been set up to curb the large-scale fraud in some specific sectors, with the participation of the Tax Administration, the AI, the UWV, Confection Intervention Team or CIT, Catering Establishments Intervention Team or HIT, Westland Intervention Team (WIT) and projects focusing on temporary employment agencies and manual farming labour.

### **Investigation**

- Multi-disciplinary investigations

Multi-disciplinary investigations are conducted under the auspices of the public prosecutions department, involving, to date, in particular, the Fiscal Intelligence and Investigation Service (or FIOD) and the Joint Administration Office (or GAK). Both organizations also work together with the interregional fraud teams.

Blank spots of cooperation: ideas for the future

The various links of the enforcement chain: policy/legislation/evaluation, prevention, control and investigation, offer more opportunities to extend the cooperation. A recent survey showed that more cooperation is possible within the following areas.

### **Policy/legislation/evaluation**

- Administrative sanctions

Joint development of legal opportunities for administrative sanctions.

- Uniformity of terms

Research into the opportunities of further uniformity of terms, e.g. a definition of the term fraud.

- Legislation regarding the registration of persons and enterprises

Joint preparations of legislation leading to a base enterprise register (or BBR).

- Treaties

To review to what extent cooperation is possible in the implementation of international treaties in the field of tax and social security.

- Registration and verification of new employees

The employers must be enabled to register and verify the tax and social insurance numbers of new employees in a simple and quicker manner (telephone, Internet etc). Subsequently, it must be possible to signal fraud at an early stage by means of the automatic file chaining (population administration, the file on employments and information of the Tax Administration and the UWV on self-employment declarations issued). Currently, the employer must register any new employees with the UWV within 30 days. It is intended to reduce this term from 30 days to 24 hours.

### **Prevention**

- Joint information campaigns

Joint approach of target groups with information material explaining the rules and regulations of both the Ministries of Finance and Social Affairs and Employment.

- Exchange of sector-related information

In the context of the development of the risk analysis, the UWV's Collecting Function has had sector descriptions drawn up. It seems logical to exchange this sector-related information with the Tax Administration.

- Media policy

The Tax Administration, the UWV and the AI could formulate a joint active media policy with respect to all relevant joint ventures. This policy must be included in a new cooperation agreement between the Tax Administration and the UWV.

**Control**

- Knowledge centres

The knowledge of the Ministry of Social Affairs and Employment may be incorporated in the knowledge centres of the Tax Administration and SZW may use the Tax Administration's knowledge.

- Sharing knowledge on risk control

The Tax Administration works on the basis of risk control models. It may be examined to what extent the SZW may also be involved in this.

- Comparison of files

The opportunities to compare files must be used wherever possible.

**Investigation**

- Cooperation FIOD (Fiscal Intelligence) and SIOD (Social Intelligence)

Since the SZW will also have its own special investigation service at its disposal, it seems logical to examine to what extent both organizations may work together in practical terms (training, internships, administrative information etc).

- The relationship with the public prosecutions department

Further to the previous aspect, the uniformity of the manner in which administrative information concerning the prosecution of criminal cases is drawn up may be increased. The same applies to the conclusion of so-called enforcement agreements with the Ministry of Justice.

**2. THE RISK SELECTION MODEL IN THE NETHERLANDS**

Cooperation by joint supervision requires, first of all, that the parties agree on the subjects to be controlled. The insight into one's own selection method and that of the other party must provide the basis for a fruitful collaboration. A general overview of the selection method of the Dutch Tax Administration is therefore provided below. In this context, the connection with the entire law enforcement policy is also discussed.

Law enforcement consists of three components, application of law, supervision and provision of services. The control and verification process forms part of the supervision component. On the one hand, law enforcement must comply with the requirements of legal equality, while, on the other hand, on the basis of efficiency and effectiveness in the performance of its duties, the Tax Administration must make choices with respect to the extent of the supervision. This means that the implementation must be business-like, based on rational arguments and not arbitrary. Making choices is regarded as the selection policy.

The selection policy is based on risk control. A risk is the (negative) chance of non-compliance in a specific situation, whereby non-compliance is defined as the failure to comply voluntarily with tax obligations. Risk control is the systematic reduction of non-compliance, wherever possible.

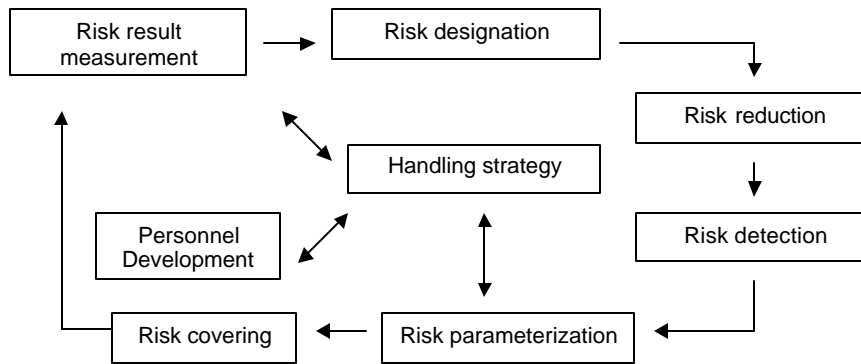


Figure 1 *Relationships handling strategy, allocation, risks and handling form*

The basic principle of the handling strategy is that a taxpayer is given the attention he deserves.

The higher the risk, the more attention.

The risk allocated to a taxpayer (in a specific situation) is based on two components: the fiscal interest and the fiscal risk. As regards the latter, a distinction is made between subject risk and object risk.

An attention-category model has been developed to operationalize the fiscal interest and the fiscal subject risk. As a result, homogeneous client groups are created. The operationalization of object risks is an entirely different path.

The handling strategy expresses the amount of attention, the handling form and the intensity.

Aspects such as the available capacity and personnel development determine the extent to which a selected handling strategy may actually be used in practice.

The process of risk control consists of a number of logical and consecutive steps.

- Risk designation: the discovery and description of the risk in the enforcement of tax laws. Many risks are obvious, such as the payment of black wages in labour-intensive enterprises. Other risks require knowledge of specific regulations in the sectors, such as the payment of commissions.
- Risk reduction: how can a risk be reduced. Measures such as amendments to the legislation, the provision of more or better information and the improvement of the use of counter information are examples of reducing recognized risks.
- Risk detection: if a risk continues to exist, despite the reduction measures, it is important to detect the risk in the stream of tax returns.
- Risk parameterization: the risk must be weighed against all other risks and a handling capacity must be allocated to it. The adequate approach (handling form) to the risk is determined in conjunction with the handling strategy.
- Risk covering: the actual handling of risks with knowledge support for the handler.
- Risk result measurement: periodic evaluation is necessary to continue to measure the gravity of the risk systematically. If a risk appears to be more important than originally believed, more capacity may be allocated to the handling and vice versa.

### **3. THREE IMPORTANT ASPECTS: BASE REGISTRATIONS, THE 'AL CAPONE BIAS' AND PROCEDURAL ASPECTS**

#### **3.1 Base registrations**

##### *Introduction*

The exchange of information and the (computerized) comparison of files is an important part of the cooperation projects. Anyone who has ever sought to compare two files will recognize the following experience: computers are very quick, but also very stupid. A unique key is essential for a useful comparison of two files. If such a key does not occur in both files, the file comparison provides mostly disinformation. For this reason, and for many other reasons, the Dutch government has launched an extensive programme that must result in a number of base registrations of information for persons, enterprises and buildings. Given the importance of this development for the subject of this presentation, I would like to discuss this in further detail.

The Streamlining Basic Data programme (*programma Stroomlijning Basisgegevens*) has the following motto: the government does not ask the obvious. This refers to the ideal situation where persons and enterprises do not have to provide information to any government body if they have already demonstrably furnished this information before. It is up to the joint government bodies to realize this ideal situation.

It is clear that this will be a major operation for the government as a whole, one that will not go without a hitch. A central element of this programme concerns the reorganization of the most important and most widely used data by developing so-called authentic registrations that will act as the unique source for (clusters) of data throughout government. Persons and enterprises will then be bothered less often by questions; at the same time, the government will be in an improved position with respect to information and it will be more difficult to fool the government. Examples of registrations where this situation has, more or less, already been attained are the Municipal Personal Records Database (*Gemeentelijke Basisadministratie voor Persoonsgegevens*) and the Land Register (*Kadaster*). A third base register: the Base Enterprise Register is of particular importance for cooperation by the Tax Administration.



Streamlining Basic Data was launched at the start of 2000, after a preparatory phase, and is expected to continue until the end of 2002. Virtually all the ministries and the Registration Board (*Registratiekamer*, currently referred to as the Data Protection Board (*College Bescherming Persoonsgegevens*)) participate in the programme.

### ***Backgrounds Streamlining Basic Data programme***

The government frequently faces issues whereby the availability of current and reliable data is essential. It becomes increasingly clear that the data registration of the government is defective and to what problems this leads. It becomes apparent:

- in the enforcement, since the data are not available to all parties, are incomplete, out of date or contain conflicting information;
- in combating fraud, as objects (persons, enterprises, buildings and such) are not uniquely identifiable, as data regarding these objects turn out to be incorrect, or because the desired file chaining fails due to the lack of standardization;
- in the reduction of the administrative burden for persons and enterprises, i.e. in the government policy to refrain from requesting persons and enterprise for the same data;
- in the modernization of the public services where the introduction of the no/one-desk idea and pro-active provision of services may only be realized in part as long as the data necessary for this remain spread around various government back offices;
- in the efficient set-up of the internal business operations of the government, as the same data are gathered and managed by several organizations as a result of which unnecessarily high costs are incurred and scarce ICT expertise is not used sufficiently efficient;
- in the policy-making, policy monitoring and policy accounts: reliable and broadly accepted management data and ratios are (too) often lacking.

The basic principle of Streamlining Basic Data is the awareness that a government does not have a high-quality and flexible data infrastructure at its disposal and is not or insufficiently able to realize its policy objectives. A government that does not have its data properly organized and, partly as a result of this, fails to attain its policy objectives slowly but surely loses its authority and the trust of the people.

This is all the more so in a society that has become more complex, dynamic and demanding and where data exchange within the government and between the government and its environment has gained both in intensity and importance. The Dutch government has formulated an ideal situation (including such elements as the once-off data provision, pro-active provision of services and the direction of one's own personal data) that may only be realized by well-organized data management.

The policy behind the Streamlining Basic Data programme Streamlining Basic Data focused on the streamlining of vital and often needed data, i.e. the data that are used *intensively*, in *more* (policy, implementation and enforcement) chains and by a large number of government organizations. Examples are data regarding persons, enterprises, buildings, income, employments and such. The many files maintained with respect to such data are often unreliable in terms of the complete and (up-to-date) correct nature of the data, and, furthermore, are often inconsistent and therefore difficult to link up due to considerably differences in the definitions of the terms used. Occasionally, but not always, there are good reasons for these differences. It is clear to what problems this leads. The fact that government organizations work alongside one another in the gathering and management of data affects the quality of the separate files. It moreover requires unnecessary efforts on the part of persons, enterprises and the respective organizations themselves.

Streamlining Basic Data intends to change this by reducing the gathering of data by government organizations to a minimum and, at the same time, by increasing the re-use of data already available to one government organization to a maximum. The programme's objective is to give an irrevocable incentive to the realization of a system of 'authentic registrations'. An authentic registration is defined as a 'high-quality file, with explicit guarantees to safeguard this quality, composed of, given all statutory tasks, vital data and/or data frequently needed for divergent reasons with respect to persons, enterprise, institutions, actions or events, qualified by law as the only officially recognized registration for

the respective data that must be used nationwide by all government bodies and, wherever possible, by private organizations as well, unless the use is explicitly excluded for serious reasons such as the protection of privacy'.

The Streamlining Basic Data programme has worked out this policy. The following, most essential, choices have been made:

- The concept of authentic registrations applies in principle to some dozen (clusters of) data. The programme deliberately focuses on a specific subset of these: the so-called base registrations (base registrations for identifiable enterprise data, building data and topographical and address data). The choice for a limited number of base registrations and the use of that term are based on the observation that the aforementioned data occur most frequently throughout the entire government and that clarity with respect to these will already considerably increase the interchangeable capacity of the existing registrations.
- The aim is to set up registrations that are limited to a compact and therefore manageable set of basic data. The registration with respect to objects, persons, enterprises and buildings is based on a minimum number of data per object, including a unique identification number, address data, referrals to other registrations (such as income, employment, licenses) and authorization data for users of the register.
- In order to achieve the situation where authentic registrations are actually used by the entire government as an authoritative and unique source for certain data and to (be able to) be accepted as such, it is laid down by law per authentic registration what the objective, the working field of the registration is and what the quality requirements are in this respect, and also how the authorization of the use, the quality guarantee and the financing are organized.
- The realization of an authentic registration means that similar data files are integrated to form one register, thereby eliminating overlap and conflicting information and filling up blank spots. The result may be a physically central or distributed register. The basic principle is that the existing organizational and information infrastructures are used thereby avoiding disinvestments.

- The realization of authentic registration is based on the idea of an easily accessible availability of the respective data, naturally insofar as it is in accordance with specific legislation (e.g. with respect to privacy). The access to the government data provides people with a potentially strong instrument to check the government, e.g. where it concerns the licenses/permits of enterprises and buildings. It also provides enterprises with the opportunity to use basic data of the government as high-quality raw material for the development of new products and services, e.g. in the field of geo-information.
- Authentic registrations must actively support the compliance with privacy laws by the government, they must provide transparency to people with respect to the manner in which the government handles personal data and it must enable people to *exercise their influence on this*. This means (*inter alia*) that it is clear per registration which personal data are gathered on which formal ground and to which third parties they are issued. Streamlining Basic Data is not an overture to the violation of privacy: on the contrary.

The programme consists of two parallel lines of action:

1. the Policy Development line of action focuses on the development of the concept of authentic registrations, the determination and instrumentation of financial and legal frameworks and the communication and provision of information with respect to the programme in order to create the necessary level of support for the policy. The Ministry of the Interior (or BZK) takes the lead in this respect.
2. the Implementation line of action focuses on the implementation of the concept of authentic registration in the form of explorations, feasibility studies and realization projects in specific sub-fields. The participating ministries are responsible for the implementation of this and cooperate in this respect with independent administrative bodies and other authorities.

*Results to date*

The foregoing indicates that the general policy behind the programme has already been established. Some issues, such as the clarification of the general (personal) number policy are currently being completed. However, they do not affect the implementation of the policy as established. The first half of the programme, whereby a considerable investment has been made in the realization of consensus on the policy to be pursued, has been completed. The second half of the programme puts the emphasis on the realization of the policy and on the further institutional enshrinement of the policy, to ensure that the streamlining of basic data will not falter after the completion of the incentive, i.e. the programme.

The policy development has been performed in constant interaction with several bodies within the various administrative levels, as a result of which a considerable level of support and commitment has been achieved within the government for the programme and the concept of authentic registration, also at an administrative and top-official level. This is an important prerequisite for the success of the programme, given that the introduction of the concept of authentic registration has far-reaching consequences for the internal distribution of duties and accounting and given the considerable effort and long breath required of the parties involved, and also given the fact that it will often have to compete with other, more short-term, internal priorities.

A deliberate choice has been made for an approach whereby specific projects are performed parallel to the development of policy. In that context, large-scale feasibility studies were already initiated during the preparatory phase in 1999 within the Implementation line of action:

- the Base Enterprise Register project focused on the establishment of a base registration of enterprises, independent professionals and organizations with a public task. The Ministry of Economic Affairs commissioned the project. The Tax Administration, the Central Bureau of Statistics (or CBS), the Chambers of Commerce, the UWV and the Ministries of Agriculture, Nature Management and Fisheries (or LNV, for the benefit of farmers) and Health, Welfare and Sports (or VWS, for the benefit of institutions and independent professional in the field of care) participate in the project.

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- The *Building Registration* project focuses on the development of a base registration of all buildings in the Netherlands. The Ministry of Housing, Spatial Planning and the Environment (or VROM) commissioned this project.
- The *Geographical Core File* project focuses on the establishment of a base registration for topographical data at a 1:10,000 scale by means of upgrading the TOP10-vector file of the Ordnance Survey (*Topografische Dienst*, Ministry of Defense).

The Insured Persons Administration project was also already initiated in 1999. This project focuses on the introduction of one uniform registration of all employees and of all benefit relations, the insurance of employees at benefits agencies for social security. The Ministry of Social Affairs and Employment commissioned the project, the registration will be conducted by the UWV. The Insured Persons Administration project is in the most advanced stage of all projects falling within the scope of the Streamlining Basic Data. In 2000, the implementation of the administration of insured persons commenced at the UWV.

### *Other activities in 2001 and 2002*

Although the realization of the aforementioned base registrations is the first priority of Streamlining Basic Data, the programme also develops a considerable number of other authentic registrations to which the participating ministries attach much value. In order to select other suitable implementation activities in addition to the activities initiated in 1999, an expert conference was held at the end of 2000 attended by representatives of the sectors of fiscal matters and social security, spatial planning and care. This has resulted in a list of 'candidate authentic registrations' that are currently examined in the context of the draft plan 2001.

One of the activities conducted in further detail (partly) in the context of Streamlining Basic Data is the modernization of the aforementioned Municipal Personal Records Database (or GBA).

In 2001 and 2002, (partly) in the context of Streamlining Basic Data, the participating ministries also work on and have planned, respectively, the following:

- an exploration of further streamlining of address data (action: Streamlining Basic Data programme bureau);
- an exploration of further streamlining of wage and income data (action by Ministries of Finance, SWZ and Health Care, Welfare and Sports);
- an exploration of further streamlining of data regarding financial and legal integrity of persons and enterprises (action by Ministry of Justice);
- a feasibility study into the authentic registration of professions and courses (action by SZW);
- further streamlining of data exchange between the domains care-tax and social insurance number (action by VWS and SZW);
- a feasibility study into the Large-Scale Basic Map of the Netherlands as authentic registration (action by the Ministry of Housing, Spatial Planning and the Environment);
- a feasibility study into the Current Level File (*Actueel Hoogtebestand*) as authentic registration (action by Ministry of Transport, Public Works and Water Management (or V&W));
- a feasibility study into the national roads file as authentic registration (action by Ministry of V&W);
- the introduction of basic parcel registration (action by Ministry of Agriculture, Nature Management and Fisheries);
- the renewal of the identification and registration systems for animals (action by Ministry of LNV);
- the introduction of care identification number (action by Ministry of VWS).

An additional objective in the streamlining idea is the promotion of the legal certainty of people, the accessibility of government information, a proper performance of public tasks and making a contribution to the structural approach to the provision of information at and between the authorities. The statute submitted for this purpose provides for a

registration system at the government on the basis of which people, the corporate sector and government may more easily gain insight into the restrictions attached to real-estate objects by the public sector.

In conjunction with the Ministry of Economic Affairs, it is examined how the Streamlining Basic Data programme may contribute to the realization of the ICT and Administrative Burden action plan focused on the application of ICT to reduce the administrative burden.

In particular, it concerns the creation of synergy with the Government Forms On-line, *Electronic Heerendiensten* projects and the Interchange of Data between Enterprises and Administrations (IDEA) project.

### **3.2 The 'Al Capone' bias**

Tax Administrations are usually properly functioning segments of the government. The Tax Administration is frequently asked to assist other organizations within the government in resolving their problems. This mostly concerns knowledge in the field of enforcement, the use of the infrastructure (organizations operating nationwide) and the information present. In the Netherlands, however, the Tax Administration is also asked to supplement other law enforcers, in particular, if these organizations have drawn too little attention, during a longer period, to their enforcement activities in a specific field.

Please note, the Tax Administration does not have to render a judgment on the choices made by such organizations in the past, the focus is on the manner in which it seeks to resolve the problems that have arisen as a result. In this respect, the Tax Administration may quickly and directly hurt people in their wallet by imposing and collecting tax assessments on (criminal) activities performed. The imposition and collection of tax assessments appears to be an efficient tool and requires less effort than the responsible organization amending for its own failure, often by means of complex legal procedures.

The idea that the Tax Administration is able to impose adequate sanctions quickly and fairly easy was also used in the past for the conviction of Al Capone. Al Capone, one of the most famous criminals of the thirties in the last century broke every imaginable law but was eventually convicted for tax fraud and not for murder, gambling or alcohol smuggling.



In the Netherlands, the Tax Administration therefore developed an action plan to deal with certain neglected areas of law enforcement, such as illegal gambling, prostitution, remote business parks etc in order to deal adequately with the problems in collaboration with other bodies. An essential aspect of this approach is that, first of all, the entire legislative field is analysed, what laws are not complied with and to what extent must the risk signaled be reduced. Reduction may mean that the undesired activity is eliminated entirely (as in the case of illegal gambling) or that the sector is normalized (as in the case of prostitution). This analysis also shows what the enforcement chain (what bodies are involved in the enforcement with respect to a specific activity) should look like. Dealing with the problems is only useful if all enforcement bodies involved are willing to invest capacity. All bodies involved must thereby also agree with their own responsibility and their place in the enforcement chain. This means that in cases where the violation of environment laws is the essence of the problem, that field must take the lead in the enforcement. Where it concerns illegal labour or illegal gambling, these fields must take the lead. The pitfall for the Tax Administration is the argument that all these activities are (probably) accompanied by tax fraud and that the action taken by the Tax Administration is an adequate solution. The Tax Administration cannot solve these problems, merely increase the price (by imposing tax assessments).

Finally, it may be concluded that before the Tax Administration enters into any far-reaching joint ventures with other government organizations, it must be (come) aware of its own role and task within the enforcement chain. This would prevent the Tax Administration from using its capacity, other than incidentally, in fields where it is not primarily responsible for the enforcement.

### **3.3 Procedural aspects**

In the cooperation with other organization, whether it concerns file comparisons, exchange of information or joint investigations, the question always arises whether, and if so, what information may be used. It is therefore necessary to examine, in the preparation of any cooperation projects, per component on that ground of which statutory provisions the information may be furnished to third parties. If necessary, the regulations must be amended in order to enable the provision of the desired information.

#### 4. AN EXAMPLE OF A COOPERATION PROJECT

In the horticultural sector, in particular, in the region around The Hague, many temporary employees are working in the black economy and, in addition, many employees do not have the right residence permits. The project plan to deal with the problems in this sector comprise the following elements:

1. **General.** This part describes what organizations participate in the project, the group of entrepreneurs to be examined (what sectors) is defined, a brief description of the problems to be resolved is given and the intended result including a time path is outlined. In addition, a description is given of the person coordinating the implementation.
2. **The project's objective.** The general objective to be pursued is outlined in further detail. Handling methods are linked to the objective and the activities that must be performed to attain the objectives are also described. In this respect, basic principles are formulated and preconditions are summarized. Possible bottlenecks are also reviewed.
3. **Set-up information position.** A description is given of the type of information that may be gathered and the existing sources for this information. The procedural aspects with respect to the gathering and exchange of information are also examined. Periodic consultations will be conducted with the participating parties, discussing the progress of the projects, the settlement of issues and agreements on the further control planning. The available information may consist of knowledge present at the participating parties, control reports and official reports, 'click' letters, sector descriptions, investigations at other enterprises active in that sector, (national) databases of participating parties, know-how and experience of staff members. Once this information is gathered and analysed, provisional selection criteria may be formulated. On the basis of these provisional criteria, some investigations may be instituted to test the criteria.
4. **The operational path.** This path consists of two tracks. Track 1 has a more preventive character and focuses in particular on new entrepreneurs. The tracking down of new entrepreneurs in the sector, actively providing information on rights and obligations and initiating follow-up visits aim at preventing these

entrepreneurs from developing into mala-fide entrepreneurs. On the basis of the selection criteria, a selection is made of entrepreneurs who qualify for an examination of the books and the enterprise on the spot. The objective is to initiate material examinations in order to outline and deal with all risks, including those of non-payment.

- 5. Collection.** As it concerns so-called wage enterprises, it is often difficult to recover tax debts from the responsible parties. These enterprises offer little objects of recovery and, insofar as possible, the payment of the tax debts must therefore occur via the pay-as-you-earn principle. Explicit attention must be drawn to the collection at the start of the project. It does not merely concern fiscal possibilities, but also civil-law possibilities to recover debts, including the possibilities regarding the liability. As regards collection, it is also important to draw explicit attention to the recovery possibilities during the audit of the books.
- 6. Other aspects of the audit of the books.** Problems that occur frequently must be registered centrally and provided with standard solutions. These solutions must be directly communicated to the staff members carrying out the project. Where possible, this must be done prior to the commencement of the audit. A description must be drawn up of the logistic process in the conclusion of the audit and all parties involved in this process must be informed of the project and their task and role in it. The coordinating activities are assigned to a project leader. A description must be drawn up of his task and role and the participating parties must be informed of this.
- 7. Other points for special attention.** An outline of the other actors with respect to the sector is recommended. For example, tax consultants specializing in this sector and trade organizations.
- 8. Communication and the provision of information.** Communication must support an effective and efficient implementation of the project. A distinction must be made between the internal communication to (the staff members of) the participating organizations and the external communication. The external communication may focus on the target group of the action, other actors involved in the sector, other public services or (via the press) the general public.

- 9. Evaluation and result measurement.** Point 2 refers to the formulation of the objective. Measures must be taken in the preparation of the project to enable a post-measurement. What must be measured and what data are necessary for this depends on what you wish to achieve. Interim measurement of the results provides input to assess whether intensification, adjustments or temporising of the project is necessary. Following the end of the project, it is possible to account for the activities by means of the evaluation and the result measurement.
- 10. Planning of the deployment of people and resources and the activities to be performed.** A capacity calculation may be made on the basis of a number of well-known enterprises. The result of the calculation indicates the number of examinations that will be initiated, subdivided according to the type of examination. In addition, some examinations may be translated into the number and level of the necessary staff members. Agreements must furthermore be made between the participating organizations with respect to the distribution of the costs of the project group (accommodation, communication, travel and accommodation costs etc).
- 11. Computerization.** Three files must be set up and maintained to support the project. It concerns a selection file including all enterprises of the target group and the aspects relevant to the selection. In addition, a file for the monitoring of the progress. This file concerns the monitoring of the performance of the activities. Finally, an evaluation file to enable the evaluation and result measurement.

Mr. Matthijs H. Jacob Alink  
Deputy Director International  
Ministry of Finance  
The Hague, Netherlands  
E-mail: [m.h.j.alink@minfin.nl](mailto:m.h.j.alink@minfin.nl)

*Case study:*

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**MECHANISMS OF COORDINATION AND COOPERATION  
BETWEEN CENTRAL GOVERNMENT AGENCIES (THE  
ADEQUACY OF THE DATA BASES AND INFORMATION  
SYSTEMS FOR INTERNAL COOPERATION BETWEEN  
PUBLIC ORGANIZATIONS)**

**Bruno Parent**

Deputy Director General  
General Directorate of Taxes  
(France)

*CONTENTS: Introduction.- 1. Since the Beginning, Cooperation Between the DGI and Other Public Administrations or Organizations Was Essentially Conceived for Control Purposes.- 1.1 To compile specific information, the tax administration has a right provided by law: the right of communication.- 1.2 Who are our partners and in what ways should we Cooperate? 2. Cooperation Evolves According to the New Challenges Faced by the DGI.- 2.1. The new challenges.- 2.2 The impact of the new challenges on cooperation between the Tax Administration and other Public Administrations or Organizations.- 2.3 But this new forms of cooperation must also arouse acceptance by the users.*

**INTRODUCTION**

In abidance with the philosophy of the filing system, the General Directorate of Taxes (D.G.I.) pursues the double objective of promoting the tax spirit or, that is, voluntary compliance with tax obligations by the taxpayers, and improving its effectiveness.

Particularly contributing to the achievement of these goals are:

- the improvement of the quality of service given to the user,
- and also, the efficient functioning of the filing system.

In this respect, cooperation between the different public administrations and entities in a State is essential, even more so, if they share the management of taxes.

In the case of France, which I will describe below, we will see that such cooperation, initially conceived for control purposes, is currently evolving under the effects of the new challenges that must be faced by the DGI.

#### **1. SINCE THE BEGINNING, COOPERATION BETWEEN THE DGI AND OTHER PUBLIC ADMINISTRATIONS OR ORGANIZATIONS WAS ESSENTIALLY CONCEIVED FOR CONTROL PURPOSES**

Tax Administrations require much information to determine, control and collect taxes.

It is not enough to obtain information on the taxpayers to control their compliance with tax obligations. Rather, it is necessary to crosscheck this information with that of other sources.

Thus, it is for this reason that there are numerous exchanges between the DGI and other Public Administrations or Entities.

For example, a computerized application called FLR (Local Crosscheck of Files) provides tax agents certain data compiled from third parties (employers, banks,...).

This application provides information on salaries, pensions and retirements, income from investments, fees and also for making investigations focused on taxpayers showing unusual situations.

### **1.1 To Compile Specific Information, the Tax Administration Has a Right Provided by Law: The Right of Communication**

This right, which is provided by law, allows the Tax Administration to obtain, upon request, and, at times, spontaneously, the necessary data for calculating, controlling, or collecting the taxes and rates under its responsibility.

This procedure is only applicable to individuals or organizations expressly provided by law and to compile information which taxpayers are obliged to provide to the tax officials.

That is why it is not applicable to individuals but, rather, affects, in general, the professionals, (individuals or corporations, administrations, various authorities) in exercising their functions.

It deals with accounting-type documents, as well as certain internal company data (such as quotations or loan contracts or even powers given in relation to a bank account), and also, information obtained by the abovementioned persons in compliance with their duties (elements of a judicial or customs process, for example).

It is also worth mentioning that this right allows for obtaining data from certain activities subject to professional secrecy such as banks, insurance companies, judicial authorities...

However, this right does not allow for obtaining information protected by medical secrecy.

To conclude, it should be noted that, with respect to the scope of this right of communication, the police services do not have this same right, vis-à-vis the tax administration, unless they act by virtue of a mandate of the judicial authorities.

### **1.2 Who Are Our Partners and in What Ways Should We Cooperate?**

It is known that public administrations and entities have much information that may interest the tax administration.

In order to optimize their transfer, the DGI established cooperation "protocols" , of which we will mention some.

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I will refer, first of all, to cooperation with the finance administrations.

*I will discuss, in the first place, cooperation between the DGI and Customs, which in the case of France, shares with the DGI the management and collection of VAT.*

Both administrations maintain very close relationships which are governed by a cooperation agreement.

Customs and the DGI participate in the struggle against fraud and each has available data, which may be very useful to the other, in complying with the tasks entrusted to them.

Priority in this cooperation, is given to the struggle against intra-community VAT tax fraud, or, that is, the tax applied to commercial exchanges between the countries of the European Community.

In fact, the returns on exchange of goods made by the French companies are presented to Customs and the information appearing therein is introduced in a database to which the DGI has access.

This allows for detecting networks of companies of short duration or which may serve as a screen, especially in the case of fraud known as "carrousel" (goods that physically or fictitiously circulate between different countries and are finally put up for consumption without every paying the VAT).

It must be noted as well that, every time it can, the DGI also takes advantage of the tax charges that may result from customs violations.

The DGI also takes advantage of the information originating from Customs in relation to vine growing.

These are returns on the sowing and harvesting of vineyards by the vine growers.

Such information allows the DGI to update the cadastral evaluations and, accordingly, the tax base of the plots of land subject to Territorial Tax.



In exchange for this, the DGI transmits to Customs information dealing with the changes that affect the numbering of the plots of land and the identity of the owners of the vineyards.

- *I will now refer to the cooperation that links us to the General Directorate of Public Accounting (D.G.C.P.)*

In France, the DGI mainly collects Value Added Tax and registration fees, while the General Directorate of Public Accounting collects most of the direct taxes such as Income Tax, Corporate Tax and Taxes in favor of the local communities.

This shared collection between the DGI and DGCP obviously implies very close relationships between both Directorates.

In this case also, the relationships are governed through a “technical agreement” which describes the type of files that are sent to the DGCP, the schedule of tasks and the results expected.

However, besides this merely technical aspect, such cooperation also involves actions so that our officials, at all levels, may become aware of the need to maintain close relationships with our colleagues from the DGCP in order to achieve overall improvement of the effectiveness of the fiscal missions we share.

To improve enforced collection of taxes, the DGCP agents also have access to the data found in our main computerized applications (income tax files, bank account files, cadastral files, information crosscheck files, etc...).

Within the framework of the Copernicus Program which I will cover in the second part of my presentation, an in-depth restructuring was undertaken of the information systems of both Directorates, whereby the agents of the DGI and DGCP may undertake the exchange of useful information for fulfilling their tax missions, according to their respective responsibilities.

- *Finally, I will refer to the relationships with the Directorate, which in our Ministry, is in charge of consumer protection (DGCCRF, French acronym).*

Such cooperation is evident in joint actions for the purpose of fighting against illegal work and the underground economy.

*I will now speak about our relationships with other public administrations or organizations.*

First of all, I will mention our relationships with the “Business Procedures Centers”.

The establishment, modification and closing of businesses are a matter of interest to a considerable number of public administrations or organizations.

In fact, such events may have implications of a legal, social, statistical and, of course, fiscal nature.

In order to avoid companies from sending a return to each of the administrations involved, “Business Procedures Centers” were created, especially before the Chambers of Commerce (for Businessmen and Industrialists), the Trade Chambers (for Craftsmen) and the Chambers of Agriculture (for Farmers).

These are one-stop sites where businesses may carry out procedures involving the initiation, modification or ceasing of activities.

In this way, a company wishing to be registered or eliminated or to modify the characteristics of its activities must only approach the appropriate Procedures Center.

The data it may provide on this occasion, are automatically transmitted to all organizations and administrations involved, in particular to the tax services.

From now on, these procedures may be carried out by means of forms placed on line in Internet.

In this way, the company may fill the return corresponding to the event (creation, modification of its situation, ceasing of activities) and send them to the pertinent Business Procedures Center, attaching, if necessary, the documents required.

Eventually, all business creations may take place through Internet and by means of the “Virtual Business Procedures Center”.

This teleprocessing option should be available in late 2002.

At present, following this first procedure, the various Business Procedures Centers generally transmit through the computer, the data to the National Statistics and Social Studies Institute (INSEE; French acronym) which is in charge of assigning the business identification number (SIRET Number, single, permanent and of a national nature).

Information concerning the creation of businesses, as well as ceasing of activities is automatically downloaded to the database of professional debtors (BDRP, French acronym), which is handled by the tax agents in charge of handling business cases and thus allows them to undertake all fiscal procedures.

In this way, the files of the DGI and INSEE are no longer divergent.

*Close links are established with other partners.*

- *With the Ministry of Equipment, Transportation and Housing:*

The French Tax Administration obtains, on a monthly basis, through computerized files, information on all new or used automobiles registered, whose value exceeds €. 23.000.

Through this information, it is possible to identify unknown taxpayers that appear in our files or whose declared income is not in keeping with this type of acquisitions.

On the other hand, in France, taxes in favor of local communities that are paid by individuals, are established at the DGI and take into account various elements, the most important being the amount of lease of buildings.

In order that the DGI may control these taxes, it must be aware of every new building or addition thereto.

This information is provided by the Ministry Services in charge of housing which centralizes all requests for construction permits and sends them every month to the Tax Administration in the form of computerized files.

With the Courts: Judicial authorities may provide the Tax Administration, either spontaneously or at the request of the fiscal services, any information they may have which may allow for assuming a case of tax fraud, whether in a civil, commercial or penal case, even though it may have been dismissed.

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This option includes not only cases that have been judged, but also those in the trial process.

In order to follow up cases that could have fiscal implications, the DGI has placed correspondents before the Courts.

- at the Police Services: it is easy to imagine the importance of information exchanges with these Services (search for lost taxpayers, detection of tax violations...).
- at the Local Communities: The legislative provisions frame and organize the exchanges between the Tax Administration and Local Communities.

For this reason the tax administration should inform the Local Communities, at their request, the real estate values declared in the transmission of inheritance in the past five years, in order that they may comply with their functions in relation to policies involving soils and their use.

Every year, the tax administration undertakes great efforts in order that the Local Communities may be aware, as soon as possible, of the tax base provisions at the local level, in order that they may promptly make a decision on their budget.

Likewise, the DGI provides each year, on paper and magnetic media, the annual list of taxpayers and the taxes paid by them to the Communities thus requesting it and which have received authorization from the personal data protecting authority, the CNIL (National Commission of Informatics and Liberties).

Lastly, the Municipalities and the Administration have the power to mutually exchange the necessary information for the census of the tax bases of direct taxes at the local level.

Such exchanges are mainly formalized when consulting the Municipal Commissions of Direct Taxes, which group users under the chairmanship of the Mayor of the Municipality.

Likewise, mayors are in charge of communicating, on a quarterly basis, the lists of death certificates. This information is exchanged, either on paper or magnetic media, within the framework of a protocol of dematerialized exchanges agreed between the Directorate of Fiscal Services and the municipalities that have available a computerized civil registry.

This information allows the DGI to supervise the filing of succession returns.

*I would also like to mention our relationship with the Social Security entities, which allows us to compile a very significant amount of information.*

In France, by virtue of the law, every individual or corporation paying salaries and compensations must declare it, in order to calculate the tax and social security contributions.

The data are transferred to a single return called the annual social data return, which is addressed to the "Social Data Transfer Center".

The Center then distributes the information thus obtained among the State Administrations and the Social Security entities involved.

Such returns may be filed, either through the computer (according to certain conditions (or on paper, (in this case, the National Social Data Transfer Center is in charge of capturing those same data).

On its part, the Tax Administration informs the Social Security bodies the data necessary for the provision and maintenance of benefits and their calculation.

The tax files established on the basis of these exchanges includes over 120 million data and involve over 34 million individuals.

This information is used for the automated and systematic comparison with the income declared by taxpayers by way of Income Tax.

The Services in charge of fiscal control may consult it at the local level.

In addition, the Tax Administration obtains other data of great interest for fiscal control from the social security entities. In fact, the social security funds may spontaneously provide the Tax Administration a summary report for each member of the medical corps, with respect to the refund of fees and expense vouchers being requested by the insured.

Likewise, these entities must report to the Tax Administration any violation to the law of fiscal regulations, which they may observe.

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Through this device, it is possible to efficiently verify the amount of income declared by the members of the medical corps.

Data transmitted by third parties and social security entities are communicated through a common identifier (called NIR), which is assigned by the National Statistics Institute.

When such comparison cannot be made on the basis of this identifier, it is made on the basis of civil registry elements (surname, names, date and place of birth).

*Finally, I would not want to conclude without mentioning the bank accounts file.*

Financial institutions and, in general, all entities receiving the deposit of bearer securities, either securities or cash, must provide the Tax Administration the references and characteristics of the accounts opened, as well as their changes or closing thereof.

Actual financial transactions, which are registered in such accounts, are not introduced in the database.

The DGI is in charge of managing this file, which was computerized in 1982 and was recently restructured in coordination with the banking professionals.

The file called FICOBA (French acronym which means Bank and Related Accounts File) and which at present includes approximately 250 million accounts, is protected by professional fiscal secrecy.

Accordingly, the data is only available to individuals and entities, which, accordingly to law, are entitled to the release of fiscal secrecy.

This is the case, for example, of the judicial authorities, the services of other financial administrations (customs, public accounting...), entities in charge of collecting taxes or rates and even social security contributions.

The recent modernization allows, above all, for a dematerialized inquiry of the file through an Intranet system with security codes.

You have just seen the development achieved by coordination and cooperation mechanisms between the different Public Administrations and Entities in France.

In addition, these mechanisms have become essential for the activities of the DGI.

## **2. COOPERATION EVOLVES ACCORDING TO THE NEW CHALLENGES FACED BY THE DGI**

The desire to promote the tax spirit or, that is, voluntary compliance with tax obligations by the taxpayers and increasing demands for quality of public service (by the users and other administrations) represent challenges, which the DGI must face within the context of development of new technologies.

### **2.1 The New Challenges**

#### *- Promote the tax spirit*

The legitimacy of the mission of the DGI is based on article 13 of the Declaration of the Rights of Man and the Citizen of August 26, 1789: "In order to maintain the Public Force and for the Administration's expenses, a common contribution is essential: it must be equally distributed among all the citizens, according to their possibilities".

Accordingly, the DGI, within the limits of its area of action, must contribute to a better acceptance of taxes and fair financing of public expenditures.

In this respect, improvement of the efficiency of fiscal control, which originates from adequate cooperation between the Tax Administration and other Public Administrations or Organizations indirectly reinforces the tax spirit.

Actually there is a great reaction to fiscal fraud, arising especially, from the availability of multiple data obtained from other administrations or organizations, and which have important effects on citizen behavior, by urging them to spontaneously comply with their tax obligations.

On the other hand, acts of evasion, at times originate from the feeling that there is no equity in control.

The equitable presence of the Administration throughout the economic sectors creates a feeling of justice and equality vis-à-vis taxes, which promotes the development of the tax spirit.

In addition, the DGI has had, for several years, a series of indicators which provide it feedback on behaviors dealing with the filing of income tax and which also allow it to measure the impact of its actions.

With respect to the tax spirit, the latter is evaluated as follows:

- In the case of individuals, through the rate of compliance with terms for filing income tax returns (approximately 95% in 2001),
- In the case of corporations, through the rate of compliance with terms for filing VAT returns (over 88% in 2001) and also the payment coefficient in terms of time (95% in 2001).

The DGI pays special attention to the evolution of these indicators that have achieved significant progress.

- *responding to the new demands for public service*

*A governmental priority: simplification of procedures*

A Commission for Administrative Simplification (COAS) was created to simplify processes for the Administration's users.

Placed under the responsibility of the Prime Minister, who chairs it, its mission is to examine and follow up the development of the annual simplification programs elaborated by each Ministry.

This commission proposes simplification measures and ensures harmonization, normalization and simplification of the administrative forms and questionnaires.

The application of this policy implies, of course, ever-closer cooperation between the Administrations.

## **2.2. The Impact of the New Challenges on Cooperation Between the Tax Administration and Other Public Administrations or Organizations**

The demand for quality of service leads us to revise our organizations and forms of cooperation with our main partner, the DGCP, with which we share the collection of taxes for historical reasons.



*I will provide you an initial example of cooperation, which in my opinion, is exemplary, that is, the case of the establishment of the Subsidy for Employment in 2001.*

What was this actually all about ?

On January 16, 2001, the Ministers announced the establishment, starting in 2001, of a subsidy for allowing the low-income population to go back to work. In fact, those interested could lose some social advantages in case they would accept a remunerated job, which could dissuade them from joining the world of labor.

This subsidy, estimated on the basis of revenue originating from the labor activity, required active collaboration from the DGI and DGCP Services.

Thanks to the general mobilization of both Services, 5.5 million tax homes received, starting on February 15, a check from the Public Treasury, for Income Tax Refund as a result of said Subsidy for employment and another 2.5 million benefited from a tax reduction.

This additional workload, which had to be carried out within very brief time spans, involved a significant mobilization of staff from both Directorates.

- *Given the complexity of our structures, the users firmly demand the simplification of our methods of operation and access to new services. The DGI and DGCP endeavor to respond to this demand through the Reform-Modernization of the Ministry, which is currently in process.*

As many of you may already know the DGI and DGCP have not been able to conclude their Single Tax Administration Project.

Nevertheless, the desire to improve the service rendered to users has led us to adapt our modes of operation within the framework of the Ministry's Reform-Modernization process.

What does this involve?

This Reform, "focused on the User" is based on numerous experiments for bringing both Administrations together, which experiments, at present, have been generalized or are in the process of generalization.

In this way, common assistance is provided in many sites.

The purpose is to simplify procedures for the user, by allowing him, at a one-stop site, to obtain information, or have his request accepted and processed, whether it is the responsibility of the DGI (calculation of the tax) or of the DGCP (collection).

This common assistance by the DGI and DGCP may be given at public finance offices where both Services are found.

A common Intranet will allow cooperative assistance to individual taxpayers at all Tax Centers and Treasury Offices.

In a single contact, they may carry out the most common procedures, such as notification of change of address, filing of a claim, of a request or extension of terms for making payment.

- *Finally, both Administrations are called to jointly carry out the total restructuring of their computerized systems through the Copernicus Program.*

The DGI and DGCP are two long-standing Administrations that have developed computerized systems that are currently not very “communicative” for the official or for the user.

To respond to the demands for a better service to the user, it is necessary to reconstruct the information systems, in order to overcome the obstacles which so much affect the exchange of information, optimum compliance with the mission and the quality of the services rendered to the users.

The COPERNICUS Program, which links the DGI to the DGCP, is focused on developing the Taxpayer Simplified Tax Account.

It will allow taxpayers to manage their overall tax situation, easily and at a distance.

This ambitious Program is massively based on information and communication technologies. Its purpose is to establish, by stages, over a period of several years, a real “e-Tax Administration”, without paper or multimedia or multiservices.

The repercussions of the COPERNICUS Program, as a result of its progressive establishment during the coming years, will be numerous and significant for the efficiency of both Administrations.

The quality of service offered the taxpayers will be considerably improved through increased availability of information, greater personalization of services rendered and increased capability of officials to handle difficulties faced by the users.

From now on we can consider that a clearer and easier to administer tax will be a better understood, better accepted and finally, better paid tax.

### **2.3. But this New Forms of Cooperation Must Also Arouse Acceptance by the Users**

In order to compare information originating from our partners with the tax data, it seems advisable to have available a single identifier.

Unlike most of its partners, the financial administrations of France, had not been authorized for a long period to use the single identifier granted by the social organizations (the NIR).

In France, the National Statistics Institute assigns an identification number to any person born in France, at the time of birth, based on the data provided by the Municipalities, which are in charge of the Civil Registries.

This system is completed with an identification of individuals born outside of France, which are of French nationality or carry out an activity in France, which must be known by the Social Services.

If, at present, the law allows the use of NIR as process identifier by the DGI, the rules established by the National Commission of Informatics and Liberties (NCIL) allows its use only for the exchange with social organizations and some third parties that have the right to use it.

As perhaps some of you may know, France does not have Income Tax withholding at the source.

The DGI has begun to make some considerations on this issue.

In fact, this form of Income Tax deduction has a double advantage:

- In the first place, it is less costly, inasmuch as it limits the number of payments to be managed.

- It likewise changes the nature of the relationship between the taxpayer and the tax administration, on being most of the procedures intended to obtain refund of an excess payment.

Parallel to this, the DGI is considering the possibility of sending the taxpayer an annual return already showing the income reported by third parties.

The taxpayer would then only have to verify the accuracy of the information provided, correct it or complete it with other income not requiring reporting by third parties (lease of real estate, for example).

The double action involving the reduction of the most traditional forms of the presence of the public authority and the greater demand of users should find an answer in the optimization of new technologies, mainly informatic, with respect to three ideas:

- Facilitating communication at a distance between the administration and the users and the requisites demanded from the latter (at a distance procedures, Internet portals...);
- Request from users the least possible amount of information (thanks, in particular, to the recovery of data through exchanges with Public Administrations or Organizations.
- Organize the Administration in accordance with the users, instead of obliging the users to adapt themselves to the peculiarities of the administrative organization.

Mr. Bruno Parent  
Directeur Général Adjoint, DGI  
Direction Générale des Impôts  
France  
E-mail: [bruno.parent@dgi.finances.gouv.fr](mailto:bruno.parent@dgi.finances.gouv.fr)

Case study:

TOPIC 2.2

## **INTERACTION BETWEEN EXECUTIVE, LEGISLATIVE AND JUDICIAL BODIES**

**María Lamagrande**

Chief of the Tax Legal Division  
Federal Administration of Public Revenues  
(Argentina)

*CONTENTS: I. National State. The Political Organization: The Division of Powers and its Consequences in the Tax Sphere. The Tax Administration.- 1. The National State.- 2. The political organization: the division of powers.- 3. The federal system and the division of powers. Consequences in the tax sphere.- 4. The Argentine Tax Administration. Its location within the political organization.- II. Interaction of the Tax Administration with the Legislative and Executive Powers.- 1. The elaboration of normative projects for the tax administration.- 2. The Argentine experience.- 2.1. Simplified System for Small Taxpayers.- 2.2. Proposed Tax Code of the Republic of Argentina.- 3. Interaction today.- Conclusion.*

### **I. NATIONAL STATE. THE POLITICAL ORGANIZATION: THE DIVISION OF POWERS AND ITS CONSEQUENCES IN THE TAX SPHERE. THE TAX ADMINISTRATION.**

#### **1. The National State**

The National State must be understood as an institutional, teleological and ethical unit, beyond the organizational forms it may adopt.<sup>1</sup>

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<sup>1</sup> PROCURACIÓN OF THE TREASURY OF THE NATION, *Opinion of 20/09/1997, Volume 222, Page. 164.*

Necessarily, every state action must be aimed at the goals of the State as such, goals that, modernly must be sought in the fundamental law of the State in question which are infused with the values and principles of a specific philosophy.

The preamble of the Constitution of Argentina synthesizes these very high goals when stating that said law is issued "...for the purpose of achieving national unity, strengthening justice, consolidate internal peace, ensuring the benefits of freedom..."; regardless of finding them expressly provided in the rest of the articles. Thus, for example, article 75 entrusts the National Congress the issuance of "protective" laws in order to provide what may lead to the prosperity of the country, advancement and welfare of all the provinces..." and "... human development, economic progress with social justice...".

General welfare or said otherwise, common welfare, functions as a sort of synthesis value<sup>2</sup>. Of neotomist origin, common welfare "consists of the series of necessary social presumptions in order that individuals and groups may achieve their existential goals and full development, integrated in the community as parts of the whole."<sup>3</sup>

Evidently, all of the other State objectives are part of that series of social presumptions: ensure freedom, justice, juridical security, economic prosperity, since, without them, undoubtedly there would be no general welfare.

## **2. The Political Organization: The Division of Powers**

Consideration of the National State as institutional, teleological and ethical unit, does not prevent basic laws from anticipating for its political organization, different government bodies of different constitutional "status", as well as the division of the powers comprising it.

Article 1 of the Constitution of Argentina provides that it "adopts for its government the federal, republican, representative form as determined by this Constitution".

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<sup>2</sup> SAGÚES, Néstor Pedro, "Elements of Constitutional Law", Volume I, pages. 205 and 61; 2nd updated and expanded Edition, Ed. Astrea, Buenos Aires, 1997.

<sup>3</sup> MONTEJANO, Bernardino, "The purposes of law". Ed. Abeledo Perrot- Buenos Aires, 1967, page. 75; quoted by CASANOVA de CABRIZA, Alicia Nora, "The Principle of Fiscal Immunity of the State", Tax Newsletter N° 43, February 2001, page. 164.

From the essential notes of the political system thus established, of interest for this presentation is that relative to the republican form, to the extent that this system is characterized, among other principles, by the division of powers.

In the Argentine political system, which is divided into the three classical powers -Legislative Power, Executive Power and Judicial Power – it is an indisputable constitutional starting point that each power must have its own and exclusive operating sphere<sup>4</sup>, which has been established as a guarantee of the rights of the community<sup>5</sup> against the abuse of power, starting from a game of checks and balances where power restrains power.<sup>6</sup>

It must be added that as of the 1994 constitutional reform, the so-called “Government Attorney’s Office” which was established as an independent body with functional autonomy and financial autarchy whose function is to “promote the action of justice in defense of legality, of the general interests of society, in coordination with the other authorities of the Republic” (cfr. art. 120 of the National Constitution), became a part of the Federal Government. It is an “extra power” body, or, a “mini power” as some doctrine<sup>7</sup> calls it in view of its independence with respect to the Executive and Judicial Powers.

### **3. The Federal System and the Division of Powers. Consequences in the Tax Sphere**

As a result of the federal state system adopted by the National Constitution, the power of taxation takes shape, fundamentally, at two main and different government levels. These are the Nation and provinces, without disregarding, in addition to the autonomous system of the City of Buenos Aires and the economic and financial autonomy of the provincial municipalities, recognized by the National Constitution which presupposes it.

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<sup>4</sup> SUPREME COURT OF JUSTICE OF THE NATION, “Lawsuit filed by virtue of Decree N° 280/84 of the Executive Power. Extraordinary Appeal”, judgment of June 22, 1987, Argentine System of Juridical Informatics (SAIJ); Summary Proceeding N° a0004420

<sup>5</sup> SUPREME COURT OF JUSTICE OF THE NATION, “National savings and Insurance Fund c/N.C.R. Argentina S.A.I.C. s/ Appeal for review of facts and law”; judgment of 15/12/1987, Argentine System of Juridical Informatics (SAIJ), Summary Proceeding N° A0006080.

<sup>6</sup> SUPERIOR COURT OF JUSTICE, Viedma, Río Negro, “Pichetto, Miguel Angel s/Writ of prohibition”, Judgment of April 16, 1993, Argentine System of Juridical Informatics (SAIJ), Summary Proceeding N° F0011897.

<sup>7</sup> SAGÜES, Néstor P., “Elements of Constitutional Law”, *op. cit.*, Volume 1, Page. 542.

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The direct and indirect contributions imposed by the Congress of the Nation are co-participative by constitutional mandate. Paragraph 2 of Article 75, provides for the establishment by means of a law-agreement, of a co-participation system between the Nation, the provinces and the city of Buenos Aires, that will be established in direct relationship with the competencies, services and functions of each of them, considering objective distribution criteria. It also provides that co-participation must be “equitable, mutually binding and will give priority to the achievement of an equivalent level of development, quality of life and equal opportunities throughout the national territory”.

Now then, in keeping with the republican system and specifically based on the principle of division of powers, the National Constitution has determined several starting points in order that the State’s power of taxation will not go beyond and thus affect the right of ownership of its inhabitants.

In this sense, it provides that the National Treasury is formed, from among other resources, with the contributions which “the General Congress equitably and proportionally imposes on the population” (cfr. art. 4° C.N.) to then reiterate, in the rule that guarantees inviolability of private property, that only Congress imposes the contributions stated in article 4 (cfr. art. 17 C.N.); the power of imposition as specific function of Congress is provided in article 75 of the National Constitution. Likewise, within the sphere of this power, the initiative of the laws on contributions corresponds to the Chamber of Deputies -formed by representatives directly elected by the citizens.

In sum, it is a question of the principle of legality or reserve of the law in the area of taxation, which calls for the creation of taxes through formal law but which goes beyond that demand, “...since the legitimacy of taxation requires, in addition to a just cause –its adaptation to the common welfare – and a due proportion between the fiscal needs and the economic capability of those who must contribute.”<sup>8</sup>

The Executive Power is in charge of collecting the Nation’s income (cfr. art. 10 N.C. and 100 N.C.). It is specifically the duty of the Head of the Council of Ministers, with political responsibility before the Nation’s Congress “To ensure collection of the Nation’s income and execute the National Budget law” (par. 7 of article 100 of the National Constitution).

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<sup>8</sup> VAZQUEZ, Susana Beatriz, “Fiscal Control”, Document presented at the CIAT Technical Conference of 1995.



Although the Fundamental Law of the Argentine Nation recognizes to the National Executive Power, exceptionally –that is when special circumstances would make it impossible to follow the regular procedures for the approval of the laws- the power to issue decrees for reasons of need and urgency, it expressly excludes the issuance of this type of rule when they deal with taxation.

The Judicial Power of the Nation is responsible for solving the conflicts generated between the administered and the Administrative Power, ensuring, above all, the supremacy of the constitutional principles and guarantees. For the judicial body it is a duty to protect constitutional supremacy, which control is exercised during the course of legal procedures, that is, in controversies between parties with their own and opposing juridical interests for the jurisdictional solution and vis-à-vis concrete and real offenses, given that the principle of division of powers prevents, according to the Supreme Court of Justice of the Nation, the generic invalidation of the laws objected before its law courts.<sup>9</sup>

#### **4. The Argentine Tax Administration. Its Location Within the Political Organization**

The Federal Administration of Public Revenues is the entity in charge of executing the Nation's tax and customs policy, through the application of the corresponding legal rules (art. 3 of Decree N° 618/97). It is an autarchic entity within the sphere of the Ministry of Economy of the Nation.

The autarchy thus established is administrative, that is, linked to the organization and operation of the institution, but “decentralized” as regards the administration of taxes, since the Ministry of Economy and Public Works and Services exercises the general superintendency and control of legality over it.<sup>10</sup>

Based on recent Decree N° 1399/01, the administrative autarchy has been strengthened by two mainstays: one, the economic autarchy, through self-financing, by means of the allocation of a percentage of

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<sup>9</sup> SAGUES, Néstor P. “Constitutional Procedural Law. Extraordinary Appeal”, page. 101, Ed. Astrea, 1989.

<sup>10</sup> GIULIANI FONROUGE, Carlos M. y NAVARRINE, Susana C., “Tax and social security procedure –Comments, doctrine, jurisprudence”, Ed. Depalma, 7th Edition, 1999.

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total net collection of taxes, whose collection, examination, receipt or fiscal execution is entrusted to the entity and, the other, the stability of the Federal Administrator.

The Administrator will be appointed for a four-year period, which may be extended for successive periods, if he fulfills the unavoidable requirement of complying with the annual management plan of the expired period.

The annual management plan to be fulfilled by the Federal Administrator will be elaborated by the Chief of Cabinet. The substantial noncompliance of the aforementioned plan for two consecutive periods will be a justified cause of dismissal of the Federal Administrator.

The Federal Administration of Public Revenues will also have an Advisory Council formed by a representative of the President of the Central Bank of the Republic of Argentina; the presidents of the Budget and Finance Commissions of the Honorable Chamber of Deputies of the Nation and the Honorable Senate of the Nation, or the legislators they may appoint; the Executive Director of the National Social Security Administration; two experts with well-known experience in taxation or public management and, lastly, a representative from the Provinces as proposed by the Federal Investments Council.

The Council has no executive functions. It is in charge of the quarterly follow up and evaluation of the annual management plan and will annually submit to the National Executive Power a report on the actions carried out during said period.

This administrative reform endeavors to achieve greater efficiency of the Tax Administration through “decentralization of operational decisions and greater autonomy for the administrator”, since he “carries out one of the strategic activities of the National Government, namely: the assessment and collection of federal taxes for financing public expenditure”<sup>11</sup>.

This greater autonomy was also granted in view of the fact that the Federal Administration of Public Revenues “**must actively collaborate with those responsible for economic policy, to simplify to a maximum the legislation and regulations on the subject matter in order to facilitate the interpretation and**

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<sup>11</sup> DECREE N° 1399/2001, *Whereases*.

**compliance with the rules in a context of stability and anticipation” and which “seeks to cooperate with other areas and agencies of the National Government for exchanging information and improving the procedures aimed at complying with the previously indicated objectives”<sup>12</sup>.**

The stability in the management of the Tax Administration is aimed at keeping it separated from political interests and changes; which circumstance will result in management devoid of all subjective character that may seek to diminish the importance of the organization’s action and goals. In this way, plans and strategies may be formulated on the basis of technical and objective guidelines that may promote professionalism, effectiveness and equity in the Tax Administration’s performance.

## **II. INTERACTION OF THE TAX ADMINISTRATION WITH THE LEGISLATIVE AND EXECUTIVE POWERS**

### **1. The Elaboration of Normative Projects for the Tax Administration**

The Tax Administration in its specific function of applying, collecting and examining taxes and additional charges provided by the specific legal rules is merely executing the legislative activity of the State. In other words, the activity of the Tax Administration cannot have a sphere of action different from that provided in the law. From there follows the importance that laws be express, clear and precise.

In the execution of the tax laws, the Administration understands the successes, errors, excesses and gaps in the tax rules, as well as the reality of every day events.

It must be observed that, in complying with its main tasks – fiscal collection and the struggle against evasion – the Tax Administration physically approaches the taxpayers. It also has information flows that are useful not only for its performance but also for the structuring of an adequate tax policy.

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<sup>12</sup> DECREE N° 1399/2001, *Whereases*.

Such understanding of the juridical and factual reality by the Tax Administration, as a result of the execution of the tax laws, which additionally allow it a direct contact with the taxpayer and counting on privileged information, must be transmitted to the operators in charge of designing the tax policy, and also listened by them, since it will serve the effectiveness of the tax laws, that will be rendered effective when the greater part of taxpayers voluntarily comply with them and when those who fail to comply are sanctioned.

In other words, fiscal reforms must be designed in such a way that they may be successfully implemented and, for this purpose, it must be a logical priority to be aware of the information, opinion and experience of the Tax Administration.

Specifically, with respect to the development of proposed laws within the Tax Administration, it is necessary to note that, in order for them to acquire the hierarchy of formal law, one must work on capturing the political will of the Executive Power as well as of the Nation's Congress.

To this end, it will be necessary that proposed laws respond to an objective, methodical and professionalized analysis of the prevailing reality. The misunderstanding or erroneous analysis of said reality may lead to propose tortuous rules or regulations that may definitely prevent economic development, a factor leading to prosperity, progress and welfare.

Tax rules must fundamentally respond to the constitutional principles, to the doctrinaire principles of taxation and, above all, they must be clear and precise. The proposal of clear and precise principles can only be developed on the basis of clear and precise ideas, which do not lose sight of the constitutional order and the purposes of the State which they serve.

No less important will be the stability for directing the tax administration which, separated from political swings, may insist on the proposed laws that are considered important. It is surprising how time and the talent of officials are put to waste in proposed laws which as a result of political changes, are lost in the corridors of bureaucracy!

## **2. The Argentine Experience**

The experience acquired through the execution of tax rules lead the Argentine tax administration to develop numerous legislative proposals.

These have included, in general terms, criteria jurisdictionally determined in a definite manner; situations which are in fact, new and not considered in the current laws in force; clarification and simplification of some of the tax rules; the promotion of new working methods.

In such procedure, the proposed laws are not sent directly by the Federal Administration of Public Revenues to the Congress of the Nation, but they are rather brought before the National Executive Power, through the Ministry of Economy, which will decide whether or not to send them to the Nation's Congress, according to the political receptivity of the rules in question, that is, of the willingness of those who exercise the political power, of listening to the proposals, advice and experiences which the Tax Administration is capable of transmitting.

Within the context of this meeting, it is interesting to consider the experience of two proposed rules, inspired and promoted from within and by the Argentine tax administration.

The purpose of one was to mitigate the problem of informality, understood as tax noncompliance which originates from ignorance of the tax rules; initiative which concluded with the approval of Law N° 24.977 on "Simplified System for Small Taxpayers".<sup>13</sup>

The other, more ambitious, was the Proposal for the Tax Code of the Republic of Argentina, which did not even reach the sphere of the legislative power.

Likewise, on considering it of interest, we will present the current status of the proposed laws submitted by the Argentine Tax Administration during the past five months.

## **2.1. Simplified System for Small Taxpayers**

The complexity of modern commercial and economic relationships — profusion of global markets, international trade, new legal persons, etc. — has complicated the juridical world, of which the tax system is a part. Thus, legal-tax systems in the world have progressively reached a high level of complexity, of which the Argentine tax system is not unaware.

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<sup>13</sup> Law approved on 2/7/1998, B.O. 6/7/1998

In this context, the Argentine Tax Administration perceived that such complexity increased the high cost of complying with the tax rules, which essentially affected the taxpayers, who, for this reason, opted for informality.<sup>14</sup>

In view of this situation, a simplified system was proposed for these small taxpayers, which was commonly called “monotax”. It was explained that “the purpose of this system was to simplify compliance with tax and social security obligations by small taxpayers and to incorporate informal workers to the social security system. If the tax is approved as proposed, subject to this tax will be those whose annual income is less than \$144,000 (at that time US\$144,000) and to determine the tax to be paid, categories are established according to the level of income and other aspects such as: energy consumption and the area of the small taxpayer’s establishment. The payment of this tax will be a fixed amount according to category that will substitute the VAT, profit tax, contributions to be paid by the employer and the payment as responsible for the monotax. The system will be optional, which means that those interested may exercise the option to join, or else fulfill their obligations according to the systems in force for the rest of the taxpayers”.<sup>15</sup>

It must also be recalled that the system also comprises those exercising professions with annual gross income lower or equal to \$36,000 (at that time U\$S 36,000). Excluded, among others are intermediation activities between offer and demand of financial resources, real estate lease or management, advertising, as well as customs brokers, directors and producers of shows, etc., and those responsible with more than one unit of exploitation and/or activity comprised in the system.

The parliamentary debate which preceded the sanctioning of the “Monotax” law shows the interaction of the Tax Administration and the Congress of the Nation, not only in the case in question, but also on occasion of discussing the previous proposed laws

Thus, in the aforementioned debate it has been said: “During the meetings between the legislators and the incumbent of the DGI and his advisers, on occasion of the parliamentary procedure of current laws 24.765 (on closures) and 24.769 (Penal Tax Law), in December

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<sup>14</sup> SILVANI, Carlos Alberto, “Tax Administration Issues”, *D.G.I. Newsletter N° 12, July 1998*, page 1119.

<sup>15</sup> SILVANI, Carlos Alberto, *op. cit.* page 1121

1996, and in the heat of those discussions and exchange of ideas, there arose what is now causing a great debate and almost periodically and with certain regularity, is the subject of news in journals and specialized reviews". It was added that: "there was talk at those meetings of the equity of the Argentine tax system, of the high costs for small and medium-sized businessmen, resulting from the administration of taxes, the complexity of the system, which required that every taxpayer –no matter how small – would resort to professional counseling which, logically, generated more expenses, among other issues of which Mr. Silvani took note and committed himself to analyze some system that would simplify taxation for small businesses."<sup>16</sup>

In sum, it was a proposed law wherein the Tax Administration accepted a complaint from society, expressed clearly and objectively and, therefore, also accepted by the National Executive Power and the Legislative Power without greater objections.

The interaction with the legislative power was prompt and expeditious characterized by flexibility and the interacting parties' willingness to discuss. The meetings of the legislators with tax administration officials contributed to the approval of the new legal system, in the understanding that it was the establishment of "...an important mainstay for normalizing relationships between the Treasury and a broad sector of taxpayers who may easily access the formal system."<sup>17</sup>

In order to show the effectiveness of the system established, it is worth mentioning that, six months after the enforcement of the law, already 790,808 monotaxpayers had already joined.<sup>18</sup>

## **2.2 Proposed Tax Code of the Republic of Argentina**

The proposed Tax Code was developed within the framework of a program of the Inter-American Development Bank (IDB) for strengthening the Federal Administration of Public Revenues<sup>19</sup>. It was based on the need to substitute the former Tax Procedure Law

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<sup>16</sup> "Parliamentary Background; Law 24.977, 1998, N° 8; page 2346; Ed. La Ley.

<sup>17</sup> From the informing member of the Chamber of Deputies, Oscar LAMBERTO, *Parliamentary Background, op.cit.*, page 2219.

<sup>18</sup> *Tax Statistics, AFIP, 1998, page 186/188.*

<sup>19</sup> *AFIP-IDB Program N° 1034/OC-AR; UNDP ARG /97/035 Project*

N° 11.683, in the understanding that the successive reforms made, which numbered more than two hundred, did not respond to reasonably homogeneous and systematic criteria. With specific reference to those reforms, in the projected explanation of reasons of the legal code, it was stated as follows "...especially starting in the sixties - innovations, corrections and aggregates comprised a disarticulated normative body", it being added that the mistakes of the system in force "...cannot be adequately corrected through an additional partial reform of the aforementioned law. It is necessary to undertake a systematic regulation of the tax and fiscal obligation in general –comprising within the second the social security obligations -, the secondary and accessory obligations, their procedures –including examination- and the penal and contraventions system. Such systematic regulation can only be carried out through a new specific code”.

Nevertheless, the main source of the proposed law was Law N° 11.683 itself. In the elaboration of the projected normative body one had endeavored, to the extent possible, to preserve the contents of all the rules of the procedural law in force that would have proved to be effective.

The Proposed Law, pervaded with a basic idea that consisted mainly of rewarding the “good taxpayer”, so many times disregarded in our country, attempted to solve substantial tax law and procedural problems.

In the specifically procedural framework, priority was given to solving the problems which the dispersed jurisdiction as regards tax law, caused to the Tax Administration as well as to the taxpayers. The idea was the creation of a special and unique jurisdiction, within the sphere of the judicial power, also with a unique procedure for aspects dealing with tax, penal-tax, social security issues and fiscal executions (in this latter case, fiscal dues were handled at the administrative level but judicial intervention was anticipated in the case of objections which the tax administration could not settle at that level), on the one hand; and on the other, the drastic reduction of the procedural terms in the proceedings carried out at the administrative level as well as the judicial instance.



The creation of the tax jurisdiction implied the elimination of the Fiscal Court of the Nation<sup>20</sup>, administrative body that operated as a second instance court, in the cases of taxpayer appeals against resolutions of AFIP-DGI which determine tax in a true or presumptive manner, impose fines or reject requests for tax restitutions; or first instance in case of restitutions that may be filed directly before it; and whose judgments are liable to being objected by means of a revision and appeals recourse limited to the pertinent National Chamber. Nevertheless, given the influence and prestige of the Fiscal Court of the Nation in our country, “the mentors of the proposed law confirmed that the intention was not to eliminate the Fiscal Court of the Nation but rather to capitalize from its valuable experience and contributing to its hierarchy through the creation of a specialized judicial jurisdiction.”<sup>21</sup>

Also discussed were other procedural issues such as the regulation of the examination process and the offering and production of evidence at the administrative jurisdiction.

The proposed Tax Code was presented to the public by the Federal Administrator in April 1999 and in view of the reform being proposed, an invitation was made for a public debate, open to all those interested to contribute their criticisms, ideas and suggestions.. To that end, the text of the proposal was made available to the public through the AFIP page in Internet.

The institutional launching of the Proposed Law aroused then, an intensive political controversy between qualified tax experts, scientific and professional associations, universities, officials from the Tax Administration and members of the Nation’s Judicial Power.

Symposiums and conferences were organized on the subject of the Proposed Law. Incumbent professors teaching subjects related to Tax Law at the School of Economic Sciences and the School of Law of the

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<sup>20</sup> *The Fiscal Court of the Nation is an administrative autarchic organization within the sphere of the Ministry of Economy and Infrastructure, whose creation through Law N° 15.265 (B.O. 27/01/1960) responds to the idea of reasonably curbing the exercise of administrative powers and prerogatives for the verification of the fiscal behavior of taxpayers; guaranteeing the necessary independence for fairly and equitably solving the conflicts between the administration and the taxpayers. For more information on the creation of the Fiscal Court of the Nation see TEJERINA, Jorge “Proposal for the Creation of an Administrative Fiscal Court”, *Derecho Fiscal*, T. IX, page 233. GIULIANI FONROUGE, Carlos M. “Notes to Law 15.265”, *Annals of Argentine Legislation*, Volume XIX, First part, page 239).*

<sup>21</sup> LAMAGRANDE, Marina C. “The Jurisdiction in National Tax Law Proposed Tax Code of the Republic of Argentina”, *Rev. Impuestos*, June 1999, page 3. Ed. La Ley.

National University of Buenos Aires expressed their opinions. The Tax Administration received and analyzed the opinions, criticisms and suggestions from the different entities such as the Chamber of Corporations, the Association of Fiscal Studies, the Professional Council of Economic Sciences of the Federal Capital, the Argentine Federation of Professional Councils of Economic Sciences, etc; as well as individual distinguished and prestigious tax experts; and incorporated the reforms deemed pertinent, which would nevertheless not interfere with the philosophy of the proposal.

In order to obtain the support of the National Executive Power for subsequently sending the proposal to the Nation's Congress, the authorized opinion of the Treasury's Attorney was requested and also meetings were held with officials from said institution.

It must be clarified that the Treasury Attorney's Office constitutes the National Directorate of the Body of State Attorneys and its main mission is to represent the State before legal-administrative courts, while also being the top legal adviser of the National Executive Power. One of its specific tasks is to undertake professional studies for improving the laws and regulations in force in public administration.<sup>22</sup> The Nation's Treasury Attorney is directly dependent on the President of the Republic and exercises his responsibilities with technical independence.<sup>23</sup>

The Treasury Attorney's Office expressed itself in favor of the Proposed Law in his Opinion of June 23, 1999.

In this regard, in the aforementioned counseling act, said high counseling entity stated.: " A general review of the proposed law allows for noting that... like its predecessor, Law N° 11.683 (B.O. 12/01/1933), it includes precepts of a substantive nature, organizes the tax jurisdiction and concentrates therein all the competencies, including contravention and penal issues." "For this reason, if Law N° 11.683 confirmed in due time, the autonomy of Tax Law, by developing appropriate rules for the collection and examination of taxes and for directing the behavior of taxpayers and collection authorities in case of controversies, the proposed law, on systematizing, organizing and simplifying the tax issue, consolidates and improves said autonomy." "The greatest merit of this proposed law is, undoubtedly, said systematization and simplification." Lastly it adds that, "Once converted into law, this Code shall become for the Application Authority an effective instrument that will afford

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<sup>22</sup> Law N° 12.954 (B.O. 10/03/1947).

<sup>23</sup> Law N° 24.667 (B.O. 25/07/1996).

certainty and legitimacy to its action, while also avoiding the necessary delays in the process. For the taxpayers and those responsible and even for third parties obliged by fiscal provisions, the proposed law provides a clear and simple drafting, devoid of unnecessary technicalities, which also contributes to give transparency to the processes.”

Regardless of the merits highlighted, the General Treasury Attorney, in turn, made some considerations with respect to specific precepts that, in his opinion, required observations. The latter gave way to the reformulation of the projected rules by the Tax Administration.

Likewise, ideas were exchanged with high-level officials of the Ministry of Justice and they were asked to give their opinions on matters that due to their nature, were under their specific responsibility. They showed some reluctance with respect to the collection of fiscal dues within administrative jurisdiction, since according to the Argentine juridical tradition, enforced collection of debts takes place through the legal process.

Meetings were also held with Judges and Council Members of the Federal Administrative-Legal jurisdiction (pertinent jurisdiction with respect to national taxes).

A result of this debate was also the proposed reform of Law N° 11.683, as valid alternative of the proposed Code presented to the Ministry of Economy by the Fiscal Court of the Nation. The promoters of this proposal began with the primary idea that was contrary to that of the proposed law. That is, the understanding that the former ritual law should be maintained, since, according to their opinion, it had a triple advantage: it is a former law, democratic result from successive parliamentary majorities, it has a rich doctrine and jurisprudence elaborated around it and it is well known by those for whom it is intended (either officials or taxpayers subject to the tax obligations and duties).

Undoubtedly, at the level of the Executive Power there originated a struggle between those in favor of one or the other proposals. Finally, as a result of the change of government, the Tax Administration did not obtain the necessary political support to continue promoting the proposed code. The alternative proposal did not obtain it either. None became a law; and furthermore, non was sent to the Congress of the Nation for their discussion by the corresponding commissions and bodies.

In spite of this, the mere fact of having achieved a scientific debate on specific difficult issues of tax procedure, such as the execution of fiscal dues within the administrative level and the creation of a specialized judicial jurisdiction, among many others, has implied a significant advance.

In fact, a consequence of the debate was the consensus on the urgent need for changes, which certainly rendered possible within a short time, substantial legislative reforms such as the modifications introduced in the judicial process of fiscal executions and the administrative official assessment process [Law N° 25.239 (B.O. 31/12/99)]; the creation of a penal-tax jurisdiction [Law N° 25.292 (B.O. 16/08/00)] and the creation of federal courts of fiscal tax executions [Law N° 25.293 (B.O. 16/08/00)].

### **3. Interaction Today**

The Argentine Tax Administration continues, at present, to struggle for legislative modifications, in the conviction that they are necessary for achieving an effective state management.

Thus, during the course of the present year, five legislative proposals, have been submitted to the National Executive Power, through the corresponding hierarchical means, that is, the Ministry of Economy which promote reforms to substantive and procedural laws, in response to the particular socioeconomic circumstances being faced by the country and the pressing need to struggle against tax evasion.

The first project proposes modifications to the Tax Procedures Law N° 11.683, the Tax-Penal Law, as well as the Law on Insolvency Proceedings and Bankruptcy.

The proposed reform of the Law on Tax Procedures N° 11.683 considers modifications of great significance dealing with the elimination of legal gaps and simplification of certain precepts, among which some of the most important ones are: the incorporation to the legal text of a system of related inquiries, currently governed by a rule of lower hierarchy [General Resolution (AFIP) N° 192]; the joint responsibility of the members of a Provisional Union of Businesses (PUB); the treatment to be given to investments from countries with low or no taxation; the power of the Administration to authorize entities, other than banks, to act as payment agents, of the authorized subject to retribute indirect

taxes; an express provision preventing the modification of the statutes of limitations provided in the ritual law by other national laws; innovative changes in the procedure before the Fiscal Court of the Nation as regards the summons to plenary proceedings and the promotion of pilot cases by the Administration and, the nonfiling of returns as a sort of fraud in specific circumstances.

Under the Tax-Penal Law it is proposed that a new specific penal type be created for whoever unduly and fraudulently recovers value added tax on exports, including, in addition as accessory sanction, the loss of the benefit; also anticipated is the elimination of penal action for acceptance and payment of the tax claim to more penal types than those provided at present and, lastly, the term of 10 working days is extended to 30 consecutive days, following expiration of the obligation, without payment of withholdings, to formalize the offense as undue appropriation of taxes and social security resources.

With respect to the Law on Insolvency Proceedings and Bankruptcy, it is worth clarifying in advance that some of the rules that govern the bankruptcy procedures in the Republic of Argentina provide for a strict comparison of the Treasury with the other individual creditors, such is the case of those that prescribe the opening of proceedings by means of notices, the term for the examination of credits, the abbreviated statute of limitations, among others; which circumstance causes the Tax Administration in particular, serious and burdensome consequences.

Accordingly, the projected legislative text responds to the idea of moderating said criterion, without affecting the guiding principle of the “pars condition creditorum”.

In this sense, the proposals are to expand the term for requesting the verification, following the publication of the notices; the obligation to include the single tax identification code, with the other identifying data of whoever is involved in the notices and or bankruptcy judgments; the obligation of the trustee to notify the opening of the proceeding to AFIP; the obligation to inform the treasury about the bankruptcy judgments and exclusion of the Treasury from the payment of the corresponding examination fee.

In addition, given that the Argentine bankruptcy law provides for an abbreviated statute of limitations for bankruptcy credits, without exception, by way of complement to the reform that is promoted in Law N° 11.683, it is suggested that precepts be incorporated which recognize

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the operativeness in bankruptcy proceedings of the causes of suspension and interruption of the statute of limitations that govern other laws.

A second proposal elaborated and promoted this year by the Tax Administration provides for modifications to the Laws on Profit Tax, Value Added Tax and Personal Property Tax.

In the sphere of Profit Tax, the proposal is: a) elimination of the exemption on purchase and sale of stock through the stock exchange by individuals and beneficiaries abroad; b) elimination of the exemption on purchase and sale of negotiable bonds made by beneficiary corporations abroad; c) nondeductibility in the tax balance of amounts corresponding to nondocumented withdrawals and entry of special tax; d) establishment of mechanisms for the determination of the tax base to avoid elusive maneuvers in transactions between related companies in the country; e) determination of legal presumption of net profit for paying indemnities for losses to individual beneficiaries abroad; and, g) establishment of special requirements with respect to deductions admitted for counterclaims originating abroad from operations in low or nontax jurisdictions.

In relation to Value Added Tax the proposal involves: incorporating transfer or assignment of rights of use or enjoyment as new taxable event; the inclusion of the figure of substitute responsible with respect to individuals living abroad for services or leases taxed in the country; the establishment of a general principle whereby the provisions of the tax law prevail over exemptions granted by special laws; elimination of the power of the national executive body to transform the tax on what is earned to what is received; establish taxation of differences in exchange resulting from the time the taxable event takes place (issuance of the invoice) up to the total or partial cancellation of the price; the establishment of taxability of services related to taxed leases or services, independently from their functional or economic subordination to them.

As regards the Law on Personal Property Tax, the proposal refers to the inclusion within the sphere of taxability, of foreign corporations with registered stock for holding stock from corporations existing in the country and the expansion of the scale of tax rates.

Now then, based on the preservation of the principle of legality, the third proposal suggests the incorporation of a rule in Law N° 11.683 on Tax Procedures to prevent the National Executive Power from establishing systems for regularizing tax debts that may imply total or partial exemption of capital, interest and fines and any other sanction, in other assumptions that are not those provided in the aforementioned legal text.

A separate proposal also provides for the elimination of Chapter XIII of Title I of Law N° 11.683 (text ordered in 1998 and its modifications) dealing with the “Special Examination System”, called “fiscal blockade”, by virtue of which examination is limited to the last annual period for which sworn returns may have been filed; additionally establishing the presumption of accuracy of the returns filed for previous periods, whose statute of limitations has not expired, until they have not been objected and the official assessment is made.

The purpose of this initiative is to directly fight against tax evasion and increase tax collection.

Lastly, the fourth proposal responds to a specific problem in the chain of commercialization of dry grains and vegetables –where evasive maneuvers are used, such as apocryphal invoices-; as regards their relationship with the export operations and the corresponding reimbursement of Value Added Tax credit.

In this line of thought, to avoid evasive maneuvers and also favor exports, the proposal involves: a) reduction of tax rate from 21% to 10.5% for the commercialization of dry grains and vegetables; b) reduction of the rate from 21% to 10.5% for all services hired by the production sector (cultivation and harvesting expenses, etc); and c) proportional reduction of rate of withholding (on account payment) to be made by exporters.

In response to reasons of tax equity, which call for providing equal treatment to the production of livestock in all its stages of production and commercialization, it is proposed that the same reduced rate be applied to all sales, leases and definitive imports of fresh or salted, dry and whitewashed, or otherwise preserved bovine hide, but without tanning; as well as to the meat and offals of the same species, fresh, refrigerated or frozen, which may not have been subjected to processes that imply a true cooking or elaboration that makes them a preparation of the product.

In sum, the legislative projects briefly described in the foregoing paragraphs were promoted by the Federal Administrator and developed by the counseling and technical areas of the Tax Administration. These normative proposals are the result of a methodical, objective and serious study of the juridical and factual reality of our country, described in the technical-juridical reports that accompany each one of the projects, and provide the reasons, bases and consequences of the modifications that are being proposed.

The logics inherent in each of the proposed reforms as well as the accompanying technical-juridical reports will serve, along with the other efforts that may be made, as valid instruments for transmitting to the National Executive Body as well as to the Nation's Congress the needs and experience of the current Tax Administration.

### **III. CONCLUSION**

With respect to the speediness with which man's experiences occur, particularly those related to his social projection, in the last few years of the XX century it has been said that changes and reforms occur so rapidly that it may not be known whether what is said, written or thought today, will be valid tomorrow and whether or not norms will be in force for a long time.<sup>24</sup>

The beginning of the XXI century made no innovation with respect to this phenomenon.

The Tax Administration, in its function aimed at integrating the legislative action of the National State, is directly linked to social life. That is, to the speediness of changes occurring therein. It experiences, understands and appreciates them.

In those experiences, it is the Tax Administration the one perceiving how law is overcome by events, and from its function, it anticipates the need for changes in tax laws as well as in those norms that comprise the framework of its specific activity.

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<sup>24</sup> VAZQUEZ, Susana Beatriz, "Fiscal Control", Paper prepared for the CIAT Technical Conference, 1995.



There is no doubt, then, that the agents in charge of designing the tax policy must listen to the Tax Administration and one way of doing so, is by considering the normative projects that are generated in its sphere and submitted to consideration by the Executive Power and the Nation's Congress. Another way of doing so, is that those in charge of designing the tax policy ask for the Administration's opinion on the projects being developed, as an additional tool for guaranteeing the effectiveness of the norms in question.

Obviously the participation of the Tax Administration in the legislative reform projects calls for a methodic, intelligent, objective, serious and conscious observation of the reality and phenomena occurring therein.

The modifications proposed and observations made must respond to clear ideas, since they are the only ones that allow for clear conclusions and fundamentally must respond to the constitutional order and the objectives –aimed at the common welfare – which they serve.

Thus understood, the interaction is necessary, valid and positive; aimed at contributing to state management; without affecting the state of Law, since the normative project will acquire or not the hierarchy of formal law, depending on what the Nation's Congress finally decides, and, in that order, it only recognizes the limits set by the National Constitution.

Ms. María Lamagrande  
Chief of the Tax Legal Division  
Federal Administration of Public Revenues  
E-mail: mlamagrande@afip.gov.ar

*Case study:*

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## **INTERACTION BETWEEN THE EXECUTIVE, LEGISLATIVE AND JUDICIAL BODIES**

**Bernardo Lara**  
Legal Deputy Director  
Internal Revenue Service  
(Chile)

*CONTENTS: I. Institutional Framework: The State of Law, the Principle of Legality and the Interaction of Public Powers.- II. The Executive Power and the Tax Administration.- 1. Taxation Power of the State.- 2. The Internal Revenue Service as Public Service.- 3. Relationship of the Internal Revenue Service with other Public Services.- 4. Control of Legality by the General Comptrollership of the Republic of the administrative acts carried out by the SII.- III. The Legislative Power and the Tax Administration.- 1. The Principle of Legality of Taxes.- 2. Control of Constitutionality of the Tax Law.- IV. The Tax Administration and the Judicial Power.- 1. Solution of Tax Controversies.- 2. Prerogatives of the Internal Revenue Service in relation to Tax Offenses.- 3. Collaboration of Judges and auxiliary entities of justice administration in the application and examination of tax rules.*

### **I. INSTITUTIONAL FRAMEWORK: THE STATE OF LAW, THE PRINCIPLE OF LEGALITY AND THE INTERACTION OF PUBLIC POWERS**

The State of Law concept implies that different bodies of power with different jurisdictions be established and that each of them may act independently in carrying out their respective functions. For this purpose, it is essential that there be rules through which the incumbents

of such bodies may be vested with the necessary prerogatives for efficiently performing their functions, that their sphere of action be delimited and that the functions which each entity must carry out be specified.

In this way, the State of Law implies a series of rules that equally bind the rulers and the ruled and which implicitly bears the hierarchical order, by virtue of which a specific juridical precept cannot violate that provided by another of a superior rank and ultimately, by the Political Constitution. In this way, State bodies must subject their action to the Constitution and the rules issued according thereto, that is, the juridical code, including those found in international treaties and those of a regulatory nature, which obligation is also extensive to any persona, organization or group.

Thus, public administration must behave with rationality and sound judgment in performing its functions, even in cases where the law authorizes its bodies to act with certain discretionality. In this sense, article 7 of the Political Constitution provides that the State bodies act validly, following the regular investiture of its members, within their jurisdiction and in the manner provided by law. It adds that no magistrate, individual or group of individuals may assume, not even on the pretext of extraordinary circumstances, other authority or rights than those expressly provided by virtue of the Constitution and the laws.

This delimitation of functions entails that each State body act within the sphere of its functions with total independence, regardless of the fact that there may be interactions between the different State powers, as proposed in this paper, through which one may show the existence of relationships between the Internal Revenue Service and the different powers of the State: executive, legislative and judicial.

## **II. THE EXECUTIVE POWER AND THE TAX ADMINISTRATION**

### **1. Taxation Power of the State**

The juridical possibility of establishing taxes, regardless of their nature, is in the Political Constitution delivered to the State. The latter, as representative of the political society in achieving the common welfare, may impose, eliminate, reduce or condone taxes of any type or nature, establish exemptions or modify the existing ones and determine their form, proportionality or progression.

On its part, the legislative initiative in any sphere may proceed from the Chamber of Deputies or the Senate, or through message from the President of the Republic. However, in the case of bills relative to the State's financial or budgetary administration, or those related to rules that impose, eliminate, reduce or condone taxes of any type or nature, establish exemptions or modify the existing ones, and determine their form, proportionality or progression, this power is given, according to the Political Constitution, exclusively to the President of the Republic, as will be analyzed further on, with respect to the process of development of the tax law.

## **2. The Internal Revenue Service as Public Service**

### **a) Structure and Organization**

According to D.L. 3551 of 1980, which regulates Examination Institutions, the Internal Revenue Service is an autonomous public service, with juridical personality, of indefinite duration, separated from the central power, which is related to the President of the Republic through the Ministry of Finance. On its part, it is a territorially and functionally decentralized entity, since in each region of the country there is one or more Regional Directorates, headed by a Regional Director, who in the territory under his jurisdiction is vested with the powers that allow him to autonomously carry out his functions, regardless of which he must abide by the rules and instructions given by the Service Director.

It consists of a National Directorate with headquarters in the capital of the Republic, and sixteen Regional Directorates, which in principle have jurisdiction over a region, within the sphere of the administrative division of the national territory, except for the Metropolitan Region, wherein there are four Regional Directorates.

An official with the title of Director is the Superior Head of the Service, appointed by the President of the Republic and being exclusively trusted by him. This position is held indefinitely, with this capacity being maintained as long as the official is not removed.

**b) Fundamental powers**

- *Exclusive power of interpretation of the tax laws*

The Internal Revenue Service is the entity in charge of applying and examining the tax provisions relative to internal taxes currently established or which may be established. To comply with this objective, it counts on a series of powers, among which is the exclusive power of administrative interpretation of the tax provisions, as well as that of setting rules and giving instructions in his capacity of Superior Head of the Service. By virtue of this prerogative, all Service officials are obliged to act according to the guidelines the Director may determine through this activity, on interpreting the tax laws and setting the rules for the correct application and examination of the taxes.

Since this is an exclusive power assigned to the Service Director, which is exercised with full autonomy, it is not subordinate to hierarchical control. Nevertheless, if in the exercise of these exclusive powers of interpretation and application of the tax laws, which correspond to the Director, there would arise **jurisdictional disputes** with other authorities related to the President of the Republic through the Ministry of Finance, the latter Minister will solve it. On the other hand, if the controversy arises with authorities that are dependent on or related to other ministries, the corresponding ministers will jointly decide thereon, and if there were no agreement, the President of the Republic will solve.

- *Counseling the Ministries*

The Internal Revenue Service Director is obliged to counsel the corresponding Ministry, when international agreements dealing with tax issues are being negotiated. The same task should be undertaken with the Minister of Finance when the latter requires it, in issues under jurisdiction of the Service, as well as in the adoption of measures which in the Director's opinion may be necessary for the best application and examination of the tax laws. In addition, he must propose to this Ministry the legal and regulatory reforms that may be advisable for the efficient application and examination of taxes.

### **3. Relationship of the Internal Revenue Service with other Public Services**

#### **a) Relationship with Treasury and Customs**

According to the Organic Law of the Internal Revenue Service, this entity is in charge of the application and examination of all the **internal taxes** currently established or which may be established, fiscal or of another nature in which the treasury may be interested and whose control is not especially entrusted by the Law to a different authority. On the other hand, with respect to **taxes on international trade**, the entity responsible is the National Customs Service which is in charge of the examination of import and export duties.

On the other hand, the entity in charge of collecting the aforementioned taxes, internal as well as external, is the Treasury Service, which in addition must collect other fiscal income and custody such funds. In exercising these powers, it must undertake enforced collection, either judicial, extra judicial or administrative of every type of tax.

The activities of these three services are closely related, since jointly they are in charge of the application, examination and collection of internal or external taxes that currently exist or which may be established. In this sense, the Treasury and the Internal Revenue Service must mutually provide each other the information they may require for timely compliance with their functions. On their part, municipal treasurers must send to the SII a copy of the list of industrial, commercial and professional patents in the way the alter may request it. In addition, they will send background information relative to the income of individuals living in their municipality or properties located in their territory. With respect to the Customs Service, the latter must send to the Service, within the first days of each month, a copy of the import or export permits processed in the previous month.

#### **b) Relationship with other Public Services**

Among the powers of examination that correspond to the Internal Revenue Service and in order to verify the accuracy of

the returns filed by the taxpayers, all fiscal, semi fiscal officials, from fiscal and semi fiscal institutions of autonomous and municipal administrations, and the authorities in general, are obliged to provide the Service all the data and background information the latter may request for the examination of taxes.

Regardless of this generic obligation, which falls on fiscal and semi fiscal officials, the tax law establishes a series of specific obligations to provide information that bears on organizations that have these capabilities. By way of example, and in addition to the ones discussed in the previous item relative to the Treasury and Customs, the Mayors and other local officials, the State Bank, the social security funds, Central Bank, the Production Promotion Corporation must provide certain information to the Internal Revenue Service relative to actions wherein they may participate or be aware of and which may be capable of disclosing the income of taxpayers. Parallel to this, the Offices of Identification, the Investigations Police of Chile and the Customs Officers of Chile render their collaboration according to the terms that will be indicated further on.

#### **4. Control of Legality by the General Comptrollership of the Republic of the administrative acts carried out by the SII**

The General Comptrollership of the Republic must control the legality of the administrative acts carried out by the various bodies of the State Administration, among them, those originating from the Internal Revenue Service.

In this sense, this entity exercises the juridical, accounting and financial control of the Service's action. The juridical control is exercised through the preventive examination and recording of the resolutions originating from the National Director and the Regional Directors of the SII, which according to law, must be examined by the Comptrollership. With respect to Accounting Control, it examines decrees involving expenditures and performs audits to verify collection and investment of the funds of the Internal Revenue Service.

### **III. THE LEGISLATIVE POWER AND THE TAX ADMINISTRATION**

#### **1. The Principle of Legality of Taxes**

##### **a) Constitutional Provision**

In the Chilean legal code, the source of taxation is the Law. It is thus that article 19 N° 20 of the fundamental Charter guarantees to all individuals equal distribution of taxes in proportion to the income or in the progression or manner determined by the Law, as well as the equal distribution of all other public obligations. This rule provides that in no case may the Law establish taxes that are obviously disproportionate or unfair, and on the other hand, that taxes collected, regardless of their nature, become part of the country's net worth and may not be assigned to a predetermined purpose. In spite of the foregoing, the law itself may authorize that specific taxes be assigned to purposes of national defense. Likewise, it stipulates that the law may authorize that taxes encumbering activities or properties with a clear regional or local identification, may be applied, within the frameworks determined by the law itself, by the regional or community authorities to finance development works.

In this sense, the fact that the obligatory source of taxes is the law, implies that the alter must determine which are the assumptions and the elements of the tax relationship. In this way, it is the Law that determines the taxable events as well as the individuals subject to the tax obligation. With respect to the amount, although it is not required that it be expressly established by the law, it is an indispensable requisite that it include the necessary elements for its determination, in order to prevent the discretionary action of the administration.

On its part, article 60 N° 14 of the Fundamental Charter provides that matters of Law are those which the Constitution may point out as laws of exclusive initiative of the President of the Republic. In this sense, and according to that provided in article 62 of the Constitution, the Head of State will have this prerogative in the bills intended to impose, eliminate, reduce or condone taxes of any nature or type, establish exemptions or modify the existing ones, and determine their manner, proportionality or progression.



**b) Respect for Constitutional Guarantees**

The Principle of Legality being analyzed is not sufficient in itself to ensure respect for the fundamental rights of individuals and intermediate groups. To this end, it is also necessary that the tax law abide by the constitutional rights and guarantees provided in the Fundamental Charter. That is, that it be in harmony with the bases of institutionality and the precepts that guarantee equality in the distribution of taxes, nonconfiscation, the right to property, freedom to carry out any economic activity and their nonassignment to specific purposes.

In this respect, equality of taxes in proportion to income or in the progression or manner determined by the law, as provided in article 19 N° 20 of the Political Constitution is a species within the gender of equality before the Law. The latter implies that no authority or individual living in a political society may act by establishing arbitrary discriminations, without a rational base. The rule being discussed, implies as rational base for discriminating with respect to the tax burden that affects a taxpayer, his taxpaying capacity, given that, in view of the objective of redistribution of income inherent in taxation, taxes are applied in accordance with the economic capabilities of each taxpayer.

On the other hand, the same recently mentioned rule provides for the principle of proportionality of taxes, on indicating that in no case may the law establish taxes that are evidently disproportionate or unfair, which implies that the tax burden affecting taxpayers must be adequate and reasonable. This is a circumstantial issue that must be seen according to the economic-social purposes of each tax; an excessive tax burden, along with affecting the right of ownership, may mean that the exercise of a legal economic activity may be definitely prevented, being both rights constitutionally provided.

The principle of legality of taxes is also limited by nonassignment, by virtue of which, taxes collected, regardless of their nature, will become part of the country's net worth and may not be assigned to some specific purpose, except if they are assigned to purposes of national defense, or financing of public works when they encumber activities or properties with a clear regional or local identification.

Finally, and according to article 19 N° 26 of the Political Constitution, the rights provided by the latter cannot be affected in their essence by legal precepts that may regulate or complement them, nor impose conditions or requisites that prevent them from being freely exercised.

**c) Processing of Tax Laws**

As already stated, in the case of bills relative to the State's financial or budgetary administration and those related to rules imposing, eliminating, reducing or condoning taxes of any type or nature, establishing exemptions or modifying the existing ones and determining their manner, proportionality or progression, the legislative initiative is exclusively attributed to the President of the Republic.

On its part, tax laws may only originate in the Chamber of Deputies, a requisite which prevents the Executive Power from considering an occasional majority that may facilitate the approval of the initiative in its first constitutional process.

Now then, during the processing of tax laws and according to the Organic Law of the National Congress, the State's administration bodies, among them, the Internal Revenue Service, must provide the specific reports and background information that may be requested by the chambers or internal bodies authorized by their respective regulations, during the processing of a specific bill, except for those which by express provision of the law may be of a secret or reserved nature.

In this respect, this Service can in no case provide the Chambers background information regarding the amount or source of taxed income, losses, expenditures and any other data relative to said income, that may appear in the obligatory returns filed by the taxpayers, background information with respect to which it is obliged to keep secret, in accordance with the provisions of article 35 of the Tax Code. Jointly, and according to its Organic Law, the Service officials are prevented from disclosing, despite the instructions of the Director, the contents of the reports that may have been issued, or to give to someone outside the Service news about events or situations of which they may have become aware while carrying out their functions.

Notwithstanding the above, the Internal Revenue Service through the Ministry of Finance shall provide the reports or background information requested by the Chambers, which are secret or reserved due to their nature, or by special provision without force of law, with the respective documents being kept in reserve. On the other hand, if they were secret because they could affect national security, the country's economic or financial security or for some other justified reason, the

Minister will only provide them to the respective commission or the corresponding chamber, at the secret session which may be held for such purpose.

**d) Delegation of legislative powers**

The 1980 Constitution confers to the National Congress the function of delegating its legislative powers to the President of the Republic, by means of provisions with force of law and during a term not to exceed one year, on issues under the control of the law, and without such delegation being extended to issues comprised in the constitutional guarantees.

The law granting the aforementioned authorization will indicate the precise issues on which such delegation may be made and may establish or determine the limitations, restrictions and formalities they may deem convenient. The General Comptrollership of the Republic must register these Decrees with Force of Law, having to reject them when they exceed or violate the aforementioned authorization.

In this way, although the fundamental charter provides for the Principle of Legality of taxes, this does not prevent the legislative power from delegating its powers to the President of the Republic, provided that the delegating laws will precisely delimit the tax powers granted, and that the delegation not exceed the term of one year provided in the Constitution.

**2. Control of Constitutionality of the Tax Law**

The previously indicated guarantees would be void of any practical contents if there would be no due control of constitutionality of the laws that impose taxes which may ensure the necessary correspondence between tax obligation and the effective legal effect of the rights of individuals.

**a) Constitutional Court**

During the process of development of the tax law there may arise conflicts with respect to the constitutionality of some of its provisions. In this situation, the President of the Republic, any of the chambers or

one fourth of the incumbent members may request that the Constitutional Court settle the conflict. Its intervention does not suspend the processing of the bill, but the objected part may not be promulgated as long as the court does not pass judgment, and if the request is accepted, the precept that has been declared unconstitutional may definitely not be promulgated.

**b) Declaration by the Supreme Court of unconstitutionality of a tax law**

The Supreme Court of Justice, officially or by request of a party, with respect to the issues it has to consider, or which may be presented in an appeal filed in any process or trial underway before another court, may declare inapplicable every tax rule contrary to the Constitution in those particular cases, either because there were formal defects in its processing, or because the precept in question violates the aforementioned constitutional principles.

**IV. THE TAX ADMINISTRATION AND THE JUDICIAL POWER**

**1. Solution of Tax Controversies**

The Chilean system attributes jurisdiction for considering and solving tax controversies to different bodies, which are solved and processed through different procedures provided in the law.

**a) Judges of Civil Courts**

They initially consider issues relative to the assessment of taxes, allocations due to death and donations, regarding the stamp tax, court order requested by the regional treasurer against the taxpayer who fails to deliver to the treasury taxes resulting from withholdings or surcharges. They also consider conservative measures ordered by the Regional Director against a taxpayer who is to be applied a monetary sanction and also the objection by the individual whose property is attached for debt in the executory processes dealing with monetary tax obligations.

**b) Judges of Criminal Courts**

They consider controversies dealing with tax offenses sanctioned with corporal punishment, court order requested by the Regional Director with respect to those taxpayers, who having been summoned for the second time to declare under oath in an administrative investigation for a tax violation, do not attend without any justified cause or do not submit the accounting records. On the other hand, in this same sphere they solve claims from taxpayers affected by apposition of seals and confiscation of accounting records and other documents related to the line of business of the alleged violator.

**c) Special Appeal Courts**

Consider appeals against the resolutions of the Regional Director relative to claims dealing with real estate valuations. It is formed, among others, by a Minister of a Court of Appeal, who assumes the capacity of Chairman of the Court.

**d) The Regional Directors in the jurisdictional sphere**

They consider the following issues:

- General claims procedures, with respect to those claims filed by the taxpayers against an assessment, bill, payment or resolution which involves the payment of a tax or the elements that serve as basis for determining it.
- Claim against a real estate valuation by the SII.
- Claim against violations sanctioned with corporal punishment, with respect to which the Director of this Service decides not to file complaint for tax violation.

The characteristics of this court are the following:

- **Special Court** not part of the judicial power intended to consider and solve tax issues. Although organically located within the State administration, is subject to the Directive, Correctional and Economic Superintendency of the country's Supreme Court, in accordance with the Republic's Political Constitution, on not being expressly exempt from this control.

- **Unipersonal Court** headed by the Regional Director.
- **Law Court**, since in the substantive as well as procedural aspects it must be subjected to the respective legal rules. At this stage, it is worth noting that since it is the General Claims Procedure, which is regulated by the Tax Code, the rules of the Civil Procedure Code are applied as a supplement to the rules of substantiation of trials.
- **Nonlegal Court**, Regional Director as judge of the first instance does not require the degree of attorney.
- **First Instance Court**, against the decisions of the Regional Director in the General Claims Procedure, the Remedy of Appeal before the respective Court of Appeals is according to rule, likewise, with respect to the latter, the Supreme Court is in charge of reviewing the form and substance of judgments resulting from appeals.

According to Law, these jurisdictional powers correspond exclusively to Regional Directors, notwithstanding the fact that article 6 b) N° 7 and 116 of the Tax Code authorize them to delegate, on other officials, these powers that are currently assigned to Tax Courts, headed by a Tax Judge, who holds an attorney's degree and exercise the jurisdictional functions that correspond to the Regional Director.

#### **e) Courts of Appeals**

They try in second instance the appeals filed by taxpayers against resolutions issued by the Regional Director in those cases wherein he acts as judge of first instance, as well as appeals resulting from resolutions issued by the Civil Court Judge on determining that inheritance and gift tax and the stamp tax.

#### **f) Supreme Court**

Considers appeals filed against judgments of the Court of Appeals and second instance judgments of the Special Appeals Courts. In addition, it is called to solve appeals filed against certain judgments that are not subject to any appeal and provided that these may have been issued with serious fault or abuse.

In another sphere, the Supreme Court of Justice must solve the **Jurisdictional Disputes** that arise between political or administrative authorities, in this case the Internal Revenue Service Director and the justice courts, which do not correspond to the Senate. The latter must consider those controversies arising between political and administrative authorities and the superior courts of justice.

## **2. Prerogatives of the Internal Revenue Service in relation to Tax Offenses**

### **a) Exclusive exercise of penal action for Tax Offense**

Criminal trials for tax offenses sanctioned with corporal punishment can only begin through complaint or accusation by the Internal Revenue Service or by the State's Defense Council, at the request of the Service Director.

At this stage, it must be specified that the judicial representation of the Treasury in all processes and affairs of any nature considered before the courts, corresponds to the president of said Council, unless the Law may have granted such representation to another official, as is the case of tax offenses which, as indicated must begin with a complaint or accusation by the Internal Revenue Service, with the representation and defense of the treasury corresponding to the Director himself or through proxy. Regardless of the above, there is also the exception of empowering the President of the State's Defense Council to assume the representation of the Treasury when he may deem it convenient.

In order to gather the necessary background to file the respective complaint or accusation, the Internal Revenue Service has special powers, which vary, depending on the penal procedural system applied, according to the schedule for the entry into force of the Penal Procedural Reform which will gradually replace the traditional inquisitive penal system, by one of an accusatory nature.

#### **- *Inquisitive Penal Procedural System***

By virtue of the provisions of article 7 f) of D.F.L. N° 7, of 1980, Organic Law of the Internal Revenue Service and article 161 N° 10 of the Tax Code, the Director is in charge of tax offenses, while this body has the

exclusive power for undertaking administrative investigations for these offenses and deciding on their prosecution before the Justice Courts, through the corresponding accusation or complaint before the pertinent Criminal Court Judge.

In carrying out this function, the Service has special powers that allow it to gather sufficient evidence for timely determining that such offense was committed, to avoid their destruction or alteration, such as ordering the apposition of seals and the confiscation of accounting records and other documents related to the line of business of the alleged offender, prerogatives which, in generic terms, fall on the investigating judge, in the case of common offenses.

He also has the power to send to the Investigations Police and Customs Officers of Chile, a list of taxpayers that are under investigation for alleged violations of the tax laws sanctioned with corporal punishment, information by virtue of which they cannot authorize the departure of these individuals from the country, as long as they do not file a certificate issued by the SII certifying that the taxpayer has granted sufficient guarantee. This power is known as **Administrative Bail**, is of an exceptional nature and is only applied in qualified cases.

This task is carried out by a Department especially devoted to tax offenses, and based on the results of the investigation made by the latter, the Internal Revenue Service Director decides whether or not to file a complaint for this type of illegal action. The report prepared for this purpose, is the basis of the action undertaken and for all legal purposes, has the value of an expert's report in the respective judicial process.

- *Penal Procedural Reform*

In accordance with the foregoing item, the Internal Revenue Service collaborates with the criminal court judges in their task of investigators of the offense, in the Inquisitive Penal Procedural System, in force throughout the territory of the Republic, with respect to those offenses incurred prior to December 16, 2000, at which time the new Accusatory Penal Procedural System began operating, wherein the task of investigating offenses of any nature was assigned to the Government Attorney's Office.



In this way, as of the date indicated and in a gradual manner, in a second phase beginning on October 16, 2001, the new Penal Procedural System is currently in force in five of the thirteen regions of the country, wherein the investigation of offenses is carried out by the **Government Attorney's Office**.

In keeping with this new system and in order to exercise the exclusive function of filing a complaint or accusation for tax offenses, the Internal Revenue Service must, making use of its examination powers, compile the necessary background information that may serve as basis for the decision to be made by the Director with respect to filing the complaint or accusation for the tax offense, or sending the background information to the respective Regional Director in order that the corresponding fines may be applied, when there is no merit for undertaking the aforementioned actions.

As for the powers that correspond to this Service in the aforementioned compilation of background information, this organization maintains the functions indicated in the previous section, as regards ordering the apposition of seals and the confiscation of accounting records and other documents related to the line of business of the alleged offender, but does not preserve the prerogative known as administrative bail.

In this new scenario, the Service may file the corresponding complaint for tax offense before the Guarantee Judge, or denounce the events detected which may presumably be tax offenses, directly to the Government Attorney's Office, to the police or to any court with criminal jurisdiction, all of whom must immediately transfer it to the Government Attorney's Office.

#### **b) Processing of Tax Offenses**

During the course of criminal trials for tax offenses and according to the Inquisitive Procedural System, the Internal Revenue Service has a series of prerogatives intended to achieve greater expeditiousness in these processes.

- The Director is entitled to being aware of the summary proceeding in any case being processed before the justice courts where common offenses are being prosecuted, when it may be

deemed according to well-founded bases that a tax offense has been committed in relation to the events investigated or pursued. In these cases, the deaccumulation of records will be appropriate, when judicial action is undertaken to pursue these offenses.

- Accusations or complaints filed for tax offenses do not require the ratification procedure.
- The records of the summary proceeding, which as a general rule are secret, may be made known to the denouncer or complainant, the Internal Revenue Service or the State's Defense Council.

### **3. Collaboration of Judges and auxiliary entities of justice administration in the application and examination of tax rules**

#### **a) Judges**

- The judges and arbitrators must ensure payment of the Stamp Tax in the proceedings they must consider.

#### **b) Real Estate Custodians**

- These officials will not register in their records, any transmission or transfer of ownership, establishment of a mortgage, census, easements, usufructs, trusts or leases, without verifying payment of all taxes that are applicable to the real estate that is the subject of these juridical acts.

#### **c) Notaries and other Attestors**

- Incumbent, deputy or provisional Notaries will report to the SII all contracts presented to them which deal with transfers of properties, mortgages and other issues that may disclose the income of taxpayers.
- In general, notaries will not authorize public deeds or documents that do not comply with certain statements or evidence required by the tax law in relation to the type of income on which a taxpayer pays taxes.

## TOPIC 2.2

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- Notaries and attestors must put on record in the documents they authorize, in relation to agreements subject to the Sales and Services Tax, the payment of the corresponding tax. Even though such payment is not proven, they must always authorize these documents, however, the respective copies will not be delivered.
- Notaries are obliged to supervise the payment of the Stamp Tax, with respect to the deeds they may authorize or other documents they may register and will be jointly responsible for its payment.

Mr. Bernardo Lara Berríos  
Legal Deputy Director  
Internal Revenue Service  
Chile  
E-mail: [blara@sii.cl](mailto:blara@sii.cl)

*Case study:*

*TOPIC 2.3*

## **MECHANISMS OF COOPERATION BETWEEN THE TAX ADMINISTRATIONS AT DIFFERENT GOVERNMENT LEVELS**

**David W. Miller**

Assistant Commissioner

Canada Customs and Revenue Agency  
(Canada)

Let me start with a premise. It would be most efficient to have one organization collect all taxes for the various levels of government in Canada. A single tax agency would be more efficient for governments, and it would be more efficient for the taxpayer. In Canada, governments also use tax administrations to deliver income tested social benefit programs, so a single administration would also offer efficiencies in this field. Arguably, a single more efficient organization would also be more effective, since it could afford to use the most current techniques, employ the necessary specialists and the best staff, and provide consistent service across Canada.

Given this premise, why does Canada currently have many tax administrations, with different situations in almost every province? Using Canada as an example, I will explain the reasons why there is not a single administration, and then consider how cooperation can be improved, and efficiency and effectiveness increased.

Perhaps the major reason for the many tax administrations in Canada is history. Canada's Constitution provides for a federal structure, with a division of powers between the federal government and the ten provinces. The three northern territories are subordinate to the federal government, and the local municipalities are subordinate to the provinces. Since Confederation in 1867 there have been, and still are, huge and changing differences in the population and fiscal capacities of the provinces and territories. The founders of Canada saw a role for the federal government in reducing these disparities, in large part by using the taxing and spending powers of the federal government. For this reason, the Constitution grants specific powers of taxation within the province to each provincial government, but all the residual powers to raise revenue were granted to the federal government. While this bias to the central government has been somewhat eroded over the years, it is still largely on this basis that the federal government manages the economy.

Before and immediately after Confederation, the federal government concentrated on collecting Customs duties, for which it still has exclusive jurisdiction, and excise duties and taxes. The provinces and municipalities concentrated on taxes based on local property. During the First World War, the federal government introduced Income Tax, and most provinces were collecting their own income taxes by 1939. During the war years, the federal government collected the income taxes for all provinces but, in 1946, Quebec opted out of this arrangement. Ontario began to collect its own corporate taxes in 1957 and Alberta in 1981. These arrangements were modernized in the 1960s and 1970s. Under the Constitution, the federal government and the provinces can collect sales taxes. Federal sales tax was first levied in 1919, and most provinces have their own mechanisms for collecting these taxes. However, most provinces use the Canada Customs and Revenue Agency (CCRA) to collect most of their revenue.

CCRA is perhaps uniquely positioned to discuss the subject of cooperation, since we have almost every possible combination and permutation of administration today. To indicate the complexity of Canada's current arrangements, Table 1 provides a summary of the variety of options that are in place to collect different taxes and duties in different provinces. These arrangements are based largely on historical circumstances, and rarely strictly on considerations of efficiency and effectiveness.

The issue is how could CCRA help improve the efficiency and effectiveness of tax collection in Canada, and can any of these considerations be of wider application. While change will not be based simply on economic and analytical logic, and politics will continue to play an important role, clearly explaining the benefits of greater cooperation should help to remove some barriers. Every potential partner views the world from a different perspective, and each filters the messages of others through their own experience and situation. It is particularly important in proposing change to confront any myths that have built up around the current arrangements, and to replace them with a clear understanding of the current reality.

In building better and more efficient arrangements with our provincial and territorial partners, we have found that several considerations are important.

- Build on success. In many cases, the best way to establish the confidence of potential partners is to show you can deliver what is proposed. While a picture is worth 1,000 words, a practical demonstration is worth one million. Convincing the first partner is clearly the most difficult step, and making this partnership successful is essential. The people involved on both sides of the initial relationship are a critical component of success. Each must trust the other, and be prepared to find compromises that will work for both parties. Once success is demonstrated, future partners will need to be convinced, but there should now be two proponents not one. While making progress is important, the time required to build the necessary partnerships should not be underestimated.
- Partnerships are rarely between equals. Each partner should clearly understand the implications for their own situation before they agree to the cooperation, and certainly before work begins. This is clearly a case where principled negotiation is preferable to compromise bargaining. In the latter each party tries to find the level at which its interests are best served, while giving the minimum to the other party in the way of concessions. In the former, each party tries to find solutions that maximize the benefits to both parties. For example, if there is to be a sharing of jointly collected revenue, on what basis is it to be divided? Does one party need cash more quickly, while the other can afford to wait to collect the outstanding debts with interest later?

- Satisfying all the partners that the benefits they obtain are reasonable. Efficiency is only one measure of success. Better compliance, a reduction in taxpayer confusion, access to specialized expertise, are all legitimate benefits for governments and therefore for tax administrations. Each partner does not need to capture the same benefits from a partnership, and it is often the case that different administrations are looking for different benefits at different times. For example, one government may wish to show it is responsive to the needs of its business community by improving service through cooperation, while the other needs the increased revenue that comes from sharing enforcement information on the same taxpayers.
  
- Where there are several levels of government, taxpayers are not sure which level is responsible for what service, and in large part they do not care, provided they receive the services and benefits to which they are entitled. Most citizens relate to an amorphous mass called “the government”, they are rarely Constitutional scholars with an understanding of the division of powers between the different levels. Taxpayers are interested in efficiency in program delivery as measured by their own need to invest time and effort, and judge “the government” by their impression of standards in the private sector. In its competitive search to attract customers the private sector has improved its service considerably over recent years. Customers’ expectations for better service from the private sector translate directly into increased expectations from tax administrations. A focus on service improvement is therefore essential.
  
- Privacy is regarded in highly asymmetrical ways. Canada has especially strict legislation to protect taxpayer information. Canadians demand that their tax information is kept confidential, but they also expect government agencies to cooperate to simplify their lives. This means that they expect their information to be strictly private, but imply it should be shared when this is in their personal interest. To add to the confusion, not every citizen of Canada shares the same opinion on when sharing is in their interest. Exploring when it is acceptable to share information, and when tax administrations should refuse to share and risk being considered backward and inefficient, is an on-going challenge. On balance, CCRA errs on the side of protecting privacy, even when this risks being considered less cooperative.

- Other partners and relationships, besides simply cooperation between tax administrations at different levels of government, are of increasing importance. These other arrangements become more critical as the Internet becomes a greater source of information for citizens. For example in Canada, when employers prepare their payroll, and remit their payroll source deductions to the CCRA, they can also remit their employees' unemployment insurance premiums and their contributions to the Canada Pension Plan for another federal department. Recently, we have concluded a partnership with the Workers' Compensation Board of the province of Nova Scotia, to collect their premiums at the same time.
- Better service leads to better compliance. This is intuitively obvious, and most of our Ministers have agreed with the proposition, but we have not been able to produce any analytical "proof". Clearly, if there was no service to the taxpayer, and if we provided no information on their obligations, taxpayers would not know what to do, and so compliance would be poor. It is therefore easy to justify some effort to inform taxpayers of their obligations. However, once the situation is reached where many people understand their obligations, the temptation is to concentrate resources on direct enforcement activities that can be seen to produce results, such as audit and debt collection. The question is how to establish the balance between service and enforcement that maximises compliance.
- Partnership necessarily implies some loss of control. If another organisation in the public or private sector administers your program, you lose flexibility in terms of both policy and administration. Some form of contract or agreement is required to make the administration possible, and to the extent that such an agreement cannot foresee all eventualities and requires changing, it will introduce delays. In addition, the other organisation will have competing priorities, either profit in the case of the private sector, or other responsibilities in the case of a government organisation. The viability of the partnership is determined by the benefits to be gained, for example lower costs, versus the losses sustained, for example additional delays in making changes to processes.



- Not all cooperation is beneficial. Every partnership has a cost, and it is important to analyse both benefits and costs carefully. New partnerships must benefit both partners, while almost certainly both will not benefit equally, the important point is that they should obtain benefits that satisfy their expectations. The best partnerships are built on the different core strengths and competencies of the partners. This allows both to make a contribution that the other partner cannot match, and to receive benefits that they cannot otherwise obtain.

Finally, let me offer a practical example of cooperation. For a number of years, the business community has been demanding that governments at all levels in Canada simplify their requirements. One way to approach this is through a common identifier that can lead to both better service and more effective enforcement. In 1994, the federal government began to provide a single business identification number to all businesses operating in Canada. This allowed CCRA to combine the registration process for its four major programs, GST/HST (VAT), Payroll Source Deductions, Corporation tax and Customs, to improve service to new businesses. In addition, CCRA is working towards a single accounting system that will allow businesses to receive a single combined statement of account for all taxes from the agency. However, the single number also allows more efficient enforcement, and collection of outstanding debts. The single identifier is thus both a benefit to business, and a more effective tool for ensuring compliance. Over the last five years, CCRA has worked with various provinces to expand this joint registration to provincial, as well as other federal programs. Currently new businesses can register on the Internet for CCRA programs, and for the provincial programs of Nova Scotia and Ontario at the same time. Several other provinces will begin using the single business identification number this year. Cooperation in this case offers advantages to all - the federal government, provinces and the business community - exactly the sort of outcome that cooperation should provide.

**Table 1: Arrangements for tax collection in Canada**

	<b>Federal Taxes</b>	<b>Other Federal Programs</b>	<b>Provincial &amp; Territorial Taxes</b>	<b>Local (Municipal)</b>
Income Tax (Individuals)	✓		All except Quebec	
Income Tax (Corporations)	✓		Except Alberta Ontario Quebec	
Corporation Capital Tax	✓		3 provinces	
National GST [VAT]	✓ Except Quebec			
Sales Tax	✓		HST in 3 provinces & 5 PST at border	
Licenses & Fees		✓	✓	x
Property Tax				x
Excise Taxes & Duties	✓		x	
Income-based Benefits	✓	✓	✓	✓
Customs Duties	✓			

Mr. David W. Miller  
Assistant Commissioner  
Canada Customs and Revenue Agency  
E-mail: David.Miller@ccra-adrc.gc.ca

*Case Study:*

*TOPIC 2.3*

## **MECHANISMS OF COOPERATION BETWEEN THE TAX ADMINISTRATIONS AT DIFFERENT GOVERNMENT LEVELS**

**Andrea Lemgruber Viol**

General Coordinator of Tax Policy  
Secretariat of Federal Revenues  
(Brazil)

*CONTENTS: 1. Introduction.- 2. Brazilian Fiscal Federalism.- 2.1 Competence attributes to pay taxes.- 2.2 Inter-Governmental transfers.- 2.3 Level of decentralization of the Brazilian Federation.- 3. Cooperation Mechanisms Among Tax Administrations.- 3.1 Federative cooperation branches.- 3.2 Information exchange mechanisms.- 3.2.1 Economic-Fiscal Integrated National Information System – SINIEF.- 3.2.2 Integrated Information System on Interstate operations involving goods and services – SINTEGRA.- 3.3 Administrative mechanisms for cooperation.- 3.3.1 National classification of economic activities – CNAE.- 3.3.2 The National Cadastre of Bodies Corporate – CNPJ.- 3.4 Joint tax models.- 4. Final Considerations: Difficulties, Effectiveness and Perspectives.*

### **1. INTRODUCTION**

The analysis of the cooperation mechanisms that exist among the tax administrations of different government levels presuppose the knowledge of the country's fiscal federalism principles. The federal system is therefore, the framework that determines the type and the

level of exchange and cooperation between the branches that belong to the different government levels. In this sense, it maybe that a paradox arises: when decentralization is stronger, the autonomy of the branches is greater and the need to establish cooperation mechanisms among them is greater. Notwithstanding, the difficulty to create mechanisms that will allow effective cooperation without affecting the autonomy and the independence of the intervening branches.

Since Brazil, is a strongly decentralized federal country, it has had experiences in favor of a greater approximation and cooperation among its government branches, be it in the tax area or in other public power areas. In response to the great autonomy of the sub-national governments and the fact that Brazilian federalism in a political democratic environment can still be considered a recent experience, the implementation of cooperation mechanisms has been accompanied by results, which are often positive and often negative. In a general manner, it can be said that the integration has been the recent strong fiscal federalism trend of Brazil, but we are still in a period where experiences are maturing, where the initial results of the approximation begin to arise, though somewhat time in regards to some of the most daring inter-governmental integration proposals.

To provide a more ample vision of the Brazilian case, this work will initially present the basic principles of our fiscal federalism, to then specifically analyze the cooperation mechanisms that exist in Brazil.

## **2. BRAZILIAN FISCAL FEDERALISM**

Brazil is a federal republic with three government levels, these are: the federal government, 26 federated units and 1 Federal District within the scope of the state and around 5,500 municipalities. This form of government has its origin in the historical development of the country, extending downward from the inherent difficult of managing a nation that has a vast territory (the fifth largest country in extension). In this manner, Brazilian Federalism was born not from the union of states or independent colonies, as it happen in some current federations such as the United States and Germany, but as an administrative determination of the central government (during times of the Portuguese crown).

Therefore it is natural that the country's federative maturity process took more time, having passed through cycles of greater centralism or greater decentralism throughout history. Currently, after the end of the military regime, which was set forth in the 1988 Constitution, which considers a significant level of political and administrative decentralization for sub-national governments.

Specifically, regarding the Brazilian tax federalism, its main guidelines are established by the Federal Constitution, which provides its general principles, limitation to the taxation power, competency attributes and the co-participation of tax revenue as well.

Consequently, the National Tax System is instituted by the Constitution itself which determines that the Union, the States, the Federal District and the Municipalities may establish taxes, hence making the taxation power a quality inherent to the State. The political-administrative autonomy, which is an essential characteristic of our current federal system, grants to each level of the government the possibility of establishing taxes, tariffs (by virtue of police power or by the use of public services) and improvement contributions (derived from public works). In what pertains to social contributions, the Federal Government may only establish most.

## **2.1 Competence Attributes to Pay Taxes**

According to the Brazilian Constitution, the following are tax competences in tax paying issues:

### **Taxes that are the competence of the Union:**

- On Foreign Trade Operations – On the Import (II) and Export (IE) of Products and Services;
- Income Tax and Yields of any Nature (IR);
- On Industrialized Products (IPI): incident value added tax on manufactured products;
- On Credit Operations, Exchange and Insurance or pertaining to the use of movables or titles (IOF); and
- On Rural Territorial Property (ITR).

**Taxes that are the competence of the States and the Federal District:**

- Of conveyance of title due to *mortis causa* and donation of any right or asset (ITCD);
- On operations pertaining to the Circulation of Goods and the provision of interstate and inter-municipal transportation services and communication (ICMS): incidental value added tax on assets in general and some services; and on the Property of Automotive Vehicles (IPVA).

**Taxes that are the competence of the municipality:**

- Rural Real Estate and Urban Territorial (IPTU);
- On the *inter vivos* Transfer, at any title, due to an onerous act, of real estate (ITBI); and
- On Services of any Nature (ISS): excluding those taxes charged by ICMS.

In addition to these taxes, the Federal Constitution allows the Union, States, Federal District and Municipalities to establish the collection of tariffs, of improvement contributions and social contributions. The Federal District, in addition to the taxes that are the competence of the state, is also in charge of municipal taxes.

In the same manner, the Constitution allows the Union to establish mandatory loans under special conditions defined by it, and social intervention contributions in the economic area. States and Municipalities may only establish contributions collected to its officers, to pay, for the benefit thereof, social security and social assistance systems.

The following chart shows Brazil's gross tax burden, pertaining to the year 2000, to provide an idea of the relative weight of taxes among the three government levels.

### Gross Tax Burden

Taxes	% of the Total	% of the GDP
<b>UNION</b>	<b>69.23</b>	<b>22.97</b>
- INCOME TAX	16.51	5.48
- INDUSTRIAL PRODUCTS TAX	5.17	1.72
- FINANCIAL OPERATIONS TAX	0.86	0.28
- FOREIGN TRADE TAX	2.34	0.77
- RURAL TERRITORIAL TAX	0.06	0.02
- CONTR. FOR SOCIAL SECURITY	15.41	5.11
- COFINS	10.65	3.53
- CONTR. FOR PROV. FINANC. MOV. (CPMF)	3.98	1.32
- CONTR. ON / LIQUID PROFITS	2.41	0.80
- CONTR. PIS, PASEP	2.64	0.87
- CONTR. SEG. PUBLIC SERVICE	1.00	0.33
- OTHERS	8.20	2.72
<b>STATES</b>	<b>26.19</b>	<b>8.69</b>
- ICMS	22.76	7.55
- IPVA	1.46	0.49
- ITCD	0.09	0.03
- STATE PROVISION	1.35	0.45
- OTHERS (AIR, ICM, ETC.)	0.52	0.17
<b>MUNICIPALITIES</b>	<b>4.59</b>	<b>1.52</b>
- ISS	1.76	0.58
- IPTU	1.41	0.47
- ITBI	0.24	0.08
- MUNICIPAL PROVISIONS	0.29	0.10
- OTHERS TAXES	0.89	0.30
<b>TOTAL</b>	<b>100.00</b>	<b>33.18</b>

Source: SRF/COPAT

## 2.2 Inter-Governmental Transfers

By reinforcing the political-administrative and tax autonomy, the Brazilian Constitution defines a “unconditional” transfer system among the Union, States and Municipalities, which may be of two kinds: direct or through the arrangement of special funds (indirect). Regardless of the type, transfers always operate from the government of highest level towards the lowest levels, that is, in the sense that it is from the Union to the States and from the Union to the Municipalities or from the States for their respective Municipalities.

Direct transfers, as defined in the Constitution, are the following:

- the total collection of the Income Tax (IR) withheld at the source, on yields paid by them, their autarchy and by the foundations that they established and maintained belong to the states and the municipality;
- 50% of the collection of the Rural Territorial Tax (ITR), pertaining to real estate located therein belongs to the Municipalities;
- 50% of the collection of the Automotive Vehicle Property Tax (IPVA), with license in their territory belongs to the Municipalities;
- 25% of the collection of the Goods and Services Circulation Tax (ICMS) ( $\frac{3}{4}$ , at least, in the proportion to the value added in operations performed in their territories and up to  $\frac{1}{4}$  according to State Law) belong to the Municipalities;
- The IOF - Gold (financial asset) is transferred in the amount of 30% for the state of origin and in the amount of 70% for the municipality of origin.

The funds, whereby indirect transfers are performed, are the following:

- **Exports Compensation Fund (FPEX):** 10% constituted by the total collection of the IPI. Its distribution is proportional to the value of the export of industrialized products, being individual participation limited to 20% of the total fund.



- **States and Federal District Participation Fund (FPE):** 21.5% of the IPI and IR collection, distributed in a manner directly proportional to the population and to the surface and inversely proportional to the per capita income of the federative unit.
- **Municipalities Participation Fund (FPM):** comprised by 22.5% of the IPI and IR collection, with a distribution proportional to the population of each unit, where 10% of the fund is reserved for the municipalities of the capitals.
- **Regional Funds:** for the financing of projects in the Northern and Central-Western regions - 0.6% of the total collection of the IPI and IR, respectively – and for the financing of the Northeastern region - 1.8% of the same base.

Therefore, constitutional transfers via funds return to the states and municipalities, 47% of the IR and 57% of the IPI collected by the Union.

The prorating transfer criterion of the FPE and FPM are directly proportional to the population and inversely proportional to the revenue, resulting in a greater share for the poorest states and municipalities of the federation and a small share for the Southern and Southeastern States.

The Federal Constitution determines that the prorating criterion must objectively promote socioeconomic balance among states and municipalities and establishes the following distribution of the FPE and FPM by Brazil's geographical regions:

Region	FPE (in %)	FPM (in %)	Population (in %)	Per capita income (in R\$)
North	25.37	8.53	7.6	3,447
Northeast	52.46	35.27	28.1	2,603
Southeast	8.48	31.18	42.6	7,706
South	6.52	17.55	14.8	6,611
Central - West	7.17	7.47	6.9	5,681

Data Source: IBGE and STN/Ministry of Treasury.

Hence, 85% of the total resources of the Fund are for the states in the Northern, Northeastern and Central-Western regions, and the South and Southeastern states just 15% of the resources. Among the regions of the Southeastern states, it is important to mention that Sao Paulo – is the richest state of the region and the most heavily populated – it receives 1% of the total FPE.

In regards to the FPM, 35.27% of the resources are directed to the municipalities of the Northeastern region, 31.18% to the Southeastern and 33.5% to the municipalities of the other regions – North, South and Central – Western. In addition to this, the prorating criterion directs: 10% of the resources of FPM to the municipalities of the state capitals, 86.4% for the other municipalities of the interior of each state and the remaining 3.6% (additionally) for the municipalities of the interior (not capitals) with over 156,216 habitants.

The FPE and FPM distribution percentages, as it was previously presented, have implicit the objective of reverting great regional income disparities that exist in the country, that is, they are established pursuant to “solidarity principles”.

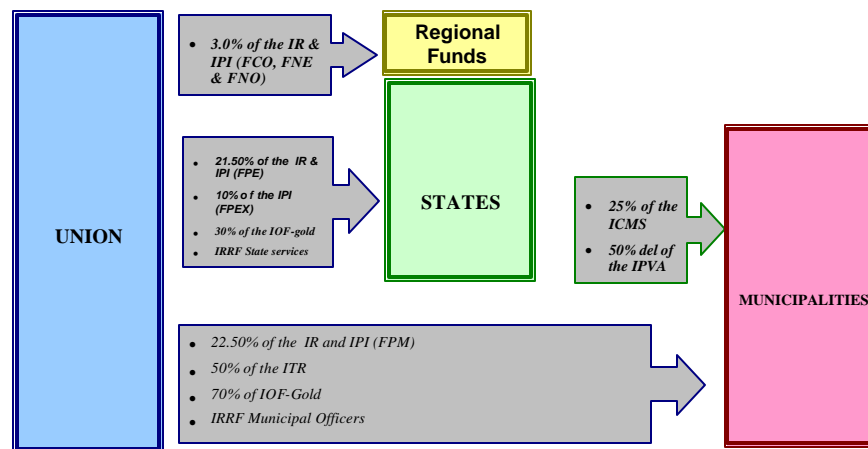
As a consequence of the prorating system of the tax revenue established by the Federal Constitution, in 2000 the liquid revenue available to the Union, the States and the Municipalities corresponded to, respectively, 59.9%, 25.1% and 15.0% of the total net income. The following chart presents the composition of the tax revenue before and after the transfers. The Union transfers around 10 percentage points to the government’s sub-national levels. Notwithstanding, it is clear that the great receptors of the transfers are the municipalities, given that the states have a small loss, around 1 percentage point with the transfer mechanism.

### Self-Owned and Available Tax Revenue

Competence	Tax Revenue			
	Collection		Available	
	% Total	% GDP	% Total	% GDP
UNION	69.23	19.87	59.88	19.87
STATES	26.19	8.34	25.13	8.34
MUNICIPALITIES	4.59	4.97	14.99	4.97
<b>TOTAL</b>	<b>100.00</b>	<b>33.18</b>	<b>100.00</b>	<b>33.18</b>

This reassignment of the tax revenue is complemented by transfers via agreements, that is, voluntary transfers – which represent a federal transfer of the resources to the states or municipalities (or of state resources for the municipalities) so that they may act in the name of the Union (or the State) in activities of federal (or state) responsibility. Transfers via agreements are usually determined by specific ordinary law or performed voluntarily among the different government areas.

### FLOW OF CONSTITUTIONAL TRANSFERS



### 2.3 Level of Decentralization of the Brazilian Federation

To evaluate the level of decentralization that exists among the different government areas is not an easy task, because there are many subjective aspects in decentralization. Objectively, to attempt to measure the volume of revenue available to each government level (self-owned revenue in addition to unconditional transfers), for the financing of their projects and activities.

The basic elements to measure the level of decentralization is the so called **decentralization ratio (RD)**, which may be applied from the point of view of expenses as well as from the point of view of the revenue (Gremaud).

**RD** = Sub-national expenses / Total expenses (national and sub-national)

or

**RD** = Sub-national revenue / Total Revenue (national and sub-national)

## TOPIC 2.3

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We have seen that the Brazilian Federation has three levels autonomous government levels: the Union, the States (including the Federal District) and the Municipalities. To calculate the RD, the sub-national government is considered as being the group of states (including the Federal District) in addition to the municipalities.

In Brazil, the distribution of the revenue available among the three government levels in the year 2000 was the following (values in R\$ 1,000):

### Revenue Available

Government Area	Revenue Available	%
Union	216,518	59.88
States and Federal District	90,859	25.13
Municipalities	54,194	14.99
<b>Total</b>	<b>361,571</b>	<b>100.00</b>

Data Source: COPAT/SRF

Therefore, **Brazil's level of decentralization is in the order of 40%** that is, 40% of the tax resources belong to the sub-national level.

The table prepared by the International Monetary Fund - FMI, that identifies the assignment of expenses according to the government's totals, for selected unitary and federal countries, presents the following results:

### Total Expenses

Country	Year	Central Government	Regional Government	Local Government
Australia	1995	58.97	36.03	<b>5.00</b>
Belarus-Russia	1992	70.73	0.00	29.23
Bulgaria	1996	<b>88.36</b>	0.00	11.64
Canada	1993	<b>41.72</b>	<b>41.20</b>	17.08
Czech Republic	1995	79.12	0.00	20.88
Denmark	1995 p	56.01	0.00	<b>43.99</b>
Estonia	1995	81.09	0.00	18.91
France	1993	82.41	0.00	17.59
Germany	1991	61.08	22.43	16.00
Hungary	1990	80.91	0.00	19.09
Iceland	1993	76.09	0.00	23.91
Ireland	1993	75.92	0.00	24.08
Latvia	1996	74.64	0.00	25.36
Lithuania	1996	73.58	0.00	26.42
Luxemburg	1994	84.65	0.00	15.35
The Netherlands	1995	76.43	0.00	23.57
Norway	1994	68.41	0.00	31.59
Poland	1996	80.52	0.00	19.48
Russia	1995 p	62.40	0.00	37.60
Switzerland	1991	49.67	29.15	21.28
United Kingdom	1995	77.30	0.00	22.70
United States	1994	53.39	25.63	20.98
<b>AVERAGE</b>		<b>70.61</b>	<b>7.04</b>	<b>22.35</b>
Variation Coefficient		0.18	1.94	0.37
<b>Minimum</b>		<b>41.72</b>	<b>0.00</b>	<b>5.00</b>
<b>Maximum</b>		<b>88.36</b>	<b>41.20</b>	<b>43.99</b>

Source: IMF, Government Financial Statistics, 1997

We see that Brazil has an RD higher than the **29.39%** average of the country presented (sum of the averages of the regional and local government). When comparing Brazil with the traditionally federal countries presented, we have the following chart:

**Federal Countries  
(Total Expenses)**

Country	Year	Central Government	Regional Government	Local Government
Australia	1995	58.97	36.03	5.00
<b>Brazil</b>	<b>2000</b>	<b>59.88</b>	<b>25.13</b>	<b>14.99</b>
Canada	1993	41.72	41.20	17.08
Germany	1991	61.08	22.43	16.00
Russia	1995 p	62.40	0.00	37.60
Switzerland	1991	49.67	29.15	21.28
United States	1994	53.39	25.63	20.98

Data Source: IMF, Government Financial Statistics, 1997

We see that Brazil has an RD lower than Canada, Switzerland and the United States and closer to Australia (notwithstanding in the alter the relative participation of the local governments is very small). Germany that has a highly developed cooperative federative system, has a decentralization level lower than Brazil. In this manner under the aspect of distribution of the resources available among the government areas, Brazil's is a strongly decentralized country.

### 3. Cooperation Mechanisms Among Tax Administrations

Having seen the basic principles of the Brazilian Fiscal Federalism, we can now see the analysis of the cooperation mechanisms that exist among the tax administrations of the three government levels. It must be pointed out that notwithstanding the fact that Brazil is a federation marked by strong political and tax decentralization, a high level of cooperation among government branches in the tax administration field was not reached due to different reasons.

Integration and cooperation difficulties among tax administrations have different causes, but among them we must first point out, that the maturity process of Brazilian Federalism, is a recent process. In fact, for less than two ago Brazil has been undergoing Federative decentralization concomitant to political pluralism, at the same time, only as from the 90's, the country had access to the technology that would allow it to build solutions for the agile and permanent exchange of information.

Another aspect to be considered in the difficulty to obtain effective cooperation, is the inherent socioeconomic disparity among the different states / municipalities of Brazil, coming from the concentration of income in the country. This generates a considerable difference between the technological level, the training of human resources, administrative capacity and the conception of management models among the different tax administrations. In this manner, many of the solutions must be leveled under, so that the poorest states are taken into consideration, but with this the richest states are no satisfied. Since the richest states and the federal government are not attended, solutions are aborted or partially adopted.

There is also the difficulty to built cooperative solutions without compromising the autonomy of the sub-national government. In a general manner, states and municipalities wish to establish the course of their policies, independent from the federal government. Any solution that implies the opening of their own instruments, to adopt shared mechanisms, generates apprehension, in the sense that it can promote dependency in regards to the determinations of the federal government.

At its same time, historically the federal government is well prepared in terms of human and material resources, which in average the sub-national governments (the same for having benefited from political centralism cycles), always saw its position with certain hegemony and, therefore, it did not have incentives to share information or establish inter-governmental cooperation mechanisms.

Having considered these factors, we should see with good eyes and in a very positive manner, all efforts made by the three levels of government during the past years with the approximation and administrative cooperation objective. As from these efforts, there a highly innovating experiences that we shall immediately present and that may be “case studies” to study cooperation in the federations of developing countries.

It is still important to mention that undoubtedly any negotiation is much more feasible at the government state level, because it is impossible to do direct interaction with and among the 5,500 municipalities, and it may only be done through representation. Therefore, due to the form of the Brazilian Federalism, it will be easier to establish cooperation mechanisms among the states, due to the importance of the tax that they manage (ICMS), which forces existence to the minimum scope of understanding. Notwithstanding, we shall also present important mechanisms that sec the integration of three government levels, including, consequently, the municipalities.

Cooperation mechanisms to be presented may be classified as:

- Cooperation management branches: the National Treasury Policy Council – CONFAZ;
- Mechanisms for the exchange (barter) of information: the Integrated Information System on Interstate operations with Goods and Services – SINTEGRA and the National Integrated System of Economic-Fiscal Information – SINIEF;
- Cooperative administration mechanisms: the Master Cadastre File and the National Classification of Economic activities – CNAE-Fiscal); y
- Joint tax paying models: the Micro and Small Company Integrated Tax and Contribution Payment System – Simples.

Therefore, there are different forms to reach integration among the different tax administrations, given the fact that each type of mechanism demands greater or lesser loss of autonomy/self-decision on behalf the intervening branches.

### 3.1 Federative Cooperation Branches

The main federative cooperation branch of the country is the **National Treasury Policy Council – CONFAZ**, created by Complementary Law N° 24, January 7, 1975. **CONFAZ** is a collegiate body, with representatives from the Ministry of Treasury (Executive Secretariat, Attorney General of National Treasury, Federal Revenue Secretariat and National Treasury Secretariat), which chairs the Council, and the **27 Treasury** Secretariats of the States.

Its basic purposes are:

- To promote the holding of agreements granting or revoking fiscal benefits in the ICMS (this tax represents in average 90% of the state tax revenue and has been an instrument of intense fiscal war – it is important to mention that decisions on fiscal benefits must be unanimously approved);
- To suggest measures that endorse simplification, the harmony of legal demands, and the reduction and the downward reduction of expenses of accessory tax obligations, with favorable reflects in the marketing costs of goods and services;



- To promote studies and suggest alterations that endorses the perfection of the National Tax System, as an economic and social development mechanism, in interrelation aspects between federal and state tax-paying issues.

CONFAZ has an Executive Secretariat, and a Permanent Technical Commission - COTEPE, that acts as a technical board through meetings and work groups. COTEPE has as a purpose to coordinate works related to politics and the management of ICMS, endorsing the establishment of uniform measures in the treatment of that tax throughout the entire national territory, as well as stating its opinion on issues pertaining to the application of the standards provided for in the Economic-Fiscal Integrated National Information System – SINIEF. In addition to this, it is COTEPE competence to advise the Ministry of Treasury and the Secretaries of State, on basic issues and guidelines on ICMS' tax policies, and coordinate the actions of the 54 work groups, among which we have the following:

- *GT-01: Crimes against tax laws;*
- *GT-06: Economic-Fiscal Integrated National Information System – SINIEF;*
- *GT-08: Evaluation of the Impact of tax reductions in the ICMS;*
- *GT-12: E-commerce;*
- *GT-15: SINTEGRA/ICMS;*
- *GT-16: Bodies Corporate National Cadastre – CNPJ;*
- *GT-26: Fiscal Benefits;*
- *GT-34: Tax Substitution;*
- *GT-37: Automotive Vehicles Property Tax – IPVA;*
- *GT-46: Equipping of Issuers of Fiscal Coupons – ECF;*
- *GT-47: Tax Reform and Legislative Supplementary;*
- *GT-52: Information System on Tax Substitution - SIST;*
- *GT-53: Tax Collection; and*
- *GT-54: Foreign Trade.*

Of these work groups, some with a clear cooperation objective among the tax administrations stand out, which end up producing solutions in terms of interaction mechanisms for the exchange of information or cooperation administrative models. In this manner, CONFAZ as a collegiate branch with participants from the treasury area of the federal and state governments creates the environment and the necessary conditions so that together, different government levels may work in the construction of cooperative solutions.

Notwithstanding, CONFAZ is not a complete federative branch, since it does not include municipal representatives and still it is current scope of action, its objectives are weakened because it does not have sanctioning mechanisms on its members.

Now we shall pass to the examination of the case studies of some of the experiences under development within the scope of CONFAZ and, in the scope of the National Classification Commission – CONCLA as well, that has an effective representation of the three levels of government, to make decisions pertaining to the classification of economic activities.

## **3.2 Information Exchange Mechanisms**

### **3.2.1 Economic-Fiscal Integrated National Information System – SINIEF.**

In 1970 the Ministry of Treasury and the Secretaries of Treasury of the States, held an agreement for the creation of the **SINIEF**, as a cooperation mechanism among the main tax administration branches and as an instrument that facilitates the exchange of information between the Union and the States.

In this manner SINIEF was the initial cooperation framework between federal and state tax administrations, even prior to the creation of CONFAZ. It is true that due to the lack of a coordinating branch, many of SINIEF's objectives took years to be effectively implemented. In any manner, as discussed later, some proposals were just the beginning and currently have generated results favorable for cooperation among tax administrations.

The SINIEF agreement had the following premises:

- The unification of books and tax documents to be used by taxpayers, at different tax levels;
- The creation of an Economic-Fiscal Information System that is adequate to promote collection, preparation and distribution of basic data, essential to the implementation of a realistic tax policy;

- The rationalization and integration of fiscal controls and tax-audits, based on information that have as a source taxpayers' fiscal registries and documentation;
- The implementation of a basic and homogeneous information system for the fast and precise knowledge, of indispensable statistics for the formulation of economic-fiscal policies at different government levels; and,
- The simplification and harmonization of the legal demands to reduce downward accessory tax obligations, with favorable reflects in the cost of marketing goods;

With the arrival of the agreement, SINIEF provided many advances for Brazilian tax administrations, these advances facilitated the exchange of information among tax administrations. Among them, we have the following:

- It determined that the cadastres of tax administrations at all government levels, should have the registry of the inscription number of the General Taxpayer Cadastre File of the Ministry of Treasury, currently Bodies Corporate National Cadastre – CNPJ. This determination facilitates the exchange of information among tax administrations, since when information is requested from a determinate company, the only requirement is to report the inscription number in the CNPJ, complementary information is not necessary to correctly identify the taxpayer;
- It unified all documents and fiscal books used by taxpayers, these documents are legally valid for the tax administrations of the three government areas. It is important to mention that fiscal books and the Fiscal Sales Notes, are basic inputs for the obtainment of tax information. The states are responsible to rule this matter;
- It established a sole coding system for economic activities and for fiscal operations and benefits; and
- It created **CFOP – Operations Fiscal Code**, which purpose is to identify operations and benefits for the entry and exit of goods and services. It is mandatory for the code to be evident in Fiscal Sales Notes and in the fiscal books, allowing tax administrations to clearly identify, which operations are being performed by the different companies.

Regarding the coding of economic activities of companies, for example, the agreement determined that the signing parties adopt an “**Economic Activities Code**” that would be prepared by a commission appointed by the Treasury Secretariats, to maintain the necessary uniformity for the operations of the Economic-Fiscal Integrated National Information System.

However, the reality was somewhat different. Years after the SINIEF agreement was signed, each tax administration had a differentiated economic coding making more difficult to add fiscal-economic information and in detriment to the development of sector tax studies.

This seed planted by SINIEF began to bloom later, today it is a cooperation project that has advanced substantially, therefore, it deserves to be analyzed as a separate case.

### **3.2.2 Integrated Information System on Interstate operations involving goods and services - SINTEGRA**

SINTEGRA was foreseen in the scope of COTEPE in 1997, and its regime was approved in October 2000. The system was developed by the Brazilian states, with the purpose of electronically controlling information on interstate goods entry and exit operations.

The Information that forms part of the System is subdivided into:

- I - Public (simplified) and restricted (complete) access cadastres;
- II - Interstate operations with goods and the provision of services, for access restricted to federated units; and
- III - Omissions in the delivery of files.

Access to simplified cadastre information must be done through the public information network – Internet, at the website [www.sintegra.gov.br](http://www.sintegra.gov.br). Access to complete cadastre information depends on the security systems of each federated unit.

SINTEGRA is a computer information system developed by the Brazilian states, with the purpose of electronically controlling interstate goods entry and exit operations.

SINTEGRA was projected according to the Vies – Value Added Tax Information Exchange System model of the European Union, this is because the largest tax of the Brazilian states is the ICMS, this is a value added tax with characteristics similar to the European Value Added Tax - VAT and, its application pertains to the states, in the sub-national level, and it is similar to the new situation of the countries that form part of the European Union.

In SINTEGRA each federated unit receives, monthly, magnetic files with the fiscal registry of the totality of interstate benefits and operations of entries and exits, done by the taxpayers established in their circumscription and carried out during the previous month, having to make the same available in the network to be accessed by the other states within a 15 day term. Previously, the taxpayer directed information to each federated unit where it performed mercantile operations.

The SINTEGRA project surpassed the initial computerized control objectives the interstate goods entry and exit operations, to turn into a “PORTAL” (website) for the integration of the Federated Units, and comprised by the following systems:

- 1) **RIS - Intranet SINTEGRA Network: private network** (*Virtual Private Network - VPN*), which interlinks the local networks of the state Treasury Secretariats distributed in the capitals of the country. The network has the security systems that are adequate to the fiscal demands of the states, in function to the fiscal secrets that they are submitted to;
- 2) **Validating Program:** system designed to validate and receive electronic information from taxpayers;
- 3) **Databanks:** servers to store information received from taxpayers. Servers are located at the States' Treasury Secretariats and are interlinked by the RIS;
- 4) **SVBD – Data Verification and Cross-Checking System:** computerized systems that allows the necessary cross checking for electric audits of the data that is stored in the databanks;
- 5) **PVF-E – Fiscal – Electronic Verification Request:** this systems allows states to request the verification of taxpayer information that is stored in other states; and,

**6) SINTEGRA Pass:** control computerized system, which is attached to the interstate transit of goods.

In this manner, SINTEGRA has revolutionized the information exchange mechanism among Brazilian states, which some years ago were unthinkable: a reliable interstate commercial scale, given the magnitude of the disparity among existing information.

Regarding the integration with the Federal Government, it is about to make effective the participation of the Federal Revenue Secretariat (SRF) in the project. The SRF has an exchange agreement with all states of the Federation. These agreements are bilateral, which demands excessive work on behalf of the SRF to attend the requests, coming from the states, which are often similar but in different formats.

With the arrival of the SINTEGRA project, SRF is seeking through this tool to optimize the information exchange process with the Brazilian states. As an example of this optimization, it is important to mention the cases of foreign trade information requested to the SRF, by the states and the information coming from the Fiscal Sales Notes requested by the SRF to the states.

In the first case, many Brazilian states have requested the SRF information on Brazil's exports and imports. These requests cover different data sets according to the different assessment periods, and with different layouts as well. Therefore, for each state SRF performs processing in its systems to make available the files requested.

These files are delivered on magnetic tapes or through the transmission of data. As from SINTEGRA it will be possible to perform periodically unique data processing, with unique formats, previously agreed among the states and making it available through the SINTEGRA network to be accessed by all states.

Regarding the second case, SRF has searched in the states information on Fiscal Sales Notes, for their fiscal auditing activities. However, the SRF not always receives information in a timely manner and in some cases it doesn't even receive it. With the full implementation of SINTEGRA, information required by SRF will be interlinked by the RIS in databanks, and the SRF may request it through the network, with unique data, periodicity and formats, previously agreed with the states, and capture the result of the processing in the SINTEGRA network.

In order to perform the exchange of information through SINTEGRA, the following steps will be required:

- That SRF turn into one more member of the SINTEGRA network, since it currently has the totality of the 27 states of the federation;
- That information exchange agreement among the states and the SRF cease to be bilateral and turn into multilateral agreements, preferably covering the totality of Brazil's 27 states;
- That SRF have at its disposition a server dedicated to the SINTEGRA network, equipped with the temporary storage of SRF's data requested by the states and the data of the statements requested by the SRF;
- That the applications necessary for the implementation of the exchange of information via the SINTEGRA network be developed.

It is important to mention that information request routines of SRF for the states, as well as the request routines for the SRF statements, through SINTEGRA, may be completely automated.

### **3.3 Administrative Mechanisms for Cooperation**

#### **3.3.1 National Classification of Economic Activities – CNAE**

The classification of economic activities is an operation instrument for the ordering of the production units that exist in the country, to enable the vision of the economic organization on which the public administration acts. The uniformity of the coding among the different information sources, is of utmost importance in institutional decision-making and for the establishment to sector policies.

Considering the strategic function of the code of activities in the organization of the economic statistics and bodies corporate cadastres, in public administration areas, its uniformity is imposed as a condition

for the articulation among sources, enlarging the analysis and critical potential of the information available in all countries, and, mainly in organized economic blocks<sup>1</sup>.

In Brazil, when the adjustment of the SINIEF was proposed in 1970, the registration process of the classification of activities used by the signatory branches of CONFAZ, only advanced during the second half of the 90's. In the federal scope, around mid-80's, there was a good unification experience of the tables used by the mercantile registry branches (Commercial Boards, ruled by the National Commercial Registry Department) and by the tax administration of the Union (Federal Revenue Secretariat). However, the biggest step took place in 1993 by initiative of the official statistical branch of the country, the Brazilian Institute of Geography and Statistics – IBGE, jointly with the main branches of the federal public administration. The work had the participation of entities from business branches and it resulted in a publication in 1994, of the National Classification of Economic Activities – CNAE, with the objective of guaranteeing the registry of national statistics and the compatibility of the national information with the international classification provided for by the United Nations.

Federal Government branches went to adopt CNAE as from 1995, including the Federal Revenue Secretariat. The states and municipalities continued working with their own tables, defined at different moments with various levels of elaboration, not compatible among themselves or with CNAE itself. The comparison of sector information from different sources was a complex activity and not always, with not very consistent results for decision-making. In addition to the multiplicity of the existing tables for the economic classification, the fact is that the coding of activities was restricted to the action areas of each branch, contributed to the heterogeneity of the quality of the information.

CNAE was not adequate for the needs of Brazil's States and municipalities that required greater detail of the economic activities, to act in the territorial stratum corresponding to their tax competences. The construction of the table was retaken in 1997, during the times on which the studies for a unified tax cadastre, under the coordination of

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<sup>1</sup> *The United Nations maintain the Standard Industrial Classification of All Economic Activities – ISIC as a reference for international compatibility. The Eurostat established the statistical Nomenclature of Economic Activities of the European Union, pursuant to UN guidelines, regulating its use in all countries of the European block. The United States, Canada and Mexico have a common nomenclature with the same purpose, updated in 1997, the North American Industry Classification System – NAICS.*



the Federal Revenue Secretariat, with the participation of representatives from the state and municipal areas. The work had the technical orientation of IBGE and extended the registration of the government sub-national needs. The split of the CNAE to be used by the tax administration, increased the level of the structure of the codes of the table, and was published by the National Classification Commission – CONCLA, with the denomination of CNAE-Fiscal, in June 26, 1998.

The work group that prepared the CNAE-Fiscal was made official as a Technical Sub-commission of permanent nature, within the scope of CONCLA, with the objective of promoting the national registration of the national classification of economic activities and to direct and support the user branches regarding the application of the table, to guarantee the uniformity of the coding system. The result expected directs to the improvement of the quality of the country's information system.

In this manner, during the past years, Brazil has consolidated a growing interaction between the statistical system of the country and the branches responsible for the main registries and administrative cadastres of the government, as per the example of countries in a more advance stage of development. It is important to consider that the cooperative practice in this regard, allows the cost savings in economic and social inquiries and at the same time, allows to adequately complete statistical information produced and provide greater effectiveness to government actions, especially under the economic-tax aspect.

The technical orientation for the application of the economic activities codes is of utmost importance in this context, most importantly in a federative country. Brazil's context, with an accented normative and administrative autonomy of the three government spheres and the adoption of certain procedures, rejected in good international practice, on behalf of federal and state branches of the most developed States – specially in the self-attribution of the code of activities which is the responsibility of the entrepreneur himself, accent the challenge of uniform coding in the country. The Brazilian solution to guarantee the national uniformity of the identifying code of the country's economic organization, is being built during the past years in a participative manner, in the scope of the Technical Sub-commission of the CNAE-Fiscal.

The implementation work of the CNAE-Fiscal constitutes a cooperation experience among the federative entities, currently considered, a successful example of the joint action of Brazil's three governmental spheres. The work performed underwent many stages:

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1. The registration of the economic activities tables (federal phase – 93/95 and state/municipal phase – 97/98);
2. The constitution of a forum for the building of joint solutions – Technical Sub-commission of the CNAE-Fiscal, organized pursuant to the Internal Regime officially published, with a well defined composition, two deliberation meetings per year and decisions by consensus (98/99);
3. The gradual implementation of the registered table in different user branches (which has already begun);
4. The construction of support instruments for the table (99/2000);
5. The update of the table, to accompany the dynamism of the economic organization and attend to the needs of the user branches (99/2000);
6. The adaptation of classification concepts and conventions – UN models – to the national administrative practice and the drafting of an orientation manual for coding (99/2001);
7. The official publication of standards and orientations for coding in CNAE-Fiscal, by CONCLA (began in 2002);
8. The study of quality control mechanisms for coding and an implementation proposal of a centralized system to guarantee the national uniformity of the coding, with shared updates (began in 2001-2003).

The CNAE-Fiscal is being implemented gradually throughout the country. The Federal Revenue Secretariat uses CNAE-Fiscal in the National Cadastre of Bodies Corporate – CNPJ as from December 1998. The CNAE-Fiscal is implemented in the cadastres of thirteen states of the federation (Feb/2002) and all the other states of the federation participate in the works and due to the enforcement of an agreement (Adjustments SINIEF 02/99 and 09/2001) in the scope of CONFAZ, they must conclude its implementation in December/2002. Twenty-two prefectures of state capitals participate in the works of the Technical Sub-commission of the CNAE-Fiscal and eight of them already concluded the implementation of the new table, this procedure is supported and recommended by the Brazilian Association of Finance Secretariats of the Capitals – ABRASF, which maintains a representative in the Sub-commission, specially designated to accompany the works.

The “updated CNAE-Fiscal form” was submitted within the scope of the statistical cooperation agreement between the European Union and the MERCOSUR + Chile, because it constituted an example of participative management of the classifications in support of computerized instrument (Santiago de Chile, Mar/2001).

Information on the Technical Sub-commission of the CNAE-Fiscal and the work performed are available at [www.ibge.gov.br/concla](http://www.ibge.gov.br/concla)

### **3.3.2 The National Cadastre of Bodies Corporate – CNPJ**

The CNPJ is managed by the Federal Revenue Secretariat and constitutes a cadastre of bodies corporate in public and private law in the tax administration, of mandatory nature. The CNPJ substituted the former General Taxpayer Cadastre - CGC of the Ministry of Treasury, as from July 1, 1998, as a resource rationalization proposal and the procedures of the different existing cadastres and for the cooperation among the tax administrations at the different government levels in Brazil, with ample simplification of the obligations required from the business sector.

When created, the CNPJ foresaw the adherence of all treasury branches of the state and municipality administrations, endorsing the national integration of the tax cadastre. Until now, there are not many signatory branches, mainly due to the absence of the adequate mechanism for cooperative management. Furthermore, difficulties in the operational order and mainly in the technological field, have delayed the effectiveness in reaching this objectives even among its few signatories.

A new alternative arises with the signing in March of the present year, of an agreement for the development of an unification project of the cadastre mechanism used by the Federal Revenue Secretariat (CNPJ, through SRF's Internet website) and by the State of Sao Paulo (electronic DECA, through the Virtual Fiscal Portal). The project will result in a virtual portal shared by the Federal Revenue Secretariat and the State Treasury for the cadastre registry of companies with headquarters in the State of Sao Paulo.

This agreement is the largest between the state tax administration and the federal government, it may certainly be considered as the agreement that introduces the national unification process, if not of cadastres of bodies corporate taxpayer, but of at least of the cadastre registry

procedures in the public administration. It is evident that the benefits for society, in the sense of the simplification of compliance with obligation on behalf of business units and the downward quality of the unified data entry. It is delayed in a process that is undoubtedly of institutional maturity that is common to the three spheres of government, the rationalization of administration costs of having endless cadastres that will continue to exist simultaneously, which results in different territorial overlaps of the same data.

### 3.4 Joint Tax Models

#### **The Integrated Tax and Contribution Payment System of Micro and Small Companies – Simples**

Created in 1996, Simples provides for the tax regime of micro and small companies of differentiated, simplified and favored treatment, in regards to the taxes and contributions included in the law that establishes it.

The registration in Simples provides for the unified monthly payment of the following taxes and contributions, which are the competence of the federal government:

- a) Bodies Corporate Income Tax – IRPJ;
- b) Contribution for Social Integration Programs and the Formation of the Public Servant Patrimony – PIS/PASEP;
- c) Social Contribution on Net Profits – CSLL;
- d) Contribution to Finance Social Security – COFINS;
- e) Tax on Industrialized Products – IPI;
- f) Contributions for Social Security, to be made by bodies corporate (INSS – employer’s quota).

In addition to this, by endorsing the operational integration among tax administrations, Simples may include the **Tax on operations pertaining to the Circulation of Goods and Services of Interstate and Intermunicipal Transportation – ICMS**, of state competence and the **Tax on services of any nature – ISS**, of municipal competence, owed by micro and small companies, as from the moment on which the federated unit or municipality in which it operates adheres to the agreement.

Agreements are bilateral and have as parties the Union represented by the Federal Revenue Secretariat and the federated unit or municipality, being able to limit to the hypothesis of micro or small company.

The registry in Simples prohibits, micro and small companies, to use or assign any fiscal incentive value or title, as well as the appropriation or transfer of credits pertaining to IPI and ICMS.

In spite of Simples' success in simplification and costs reduction for micro and small companies, we cannot deny the low adherence of sub-national governments to the system. In fact, no state has subscribed to the agreement and only 124 municipalities have adhered to the system<sup>2</sup>. In this regard, we have some comments.

Firstly, it is obvious that in a certain manner the lack of adherence damaged the system's global and unitary conception. The idea of having a unique relation of the tax administration with the taxpayer, that would integrate the three levels of government, was damaged. This makes taxpayers to continue having to present accounts to different governments, therefore, legislation changes and aliquots in each fiscal jurisdiction where it operates and mainly, being subject to the value added problems mentioned in the preceding item. Summarizing, in spite of the fact that its relation with the federal government is improving, the issue of having to present accounts to different governments continues.

Secondly, it is important to have clear that Brazil's strong federative decentralization, jointly with some frustrated attempts of integrated programs between the Union and the states, constitutes the main political reason that prevented the signing of the agreements. In reality, the tone of the arguments of the sub-national governments in any reform process in Brazil, has been to look for greater tax autonomy. A system such as Simples goes against this desire of greater independency of the states and municipalities, since it withdraws the capacity to legislate on tax, leaving them at the will of the federal government standards. Undoubtedly, this is a very particular condition of Brazil and it must be respected, because it is part of the maturity of our federative relations.

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<sup>2</sup> *Three states have already adhered (Maranhão, Rondonia and the Federal District), but all agreements were denounced. The 124 local governments that also adhered do not constitute a significant group, when considering that there are 5,500 municipalities in the country.*

Thirdly, in addition to the political argument, the sub-national governments tend to depend on federal transfers, losing their power to adjust aliquots or reduce exemptions during a period that requires greater revenue and to effectively examine taxes. More than this, given the great economic-tax diversity that exists among Brazilian states, the limits and aliquots suggested by the federal government may not be adequate to the reality of determinate jurisdiction, specially the poorest ones.

Lastly, it is important to make clear, that the lack of adherence does not imply equal treatment of the ICMS and ISS among small and large companies in the country. On the contrary, almost all states established some favored treatment system for small companies, sometimes similar to Simples, but that were adapted to the local or regional reality. In general, governments allow taxes to be paid under presumed basis on billing or as a fixed quota (regardless of the sales for the term). But, each government, established its own limits and meaning to what is a small company and applies its own particular legislation. Logically, this lack of harmonization of criterion is far from being an ideal situation, but what is important is that, given the federative conditions of the country, micro and small companies, are in fact, enjoying a favoring system, regardless of their local peculiarities.

#### **4. FINAL CONSIDERATIONS: DIFFICULTIES, EFFECTIVENESS AND PERSPECTIVES**

In this paper we saw that Brazil is a Federal Republic with a high level of decentralization and autonomy in its federated entities. This characteristic ends up generating a trade-off between autonomy and cooperation. In general, the greater the autonomy, the greater the need for cooperation mechanisms, but it is even more difficult to implement the cooperation models without hurting autonomy itself.

Mainly due to the issue of the autonomy in federative relations, in spite of the different national integration initiatives that exist in Brazil's legislation, the level of cooperation among tax administration is low, be it in the registration and exchange of information or be it in the execution of operational and managerial activities.

For example, Brazil still seeks the cadastre unification of taxpayers, while it advances to perfect the sector classification thereof and, consequently, improve the quality of institutional information. Much has been attained, but there is long road to be covered in the search of cooperative actions between the different government levels, which will result in the enlargement of the potential knowledge on taxpayers of the different sectors of the economy and in the adequate application of the tax system, with the due simplification of compliance obligations on behalf of society with the public administration.

It may be well true that much has already been reached, recently with the signing of an agreement between the Federal Revenue Secretariat and the State of Sao Paulo to implement a unified cadastre, but there is wide space to perfect and nationalize these mechanisms.

Information exchange mechanisms have received much attention from tax administrations, and undoubtedly SINTEGRA arises as the best success example in this area. In reality, this system or information exchange mechanism will only be effective among different government levels, with the participation of the Federal Revenue Secretariats, which is currently evaluating its adherence to SINTEGRA.

Regarding the creation of SIMPLES, this simplified system, even though it allows the full integration of the fiscal treatment of the micro and small companies, at the three government levels, did not achieve the results expected from the inter-governmental point of view. The low adherence of the states and municipalities to the system, is mainly due to the difficulty of negotiating solutions that are adequate to the different demands among the three government levels. Hence, considering the high tax autonomy of the sub-national administrations, the creation of similar programs at the state and municipal level was preferred, in parallel to the federal government system, which is certainly far from the initial objectives of SIMPLES.

Therefore, it is clear that challenges are great and the task to establish an effective cooperation system, in a strongly decentralized federative country, it is very complex. It is important to point out that integration is a process that must mature throughout time, as tax

### TOPIC 2.3

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administrations perceive that their joint action is more efficient than isolation. Certainly, this is, the current trend of Brazil's tax administrations that are undergoing an approximation and cooperation process. Previous experiences, even though they have not obtained the results expected, have generated a pro-integration environment and have proven that this is right way to follow.

Ms. Andrea Lemgruber Viol  
General Coordinator of Tax Policy  
Secretariat of Federal Revenues  
Brasilia, DF, Brasil  
E-mail: [andrea@fazenda.gov.br](mailto:andrea@fazenda.gov.br)



**TOPIC 3**

**INTERNATIONAL COOPERATION TO IMPROVE  
TAX COMPLIANCE**

*Lecture:*

*TOPIC 3*

## **INTERNATIONAL COOPERATION TO IMPROVE TAX COMPLIANCE**

**Eduardo Enrique Díaz Guzmán**  
General Administrator of Large Taxpayers  
Secretariat of Finance and Public Credit  
(Mexico)

*CONTENTS: Background.- Definition by OECD of systems with harmful tax practices.- Other OECD works / Special Project Team.- Actions undertaken by Mexico against countries with harmful tax practices.- Conclusion.*

### **BACKGROUND**

The globalization of the economy and internationalization of capital flows may cause harmful tax competition between the states, with serious consequences for national tax bases. In fact, when there are significant differences in the tax systems prevailing in said states, normally it is more attractive to enter into transactions in a state with minimum or reduced tax charges, instead of making them in countries with greater tax burdens.

The difference in the aforementioned tax systems and the great mobility of transactions at the international level may lend itself to the generation of forms of evasion that may be used to advantage by the taxpayers in order to erode the tax bases of the countries.

For this reason and in order to counteract the foregoing problems, the Committee of Fiscal Affairs of the Organization for Economic Cooperation and Development (OECD), through the Forum of Unfair Practices, began its work toward the development of general criteria for identifying harmful tax aspects of tax jurisdictions in particular; paying particular attention to the following aspects:

- 1) Identification of jurisdictions with none or minimum taxes,
- 2) Lack of effective exchange of information,
- 3) Lack of transparency
- 4) Identification of countries without significant business activities.

As a result of the works carried out in relation to the aforementioned aspects, the OECD's Committee of Fiscal Affairs published in June 2000, a preliminary report with the following data:

- Forty seven potentially harmful tax systems were identified in OECD member countries,
- A list was made of 35 countries or territories that respond to the definition of tax haven,
- A series of joint works between the OECD and countries listed as tax havens was proposed, through which the elimination of harmful tax practices would be sought.

Among the joint works mentioned in the previous paragraph, one of the most important ones carried out by the OECD member countries, including Mexico, has been to hold meetings with countries considered tax havens, with the intention of designing strategies intended to eliminate one of the most harmful factors, namely. The lack of information exchange.

The foregoing is due to the fact that in the past meetings of the OECD's Forum of Unfair Practices, it has been concluded that the four key factors for considering a country or territory as a tax haven (Jurisdictions with none or minimum taxes, lack of information exchange, lack of transparency and the performance of insignificant productive activities) the two most important ones were, undoubtedly, the lack of transparency and above all the lack of information exchange.

**DEFINITION BY OECD OF SYSTEMS WITH HARMFUL TAX PRACTICES**

As previously indicated, the OECD undertook several efforts for identifying potential harmful tax systems, it being admitted as a fact that they could be identified at the level of the tax system of a specific country or as a specific system operated by some OECD member country.

In this sense, it is admitted that countries considered tax havens, as well as those with preferential tax systems, can potentially cause damage by:

- Distorting financial flows,
- Seriously eroding the national tax bases,
- Discouraging taxpayer compliance,
- Increasing administrative costs of tax authorities and taxpayers.

In view of the above reasons, the OECD recommendations for combating this type of harmful practices are divided into two main categories:

- a) Adoption of measures of bilateral or multilateral cooperation (recommendations relative to tax agreements and international cooperation).
  - Increase the exchange of tax information,
  - Increase the use of simultaneous audits,
  - Agree on assistance mechanisms for collecting tax credits,
  - Promote international cooperation in combating harmful tax practices.
- b) Adoption of unilateral or by residence measures (recommendations relative to national legislation).
  - Adoption of tax schemes of foreign holding companies to avoid deferral in the recognition of revenues.

- Modification of the local legislative framework to discourage investments in countries with harmful tax practices, including:
  - Rules for reporting investments in this type of countries, which may consider strong sanctions in case of noncompliance.
  - Restriction of deduction in payments to entities in tax havens,
  - Application of tax withholding at the source in certain payments to residents in countries with harmful tax practices,
  - Rules of residence,
  - Application of rules and guidelines on transfer pricing, etc.

#### **OTHER OECD WORKS / SPECIAL PROJECT TEAM**

Following the publication of the preliminary list of 35 countries identified by the OECD as tax havens, within said organization it was agreed to set up an ad-hoc group of member countries, whose main objective would be to approach each of the countries identified as tax havens, in order to convince them to change their taxation system and to cooperate at the international level in the effort aimed at eliminating harmful tax practices. The aforementioned group is known as Special Project Team.

It must also be noted that another objective of the aforementioned working group is to develop a final list of countries considered tax havens, consisting of all those jurisdictions which during the process of rapprochement have showed no intention of cooperation in the international effort to fight against harmful tax practices. This will also result in discouraging residents from other countries or from the very OECD member countries, from undertaking transactions with those clearly identified as non-cooperating countries.

In this sense, starting in 2000, the Special Project Team formed by nine OECD member countries (Australia, Belgium, Czech Republic, Germany, Japan, Slovak Republic, New Zealand, United Kingdom and United States of America), began to approach 9 tax havens considered

cooperating jurisdictions. Currently, the OECD group of member countries continues to approach other tax jurisdiction identified as potential tax havens, in order to increase the list of cooperating tax jurisdictions.

It must be noted that the purpose was to jointly carry out the necessary works to promote the exchange of information between OECD countries and cooperating jurisdictions, under the supervision of the OECD Working Group No. 6, of which Mexico is an active member.

As a result of the work carried out by this group of member countries and cooperating jurisdictions, two types of information exchange agreement models were proposed, one of a bilateral and the other of a multilateral nature.

Even though the approval of both exchange models is still pending, the work carried out by this group is an important example of cooperation between countries for the purpose of eliminating harmful tax practices (lack of transparency) between countries.

In this sense, the agreement and future approval of the two versions of the model agreement for the aforementioned exchange of information shall undoubtedly be an effective instrument, whereby the countries that are party thereto may count on the necessary information for improving their examination and prevention acts, in relation to transactions by taxpayers which may probably not have been reported for fiscal purposes.

Thus, and until the two versions of the aforementioned Model Agreements are approved, Mexico will establish a specific position with respect to the modality of information exchange it will adopt.

### **ACTIONS UNDERTAKEN BY MEXICO AGAINST COUNTRIES WITH HARMFUL TAX PRACTICES**

On the other hand, and in relation to the measures adopted by Mexico for combating harmful tax practices, starting in 1997, a series of unilateral type actions was incorporated in our legislation, which are aimed at discouraging investments in countries with harmful tax practices, through the following tax measures:

- a) An information return was established for purposes of making known investments made in countries considered territories with preferential tax systems, which must be filed before the Mexican tax authority in the month of February of the fiscal period following that for which the respective return is filed.
- b) Tax provisions were established to determine in advance the revenues originating from investments in entities established in tax havens. The purpose of this obligation is to avoid deferral in the recognition of revenues, which would otherwise not be recognized until their distribution, or through the distribution of dividends.

Taxable revenues derived from this type of investments are determined annually and are not accumulated to other taxpayer revenues.

The foregoing revenues may be accumulated on the basis of gross revenues obtained (without reducing authorized deductions) or net earnings obtained; depending on whether or not the taxpayer has at the disposal of the tax authority, the accounting records of his investments in preferential tax territories.

- c) Payments made to resident corporations in territories with preferential tax regimes are considered nondeductible, unless it is proven that they comply with provisions relative to transfer pricing. The foregoing rule is not applicable in the case of unrelated persons.
- d) High withholding rates were established with respect to payments (interest, royalties, etc.), made to residents in territories with preferential tax systems.
- e) Likewise, included in our legislation was the definition of Investments in preferential tax systems, which comprise those made through branches or corporations, those made through holding of stock, bank or investment accounts and any other investment in a juridical figure similar to the aforementioned ones, which may have been created according to foreign law, as well as those made through intermediaries.

- f) In addition and with respect to definitions of a tax haven, it is admitted that not all investments made are aimed at deferring recognition of revenues by the taxpayers, for which reason, exceptions should also have been recognized.

In this sense, those cases wherein the holding of stock by the taxpayer does not allow him to decide the time for distributing earnings shall not be considered investments in preferential tax systems. In spite of the above, and unless there is proof to the contrary, there is the presumption by the Mexican tax authority that the taxpayer influences the control of investments in preferential tax systems in all cases.

Likewise, revenues generated in those territories will not be considered cumulative, provided that such revenues originate from business activities in said jurisdictions and at least 50% of the total assets are business assets.

Individuals who may have carried out or maintained investments in territories with preferential tax systems not exceeding \$160,000.00 Mexican pesos, will accumulate the distributed dividends or earnings originating from the aforementioned investments, until the time they are actually received.

- g) On the other hand, a sanction was established, ranging from three months to three years imprisonment, to be applied to whoever fails to file for more than three months, the information return with respect to investments made or maintained in territories with preferential tax systems.
- h) An extensive list was established of countries considered tax havens, which currently comprises 93 countries.
- i) It is anticipated that taxes paid by the resident corporation in a territory with preferential tax systems may be credited according to the average daily direct participation.

Also allowed is the crediting of income tax previously paid on dividends or earnings distributed by the resident corporation in a territory with preferential tax systems, when they originate from earnings for which corporate income tax was already paid in Mexico.



## **CONCLUSION**

As may be seen from the foregoing, the introduction by Mexico of legislation on tax havens under the unilateral approach, has allowed a reasonable legal framework for effectively combating harmful tax practices in transactions with countries identified as tax havens.

Undoubtedly, the previously mentioned normative framework will be perfectly complemented upon conclusion within the OECD of work related to the implementation of bilateral or multilateral information exchange agreements with tax havens.

The future adoption of the model agreement by Mexico, for negotiating information exchange agreements will be an effective measure that will complement the examination tasks which our country will continue to carry out.

Mexico will thus continue to work with the OECD in approaching countries considered tax havens, as well as in the development of the two existing versions of the Model Agreement until they are concluded.

Mr. Eduardo Enrique Díaz  
General Administrator of Large Taxpayers  
Secretariat of Finance and Public Credit  
Mexico  
E-mail: [eduardo.diaz@sat.gob.mx](mailto:eduardo.diaz@sat.gob.mx)

*Case study:*

*TOPIC 3.1*

## **MECHANISMS AND ACTIONS FOR MUTUAL ADMINISTRATIVE ASSISTANCE**

**Mats Henriksson**  
Tax Director  
National Tax Board  
(Sweden)

*CONTENTS: Introduction.- International administrative co-operation to protect national tax bases.- Countries with a high overall tax burden.- Basis for mutual administrative co-operation.- Legal base in Sweden.- Sweden's commitments to administrative co-operation.- Regional co-operation on voluntary basis.- Forms of Administrative Assistance.- The Swedish experiences.- Attitudes and motivation.- Difficult and sometimes unrewarding work.- Selection of audit cases.- Indirect taxes with short reporting periods.- Technical factors.*

### **INTRODUCTION**

#### **International Administrative Co-operation to Protect National Tax Bases**

The increasing pace and impact of internationalisation has intensified the economic interaction between countries. As economic systems become more global, so do the problems facing tax policy makers and administrators. Tax systems need to cope with increasingly mobile tax bases internationally. Governments find themselves confronted by transactions based on advances in communication technologies, development of complex, innovative financial instruments, the expansion of tax havens and preferential

regimes, threatening to distort otherwise beneficial tax competition. In addition to the difficulties met in taxing income from capital, the increasing mobility of skilled labour is making also part of the wage income tax base more elusive. Many international transactions, particularly in the field of indirect taxation such as intra-community trade between Member States (MS) of the European Union (EU), cannot be fully monitored by one national tax administration alone. Here the tax system itself calls for co-operation between tax administrations.

Therefore, the national challenge posed by the need to provide a fiscal environment that is conducive to trade and investment flows while securing a broad tax base can only be met by co-operation on an international level. Tax administrations in different countries need to co-operate not only in combating cross-border tax abuses, but also to perform their normal compliance management work.

### **Countries With a High Overall Tax Burden**

Co-operation with other tax administrations is of particular importance for countries with a high tax burden. They are facing considerable efforts on the part of taxpayers to reduce their tax bases. International transactions and the use of tax shelters or preferential regimes play an important role in this respect.

Sweden has chosen to finance most of its welfare programmes through the public sector. It is therefore a country with a very high tax burden, possibly the highest in the world. The overall tax burden has amounted to over 50 percent of GDP over several years. Not surprisingly, the tax gap (the difference between intended tax revenue and actually collected taxes) in connection with international transactions is considerable. In recent estimates by the National Tax Board (Evasive tax bases; Report 2002:2, available only in Swedish) this part of the tax gap has been calculated to 20-35 Billion SKR (2-3,5 Billion USD). A breakdown of this total indicates, that indirect taxes make up for 10-15 Billion SKR. The balance comes from unreported savings abroad and transactions where Tax Havens are involved. The losses connected with international transactions represent roughly one quarter of the total tax gap, which has been calculated to some 90 Billion SKR (8,5 Billion USD). The same level has been calculated for several other countries in northern Europe. Most of these can be characterized as countries with high tax burdens.

Co-operation with other tax administrations is therefore an important issue for Swedish Tax Authorities.

### **Basis for Mutual Administrative Co-operation**

International co-operation allows tax administrations to obtain information from other administrations, act beyond their national borders to carry out examinations abroad, take part in mutual or simultaneous control actions and notify taxpayers. In some cases co-operation may also include collection and recovery of tax debts.

These activities might be carried out without the need for conventional commitments. Information may be accessible from open sources not under secrecy restrictions. Other tax administrations may be willing to extend a helping hand. Voluntary co-operation is, however, an insufficient basis for organised and effective administrative assistance.

The responsibility of tax administrations is foremost to protect their own national tax bases. Potential competition between states regarding tax bases is a reality.

In the absence of obligations to assist other administrations, such efforts will have low priority. The assistance and co-operation is therefore likely to be half-hearted and of indifferent quality and thus of limited value to the receiving party. National legislation, intended to protect taxpayers, such as secrecy provisions regarding private economic information and the procedural rules in respect of the powers of the tax administration to examine and investigate in connection with taxation, call for strict rules for co-operation with administrations abroad. The taxpayers must be confident that any administrative assistance between tax administrations does not violate his rights. The system for international co-operation must be transparent and of high quality.

Against this background it is imperative that administrative co-operation and mutual assistance between the tax authorities be regulated. Countries willing to co-operate internationally should demonstrate this by signing treaties, conventions and agreements to provide a legal framework for such co-operation.

## Legal Base in Sweden

In 1990 Sweden implemented a national legislation outlining the conditions under which Swedish authorities may co-operate with other administrations on a mutual basis in tax matters. The law covers exchanges of information, simultaneous control actions, notification of taxpayers, collection and recovery of tax debts. It also names the Competent Authority, in most cases the National Tax Board, the headquarters of the tax administration. The law allows the Tax Administration to co-operate with administrations abroad, provided an agreement exists between the involved countries. In connection with Sweden's accession to the EU, the law was amended and now also covers exchanges of information based on EU Directive (77/799 EG) on mutual assistance. The law covers all taxes.

## Sweden's Commitments to Administrative Co-operation

Sweden has signed *bilateral* tax treaties with 80 countries. Most of these, except the treaty with Switzerland, include an article on exchange of information, based on Article 26 of the OECD Model Convention. The exchange of information covers all taxes imposed on behalf of the contracting states. The obligation concerns information necessary for taxation, unless the domestic tax legislation concerned is contrary to the Convention. The obligation is also limited in case of lack of reciprocity (legal or factual), if the information is not available under domestic law or administrative practice, and where there is a risk of disclosure of business or professional secrets, and this disclosure would be contrary to public order.

In addition to these bilateral treaties, Sweden takes part in several *multilateral* arrangements on mutual administrative assistance. The oldest and most far-reaching of these is the **Nordic Convention on Mutual Assistance in Tax Matters** (originally 1972; present 1990) between Denmark, Finland, the Faeroe Islands, Greenland, Iceland, Norway and Sweden. The convention includes the following activities;

- Automatic exchange of information
- Spontaneous exchange of information
- Exchange of information on request

- Presence at examination activity in the other state
- Simultaneous audit
- Notification
- Enforced collection of tax debts
- Transfer of (preliminary) tax.

The Council of Europe and the OECD have developed a joint **Convention on Mutual Administrative Assistance in Tax Matters**. Sweden has ratified the Convention that in most areas matches the Nordic Convention. The former Convention holds an advantage over tax treaties, as it is possible to join it without the need to negotiate bilaterally with other states.

In 1995 Sweden gained accession to the European Union. This led to an implementation of Community legislation or, in the case of Regulations, to a direct legal effect in Sweden. The **EC Directive on Mutual Assistance (77/799 EEC)**, initially covering income taxes and taxes on capital, extended to VAT in 1979 and excise duties in 1992, became effective as Sweden gained membership. This Directive opened a possibility of administrative assistance with Portugal, a country with which Sweden has no bilateral tax treaty.

The **Regulation (218/92 EEC)** holds provisions for computerized exchange of information on VAT over the VIES (VAT Information Exchange System). Businesses engaged in intra-community trade are obliged to submit a quarterly form containing the total value of goods to every purchaser. This exchange of information allows verification of the tax liability of the purchaser in the country of destination.

The European Commission runs the **Fiscalis-programme**, aimed at promoting community policies in the field of indirect taxation. One of the tools of the programme is the multilateral control (MLC), where field audits regarding corporate groups or trading partners, engaged in business operations in different countries, can be co-coordinated in several MS. These control activities can be partly funded by the Commission.

## **Regional Co-operation on Voluntary Basis**

The conventions, treaties and agreements mentioned above provide the necessary legal base for co-operation. They also impose obligations on the participating countries, particularly in the case of the EU in respect of VAT and excise duties. The common VAT system demands that MS co-operate very closely and the performance and efforts of the MS are monitored by the Commission Services, since the VAT base is one element in the calculation of the member fee to the EU.

In addition to these obligations, Sweden is committed to several other, voluntary, co-operation efforts. The Nordic countries have a long history of mutual assistance in tax matters. The Nordic Convention is testimony to these efforts. The Nordic countries meet regularly on different levels; on ministerial level to discuss experiences regarding the application of the Convention in operational practice, on Director-General (Of Tax Administrations) level to plan and give directions for coming joint activities. During meetings with the heads of the Compliance Management Units and a group for simultaneous audits, these directions are transformed to action plans and suggestions for selection of cases for audit. The Nordic co-operation efforts also include issues regarding computerised audit techniques and joint training efforts.

Sweden is also active within the Baltic Sea co-operation initiative, which includes all nations bordering on the sea (Russia, Estonia, Latvia, Lithuania, Poland, Germany; Denmark, Finland and Sweden) but also Norway and Iceland. Among other initiatives, the countries have agreed to undertake joint control actions, including exchange of information. The bilateral treaties provide the legal basis for this co-operation between the countries involved.

## **Forms of Administrative Assistance**

Every MS of the EU is obliged to organise a **Central Liaison office (CLO)** and to exchange VAT information automatically, using the VIES. The CLO is responsible for contacts between MS regarding administrative co-operation. The exchange of information via the CLO is either based on requests from other MS or automatic. It is possible to analyze this information stream and find patterns that could provide useful input into the risk management process.

The **Excise Liaison Office (ELO)** is the corresponding, EU related, organisation in the field of harmonized excise duties.

Exchange of information, the most widely used tool for administrative assistance can be spontaneous, automatic or on request. Information that can be of importance for the tax administration in another state and is sent to that state without being requested or subject to a specific agreement is generally called a **spontaneous exchange** of information. The information, which is usually covered by an exchange of information article in the tax treaty or an agreement based on the treaty, is made available as a side effect from the national examination activities.

An **automatic exchange** of information is also normally based on commitments in tax treaties or conventions or in specific agreements. Automatic exchanges usually apply to mass information regarding wages, pensions, royalties, interest on savings, dividends, refunds of VAT to foreign traders etc, paid to persons resident or domiciled abroad. The source state passes the information on to the state of residency automatically without previous request. The material is usually not examined by the tax administration of the source state. Normally, the information is made available to the tax administration automatically by virtue of an obligation in the national tax code.

Exchange of information **on request** is the most limited tool in terms of volume of information. The obligation it imposes on the tax administration is, however, more substantial. Information is provided on specific request, in respect of an identified taxpayer, and may also be limited in other ways, such as a specific reporting period. So-called “fishing expeditions”, mass requests regarding unidentified persons, are generally not accepted.

Some treaties, conventions and agreements provide for a possibility for officials from another tax administration to be present during an audit, examination or investigation.

The expression **simultaneous audit** is used when two or more states agree to undertake an examination (usually in the form of a field audit) at the same time and regarding the same reporting period, each within its own jurisdiction, of one or more taxpayers, which are interesting from a control point of view. These audits are normally based on agreements following the OECD model



agreement for the undertaking of simultaneous tax examinations (C (92)81/FINAL) or the Nordic Convention. To facilitate this co-operation, the Nordic tax administrations have issued guidelines for the performance of simultaneous audits, covering administrative issues and including computerised audits. A project group with members from Denmark, Finland, Norway and Sweden carries the responsibility for selection of audit cases. The group has also developed standards for basic controls and reporting.

**Multilateral controls** are performed under the Fiscalis programme within the EU. It is one of the tools available to promote community policies in respect of indirect taxes, particularly VAT. The MLCs are partly funded by the Commission. In a MLC officials from three or more MS take part in a jointly planned and executed control activity. A legal basis for exchange of information, i.e. involvement or delegation from the national competent authority, is needed.

The Nordic Convention, The Council of Europe and the OECD Convention on Mutual Administrative Assistance and the EC Directive on Mutual Assistance offer the possibility of **presence at examinations abroad**. This is a more limited form of co-operation in control activities. The official may not take an active part in the examination or investigation abroad. Even so, it may be of great value for the official to examine the conditions on the spot and form a personal impression of the conditions in the particular case.

Some bilateral treaties and EU Regulations and Directives open the possibility of administrative assistance between the parties regarding **enforced collection** and **recovery of tax**. In Sweden enforced collection of taxes and civil debts is a responsibility of the Enforcement Service, a sister organisation to the tax administration, both under the National Tax Board. The Enforcement Service is the competent authority in matters regarding enforced collection and recovery of tax.

### **The Swedish Experiences**

The presentation above demonstrates that a variety of tools for administrative assistance and co-operation, based on treaties, conventions and agreements with a large number of states, are available to the Swedish Tax Administration. The possibilities to obtain information for tax purposes and to take part in joint control

activities are at least on level with most developed economies. The co-operation with countries in Sweden's immediate neighborhood is well developed and uniquely far-reaching. The membership in the EU provides new possibilities, particularly in the field of indirect taxation. Provisions intended to improve administrative assistance between MS also in respect of direct taxation are presently being developed.

Against this background it may seem surprising that tax losses in connection with international transactions amount to as much as a quarter of the total losses in Sweden. This is a considerable over-representation in comparison with domestic transactions. One of the obvious reasons for this is, that treaties, conventions and agreements are not applicable on Tax Havens or preferential tax regimes and many countries engaged in harmful tax competition. Where such countries have signed agreements, the co-operation tends to be limited to cases of tax fraud. Another reason is unsatisfactory administrative harmonisation. The possibilities to use international transactions in efforts to evade high tax regimes like Sweden are therefore considerable. The recent calculation of tax losses suggests that the losses related to international transactions with Tax Havens and preferential regimes is possibly not the most serious problem in terms of revenue losses. Very substantial losses are connected with transactions involving countries with which Sweden in fact has some kind of agreement. It is therefore reasonable to deduct that the tax administration is not able to use existing possibilities for co-operation and administrative assistance to full effect. There are many reasons for this. The Swedish experiences will be discussed below.

### **Attitudes and Motivation**

The attitude and commitment of tax officials, particularly the attitude of operational managers are major success factors in respect of international co-operation. Their responsibility is to use the available tools in their daily work. Managers prioritize and allocate resources. Taxation is by tradition a national responsibility. A clear majority of staff members in the Swedish Tax Administration were recruited and trained at a time when internationalisation and globalization was in its infancy. Their focus has been and largely still is the national aspects and problems of taxation and collection of taxes. Only few officers have specialized in international taxation issues. The

Swedish Tax Administration is organized according to functional principles and the operations are fully integrated. This means that every tax office and unit has the full responsibility for handling all tax matters of the taxpayers allocated to it within its geographical jurisdiction. The only exception is excise duties, currently administered by a special branch of the National Tax Board nationwide. The consequence of this organizational principle is inevitably, that international tax matters constitute only a minor part of the total workload of every organizational unit. Although the integrated approach is not always applied down to individual staff member level, that minor part is insufficient to create the “critical mass” that will allow staff members to develop and maintain the necessary skills for administrative co-operation. The same experience is relevant in respect of administration and management of VAT.

Although tax officials in general are aware of the increasing internationalization and its potentially serious impact on the Swedish tax bases, few fully realize the implications for the future tax administration. It is, particularly in the areas of intra-community VAT and excise administration, no longer possible to fulfill the mission of the tax administration without co-operation with administrations in other countries. Some transactions and movements of goods cannot be verified by the administration in one country alone. It is therefore necessary to have confidence in the capability, competence and commitment of administrations abroad.

### **Difficult and Sometimes Unrewarding Work**

Working with international tax issues and administrative assistance is by many standards more difficult, time-consuming and less rewarding than national tax matters. More often than not administrative assistance requires the involvement of competent authorities in both countries. This follows bureaucratic procedures and often causes serious delays. The requested information, with the exception of automatic exchanges, may not be complete or adapted to the procedures and other demands of the receiving country. Considerable efforts may have to be allocated to make the information readily available for the purpose it was intended. Where the information is available only after the period in which the taxation, including examination, has expired, it may be necessary to use less streamlined procedures to impose an additional tax liability. Most tax administrations operate with slender resources and are under pressure to reduce the administration costs. Therefore,

time-consuming work outside the main work processes is unwelcome. Providing assistance, spontaneously or on request, is an activity that may require knowledge regarding tax administrations, legislation and procedures in other countries. It may also be necessary to understand their provisions on secrecy in tax matters and their administrative culture. Usually, the activities have ad hoc character and are not possible to plan and can therefore be regarded as an extra burden, adding to an already high workload. Most tax administrations have systems to measure performance. It may be difficult to measure the effect of assistance to other administrations, since reporting back is late at the best and normally non-existent.

The experience in Sweden is that the effectiveness of administrative co-operation investments is decisively lower than domestic controls. This is certainly the case in terms of direct effects on revenue. The impact on compliance is indirect and difficult to measure. Many administrations measure performance of control activities in terms of additions to the reported tax base or additional collection of taxes. By those standards, international administrative assistance is a poor performer. It is therefore essential to justify co-operation efforts by other success criteria. One of these is to emphasize the increasing importance of mutual assistance and make it clear to staff members that they cannot expect -in the future- to perform their responsibilities satisfactorily using only domestic tools and means. Assistance is necessary and foreign tax administrations and tax officials must be trusted. It is also important to stress the importance of not creating examination-free zones. The taxpayer must be given the impression that control activities can appear everywhere and that information even regarding international transactions can be made available to the tax administration. The intention is to create a preventive effect and should be a cornerstone in the compliance management philosophy in every country.

### **Selection of Audit Cases**

Simultaneous audits and multilateral controls can be very effective tools for monitoring intra-group transactions and transactions between related parties in different countries. The EU and the Nordic countries have found difficulties in the selection of suitable objects. The states involved have different legal and procedural approaches, and the issue of timing and resources present problems even in cases where there is a consensus regarding the selected objects.

Having recognized this, the Nordic countries have formed a joint permanent group for selection of objects for simultaneous audits and co-coordinating the activities. In the EU similar considerations are likely to lead to simplified procedures and a joint selection process regarding multilateral controls in the near future.

### **Indirect Taxes with Short Reporting Periods**

Mutual assistance in the field of indirect taxes, in particular VAT, is challenged by considerable problems connected with the characteristic features of these taxes. The short reporting periods (monthly, bi-monthly or quarterly) and the credit mechanism with refunding within relatively short periods, create an environment that places heavy demands on the speed and quality of the administrative assistance. Control activities have to be performed without delay; the information must facilitate reconciliation between tax returns of different countries with non-matching reporting periods and where there are differences in the tax legislation. Again, some of these difficulties can be overcome where the statute of limitation allows additional taxation measures to be undertaken over a long period, but such measures are usually subject to less streamlined procedures. Loss of momentum and decreased efficiency is therefore a strong possibility, unless the mutual assistance is very well organized and performed.

### **Technical Factors**

Successful administrative assistance in the form of exchange of information depends also on technical factors like identification of taxpayers and standards for electronic transfer of information, whether automatic or spontaneous. The importance of Taxpayer Identification Numbers and effective registration procedures can hardly be over-rated. Standards for electronic transfer of information are the subject of one of the other parallel sessions and will therefore not be elaborated on here.

Training of staff members is another success factor in preparation for international co-operation. Within the EU common training standards have been developed for managers and staff members responsible for VAT administration. This is intended to ascertain an equal level of competence regarding community legislation and

procedures. The vision is that officials in the MS shall be able to act as one common tax administration. Expanding the training standards to common training activities is a strong possibility in the future. Preparations are under way within the Fiscalis programme.

One important component for the MS is language training, probably a more serious consideration in Europe than in the Americas.

This presentation of experiences above can be interpreted as pessimistic. The intention is merely not to turn a blind eye to the problems.

The Swedish experiences can be summarized under the following bullets

- Mutual assistance and co-operation between administrations of different countries is becoming increasingly more important. National administrations can no longer successfully protect their tax bases unaided. Nations must therefore liaison and create legal frameworks for mutual assistance in tax matters, including tax collection and recovery of tax debts.
- Efforts to improve international co-operation must be accepted as investments for the future. Short time effects are difficult to measure and often disappointing in terms of efficiency.
- Considerable difficulties will have to be tackled and overcome.
- The key factors to success are positive attitudes among managers on all levels and well-trained and motivated operational staff members. It is essential to accept obligations to assist other administrations and to see the potential in co-operation with them.

Mr. Mats Henriksson  
Tax Director  
National Tax Board  
Sweden  
E-mail: mats.henriksson@rsv.rsv.se

*Case study:*

*TOPIC 3.1*

## **MECHANISMS AND ACTIONS FOR MUTUAL ADMINISTRATIVE ASSISTANCE**

**Haseena Ali**

Commissioner and Chairman  
Board of Inland Revenue  
(Trinidad and Tobago)

*CONTENTS: Introduction.- Why the critical need for international cooperation in tax compliance.- Mechanisms for Mutual Administrative Assistance.- Mutual Administrative Assistance - The Trinidad and Tobago Experience.- Conclusion.*

### **INTRODUCTION**

#### **Why the critical need for international cooperation in tax compliance**

In today's world almost every discussion on international taxation includes a reference to the Global economy. This is not a chance happening. Economic globalization is a world reality and once the process has started, it will only develop further. Why is economic globalization proceeding at such a rapid pace? I suggest that it is because the benefits outweigh the negative aspects. The benefits are several and are easy to discern as one looks at issues such as the free movement of large amounts of capital, goods, people and perhaps what is most important, the free movement of information. However, this same freedom or rapid flow across borders is enjoyed by illicit activities. No longer are tax problems limited, even in the case of a single taxpayer, to any one country.

Compliance is important internationally, since the same taxpayer may pay taxes directly or indirectly in several countries. The rapid growth of multinational corporations is a prime example of this. Non-compliance in one jurisdiction may well signal a significant level of non-compliance in all. Accordingly, Tax Administrations should not adopt a selfish attitude, because it appears that a particular taxpayer does not impact on their revenue base.

## **MECHANISMS FOR MUTUAL ADMINISTRATIVE ASSISTANCE**

### **[1] General Double Taxation Treaties**

These cover a wide range of topics and are either bilateral or multilateral in the case of an economic group of countries. These treaties provide rules for taxation of income, so that the same income either may not be taxed twice or the tax may be shared between jurisdictions with the country of residence giving tax credit relief where applicable. These treaties may also provide, in general terms, for information exchange and mutual assistance in tax collection.

### **[2] Exchange of Information Agreements**

Specific agreements for information sharing may also be entered into. These are detailed and document a number of ways in which information may be exchanged. It is now generally recognized that the inclusion of an exchange of information article in a double taxation treaty does not go far enough and accordingly, separate treaties on information exchange have been encouraged.

### **[3] Mutual Assistance Agreements**

Special attention can also be paid to mutual assistance procedures, either with respect to the conduct of investigations or the collection of liabilities that have already been assessed. At present, where there is no mutual assistance in collection, a taxpayer simply has to engineer the movement of himself and his investments and monetary resources to a country other than that in which he may have incurred a large tax



liability. Without mutual cooperation, the taxing authority has no jurisdiction over the taxpayer and/or his assets when they are moved outside of the country's physical boundaries.

#### **[4] Shared Databases**

The development of shared databases is another powerful mechanism in mutual assistance. This I believe is being covered in greater detail in another presentation. However, the general statement can be made here that just as the information highway is used to promote illicit activities, that same highway, using the vehicle of shared information, may yet be the most efficient single tool in combating the international activities of any single taxpayer or group of taxpayers.

#### **[5] A World Tax Organization**

Mr. Vito Tanzi, Director - Fiscal Affairs Division of the International Monetary Fund, in a 1998 presentation to the CIAT General Assembly, posed the question. "Is there a need for a World Tax Organization." I would venture to say that the short answer is "yes". There is a need for a world tax body where members and subscribers to this organization share common experiences and assist one another in tackling the global taxation issues. Perhaps, the hindrance to such an organization being formed at present is the divergent taxation policies in some areas between struggling, developing economies and the larger developed countries.

#### **[6] Harmonization of Taxation**

Harmonization of taxation between countries belonging to the same economic grouping is also a step in the direction of facilitating mutual administrative assistance. However, this is not easy to achieve. Even among countries in a single economic community, there will be a jealous guarding of the traditional tax bases, since tax revenue may be derived from a different economic emphasis. An example of this is the CARICOM Group, where the economic activity contributing the most to tax revenue may differ from petroleum and other mineral resources to tourism or agriculture.

### **Tax Exchange of Information Agreement**

Trinidad and Tobago also has The Exchange of Information Agreement with the United States Internal Revenue Service, which

deals in more detail with obligations of the tax administration to provide the information requested especially in relation to information from banks.

### **CIAT Draft Exchange of Information Agreement**

CIAT has developed a Draft Exchange of Information Agreement, which was approved by the General Assembly. The next step is for members to adopt the agreement among themselves, so that it could be implemented. To be meaningful, member countries must put themselves in a position to reciprocate. For some countries like Trinidad and Tobago, this means that certain changes will be required in the structure of the organization and certain laws will need to be amended.

## **MUTUAL ADMINISTRATIVE ASSISTANCE - THE TRINIDAD AND TOBAGO EXPERIENCE**

Trinidad and Tobago is a small country with limited resources. One may say that all countries have limited resources. This is true, but some are more limited than others. The foregoing is simply to make the point that some aspects of Mutual Assistance would impact more on a small lesser-developed country than on a larger more developed nation. For example, where physical examination of records is required, a large multinational may take a substantial percentage of the audit staff of a small country to assist another country in respect of one request.

Another problem with collecting information for another tax jurisdiction, is the motivation of the officers working to provide the assistance. Since there is no direct revenue resulting from such an exercise, the officers may spend more time and be less focused than if tax revenues were accruing to their own country.

When information is requested from abroad that involves in depth work by skilled examiners, the time delay from the request to the delivery of the information is often too lengthy. The time lapse may result in the information being no longer relevant, since the requesting country may have closed the investigation and may no longer require the information.

### **CONCLUSION**

This short presentation has sought to address in a very simple and direct manner, the issue of mutual administrative assistance as seen through the eyes of a small nation with limited experience in this regard. What is clear, is that to better assist the formal cooperation established through agreements, the competent authorities of different countries need to establish a greater liaison through e-mail contacts and perhaps annual working meetings. In addition, issues relating to the provision of resources to meet the contractual obligations for mutual assistance need to be addressed in the early stages of resource planning by tax administrations. The lack of resources is a problem that has been identified in both presentations on this topic. Action starts with agreements, but results are more effective by establishing closer working relationships.

Ms. Hassena Ali  
Commissioner and Chairman  
Board of Inland Revenue  
Trinidad & Tobago  
E-mail: birchair@ird.gov.tt

*Case study:*

*TOPIC 3.2*

## **THE COMBAT AGAINST HARMFUL TAX PRACTICES**

### **Jeffrey Owens**

Head, CTPA, Division of Fiscal Affairs  
Organization for Economic Cooperation and Development  
(OECD)

Today, the OECD is publishing its List of Uncooperative Tax Havens (see Box I). But the issuing of the List, although it is an important landmark in the OECD's ongoing work aimed at ensuring fair competition in the global financial services market, is far less important than OECD's success in getting more than thirty offshore financial centres to publicly commit to the principles of transparency and effective exchange of information.

#### **Box I**

#### **LIST OF UNCO-OPERATIVE TAX HAVENS**

18 April 2002

1. In connection with its work on harmful tax practices 31 jurisdictions have made commitments to transparency and effective exchange of information and are considered co-operative jurisdictions by the OECD's Committee on Fiscal Affairs.
2. Although a small number of jurisdictions identified as tax havens in June 2000 have not yet made commitments, the OECD would welcome continued dialogue with these jurisdictions and the prospect of their future commitment to transparency and effective exchange of information.
3. The following jurisdictions, which have not yet made commitments to transparency and effective exchange of information, have been identified by the OECD's Committee on Fiscal Affairs as unco-operative tax havens.
  - Andorra
  - The Republic of the Marshall Islands
  - The Principality of Liechtenstein
  - The Republic of Nauru
  - Liberia
  - The Republic of Vanuatu
  - The Principality of Monaco

The OECD's project on counteracting harmful tax practices is part of a wider initiative by OECD countries to promote good governance in a globalised economy. Trade and financial liberalisation has enormous potential to improve living standards around the world. But it also brings risks, including the risk of abuses of the free market system, which could have a negative impact on the world economy and on people, by distorting the flow of capital and undermining the ability of governments to finance the legitimate expectations of their citizens for publicly provided goods and services.

The OECD project is intended to counteract harmful tax practices. The focus of the project is on geographically mobile activities, including financial and other services, given that the risks posed to governments are greater with respect to these activities than in others. Such tax practices can distort financial services and can be exploited by tax evaders to erode a country's tax base, shifting the tax burden from dishonest to honest — and generally poorer — taxpayers.

By providing a framework within which all countries – developed and developing - can work together to eliminate harmful tax practices, the OECD seeks to promote an environment that foster economic growth and development world-wide. The OECD project does not seek to dictate to any country what its tax rates should be, or how its tax system should be structured. It also does not seek to hinder enterprises in carrying out their normal business or to threaten the privacy of taxpayers. It seeks to encourage an environment in which transparent and fair tax competition can take place.

It was with this objective in view that the OECD published a report in 1998 entitled "*Harmful Tax Competition: An Emerging Global Issue*", which amongst other things developed criteria to identify the harmful aspects of a particular regime or jurisdiction. The 1998 Report was followed by a report in June 2000 entitled "*Towards Global Tax Co-Operation: Progress in Identifying and Eliminating Harmful Tax Practices*". That report:

- Identified 47 potentially harmful preferential tax regimes in OECD Member countries.

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<sup>1</sup> Luxembourg and Switzerland abstained from this and subsequent reports.

- Listed 35 jurisdictions found to meet the tax haven criteria.
- Proposed a process whereby tax havens could commit to eliminate harmful tax practices.
- Made proposals for associating non-member economies with the harmful tax practices project.
- Proposed elements of a framework of co-ordinated defensive measures designed to counteract the erosive effects of harmful tax practices.

A report entitled: *"The OECD's Project on Harmful Tax Practices: The 2001 Progress Report"* released in November 2001, set out a number of additional modifications to the commitment process for tax havens. The Report confirmed that commitments from tax havens would be sought only with respect to the transparency and effective exchange of information criteria to determine which jurisdictions are considered as uncooperative. It also stated that the potential framework of co-ordinated defensive measures would not apply to uncooperative tax havens any earlier than it would apply to OECD Member countries, noting that OECD Members retain the sovereign right to apply any defensive measures as appropriate, either within or outside a framework of co-ordinated defensive measures. These modifications do not affect the application of the 1998 and 2000 Reports to Member countries and non-member economies.

Today we can see that our willingness to listen to the concerns of the jurisdictions and to engage in an inclusive and constructive dialogue aimed at improving our processes while at the same time remaining firm on our core principles has had the desired outcome. We believe that all of the jurisdictions which have made commitments have done so in good faith and will fully implement them, so that by January 2006 they will have transparent regimes and be engaging in effective exchange of information on both criminal and civil tax matters. We will work with these jurisdictions first to develop implementation plans and then in the carrying out of those plans.

Exchange of Information is at the core of this project. For the last 18 months we have been working with eleven jurisdictions that took an early decision to commit to provide a legal framework that would facilitate the exchange information for tax purposes between OECD countries and committed jurisdictions.

The instrument has now been finalised and is available on the OECD's website (see [www.oecd.org/daf/ctpa](http://www.oecd.org/daf/ctpa)).

Whilst this is not a binding instrument and is intended to function as a model, we hope that financial centres throughout the world will strive to meet the standards of transparency and exchange of tax information that are set out in the instrument. We will use this instrument as a basis for an on-going dialogue with the committed jurisdictions to work towards the implementation of the standard.

During the course of this work we have developed a true partnership with the jurisdictions and their input into the instrument has been crucial in ensuring that it meets the objective of effective exchange of information without damaging legitimate business activities. We commend these jurisdictions for the decision they have taken and will continue to work closely with them.

We know that all of the committed jurisdictions have concerns about establishing a level playing field. We share these concerns. Financial services are extremely mobile and it is not in our interest that harmful activities move from a committed jurisdiction to a jurisdiction or a country which fails to meet the transparency and exchange of information standards. By having a very large number of onshore and offshore financial centres commit to the same principles, we have gone a long way to achieve a level playing field. At the same time, the framework for co-ordinated defensive measures will ensure that unco-operative financial centres will not gain a competitive advantage.

We are convinced that these commitments, particularly by the more sophisticated financial centers will, by enhancing their reputation, help them to prosper. To be sure, in cases where the financial activity is driven by the desire to conceal income or wealth from tax authorities, this type of business – what may be called exchange of information sensitive business – will move out of the committed jurisdictions. We accept that some jurisdictions may need assistance to implement their commitments. We have already engaged in a discussion with OECD Member Countries and international and regional organisations to put in place a framework for an assistance programme.

The List of Uncooperative Tax Havens (see Box 1) identifies 7 jurisdictions which took the political decision not to make a commitment at this stage of the project. The OECD encourages them to reconsider this decision and we are prepared to continue our dialogue with them. All that they need to do is to follow the lead of the committed jurisdiction by committing to transparency and effective exchange of information.

The List will be used by OECD countries to consider what measures they should now take to defend their tax bases. As agreed in the 2001 Progress Report, any framework of coordinated defensive measure will not apply to uncooperative tax havens any earlier than it will apply to OECD Member Countries with harmful preferential tax regimes. The Committee on Fiscal Affairs is currently examining how the defensive measures identified in the 1998 and 2000 Reports, and which already exist in many OECD countries, can be made more effective. It will review their implementation in Summer 2003.

The success of this project will benefit both developed and developing countries. By getting these engagements to change on the part of the offshore financial centres, we are helping to protect the tax base not only of OECD countries but also of developing countries. We also believe that by promoting transparency and cooperative agreements between all economies our work will contribute to efforts to counter money laundering and the financing of terrorism and will strengthen the international financial system.



## **Annex**



## Annex I

### Some commonly asked questions

Today the OECD issued its List of Uncooperative Tax Havens. It contains 7 jurisdictions which have made the political decision not to commit to the two key principles of fairness that OECD Member countries have been advocating: transparency and effective exchange of information. This annex provides some answers to commonly asked questions.

**Q1. There has been a lot of activity recently in the OECD's fight against harmful tax competition. I'd like to make sure that I have an accurate scorecard, regarding which nations are onboard and which ones are not. By my last count, the OECD had reached positive results with 27 of the 35 low-tax jurisdictions targeted in the OECD's June 2000 tax haven report. The 9 remaining jurisdictions were as follows: Andorra, Liberia, Liechtenstein, the Marshall Islands, Monaco, Nauru, Panama, Samoa and Vanuatu. Is that enumeration current and correct?**

**A.** No. The arithmetic is not simple. As of today we have 31 jurisdictions that have committed, 3 that we have agreed should not be on the List and 7 that have decided not to commit. So from your list you will have to delete Panama and Samoa.

**Q2. After so many delays you must be pleased to get out the List?**

**A.** There have been delays in issuing this List but we have been able to use the extra time – the original deadline was 31<sup>st</sup> July 2001 – to refine our process, to make it more politically acceptable and to deepen our understanding of the concerns of the offshore centers. The results of this dialogue can be seen today. Not in the List itself, but in the fact that we have succeeded in getting 31 jurisdictions – including the major offshore financial centers – to join OECD countries in committing to the principles of transparency and effective exchange of information.

**Q3. How should we interpret the List?**

**A.** This is a List of jurisdictions that have at this point in time taken the political decision not to commit to our two principles. We regret this decision and I hope that our dialogue can continue and that they will reconsider.

**Q4. What persuaded so many jurisdictions to commit?**

**A.** Dialogue. More dialogue and yet more dialogue. But also self interest. A recognition that it is in their long-term interest to enhance their reputation by confirming that they are committed to playing a constructive and responsible role as members of the global financial community. And clearly, the post 11 September environment has put a premium on transparency and co-operation.

**Q5. What are the consequences of making a commitment?**

**A.** We see the making of the commitments as the beginning of an on-going dialogue. We are committed to helping these jurisdictions fully implement their commitments and to providing the technical assistance that they may need. It is up to them to determine what their domestic systems should look like in terms of tax rates and other specifics, but having taken this decision we believe that they and we can work together to ensure a fair and level playing field based on fair competition in terms of tax arrangements.

**Q6. Some commentators have suggested that these commitments have not been made in good faith. Would you agree?**

**A.** No. The jurisdictions that have made these decisions have thought long and hard before doing so. The commitments have been made at the highest political level. The political authorities in these jurisdictions have analysed carefully what will be the implications for their economies. I am convinced that all of these commitments have been made in good faith. And, of course, we will be monitoring implementation so that by 1 January 2006 these commitments will be fully implemented.

**Q7. But what happens if a jurisdiction fails to live up to its commitments?**

**A.** The List is dynamic. That means that if a jurisdiction ceases to co-operate by failing to fulfil its commitments, it will be put on the list of uncooperative jurisdictions. Similarly the jurisdictions that are on the List can be taken off if they agree to abide by the two principles, and we hope that that will happen

**Q8. Why do you think many of the targeted jurisdictions waited so long to come to terms with the OECD? In other words, why weren't these agreements more forthcoming last year following the Barbados Consultation (January 2001)?**

**A.** The project has evolved since January 2001 both in the commitment process, which became far more politically acceptable to the jurisdictions (in fact they help us design the process) and in substance with the dropping of the no substantial activities criterion to to determine whether a jurisdiction would be identified as unco-operative..

**Q9. It also stands to reason that the threat of possible economic sanctions from OECD member states was a motivating factor — again, in that it forced the other side to deal with the issue. Would you agree?**

**A.** I do not like the term sanctions. What has been anticipated right from the inception of this work is that there will be defensive measures, measures which national governments – not the OECD – can take, if it is in their interest, to effectively enforce their tax rules and protect their tax bases. Many of these measures are already used by OECD Member countries and non-member countries. We are working on how to make these national measures more effective through a framework for implementing a common approach. We have agreed that these defensive measures will not apply to uncooperative tax havens before they apply to OECD countries that fail to remove the harmful features from their harmful tax practices. In practice, the use of these defensive measures will not arise before the summer of 2003

**Q10. So the defensive measures will apply to uncooperative OECD countries?**

**A.** At the end of the day there is only going to be one distinction: co-operative versus uncooperative.

**Q11. Some critics have charged that the OECD's use of deadlines and the threat of sanctions was heavy handed. Looking back, is it fair to say these tactics were necessary to keep the process moving?**

**A** We needed to encourage jurisdictions to come to the table. Our Member countries thought long and hard on what would be the most effective approach and concluded, as did the FATF, that we needed deadlines and a distinction to be made between cooperative and uncooperative jurisdictions.

**Q12. Occasionally we hear vague suggestions that the OECD has been "taking it easy" on Caribbean tax havens relative to their counterparts in the Asia-Pacific region. The supposed explanation is that many of the Caribbean nations have historical (colonial) ties to OECD member states. For the record, none of those charges have ever been substantiated. Would you like to take this opportunity to respond — assuring our readers that there has been no such bias?**

**A.** This is completely untrue. All jurisdictions have been treated equally, as can be seen from the consistency of the commitments made by the 31. Also do not forget that many European jurisdictions have very close ties with the UK and the Pacific Islands with Australia and New Zealand. I am also sure that the Carribeans would disagree that we have been "taking it easy" with them.

**Q13. There was a time when most of the intellectual debate regarding this project (apart from the political aspect) concerned its likely effect on tax rates? Critics charged that the OECD was trying to increase worldwide tax rates, starting with these 35 targeted jurisdictions. In fact, the presence of low (or no) tax rates was expressly listed as one of the four determining criteria in the OECD's April 1998 tax haven report. Since that time, however, we have witnessed several**

**jurisdictions, for example the Netherlands Antilles, co-operate with the OECD while at the same time LOWERING their marginal tax rates. My question is whether it's safe to say that this initiative is not about raising tax rates? And that the heart of the matter is really information exchange and fiscal transparency?**

**A.** There simply never has been any basis for the charges that the OECD was trying to raise tax rates or harmonise tax systems. Let's look at the facts. The project certainly isn't about raising or harmonising tax rates or systems, just take a look at the diversity of tax rates within the OECD. As you've noted, the Netherlands Antilles has lowered its marginal tax rates and other committed jurisdictions don't have income tax systems at all. This is a choice we respect. This project is not about dictating to countries what their tax systems or tax rates should be and it's not about unfettered access to information or invasion of privacy. It is all about fairness in taxation, and promoting an environment of transparency and co-operation where taxpayers can be sure that all are paying their fair share of taxes.

**Q14. Where is 'ring fencing' — another of the OECD's four original criteria set out in the 1998 tax haven report. Does the OECD still view ring-fenced regimes as inappropriate? Will they have to go by December 2005?**

**A.** Ring fencing is still applicable as a criteria to identifying harmful preferential regimes in OECD countries. As regards the offshore jurisdictions, the OECD Member countries would continue to welcome the removal of practices that are implicated by the no substantial activities criterion, but this is a choice for them to make.

**Q15. What are the implications for the Listed jurisdictions?**

**A.** First let me emphasize that the OECD is not slamming the door on these jurisdictions. Our objective was and remains to get all jurisdictions to commit. We regret that 7 jurisdictions took the decision not to commit at this time. But we remain open to continuing the dialogue with these jurisdictions and that dialogue is ongoing.

**Q16. Most of the countries that have come to terms with the OECD have agreed to undertake specific domestic reforms — either legislative or regulatory. In other words, most of the tax havens have promised to actually change the rules by which they operate. But a few nations, I think Barbados for example, seem to be dealing with the problem in a different way. The press release (dated January 31) announcing Barbados’s agreement with the OECD simply indicated that the country wouldn’t be included on the next version of the OECD tax haven blacklist — apparently WITHOUT undertaking any additional reforms.**

**My question is: are we dealing only with semantics here, or is there genuine substantive difference in what Barbados actually agreed to do - relative to the other nations?**

**A.** Barbados was not included on the list of unco-operative tax havens because, after careful review, we concluded that Barbados has transparent tax and regulatory systems and has in place a mechanism that enables it to engage in effective exchange of information. Barbados also stated that it was willing to enter into tax information exchange arrangements with those OECD Member countries with which it currently does not have such arrangements. Barbados has also made certain legislative changes that enhanced the transparency of its regulatory system. The bottom line is, there is no substantive difference here.

**Q17. Several years ago at a tax conference in New York I heard you offer a colourful metaphor for describing the fight against international tax evasion. You said it was a bit like trying to squeeze one end of a balloon — the air doesn’t go away, it simply moves to the other side. Does that analogy still apply today given the changes that have taken place?**

**A.** Harmful tax practices are like a balloon. Squeeze them out of one region and they may appear in another. Which is why we need a global response and welcome the willingness of countries as diverse as South Africa, India, Russia and China to work with us on this project.

**Q18. Given the highly mobile nature of investment capital and finance resources, is the OECD worried that the success of this project, to date, may inadvertently**



**work to the benefit of the uncooperative jurisdictions? In other words, aren't you broadcasting to the tax cheaters of the world that they will get caught if they operate in countries A, B, or C (those removed from the blacklist) — with the implication being that they'd be smart to shift their activity to countries X, Y, and Z (those still on the list)?**

**A.** This is a danger. But it is certainly less dangerous when 31 jurisdictions – almost all of the major financial centers – have committed to the project. Also, this is where the framework of coordinated defensive measures kick-in. This will make it increasingly difficult for tax cheats to operate out of uncommitted financial centers.

**Q19. I've heard that an official from the Isle of Man said recently that his government did not consider itself obligated to reform its fiscal regime until Switzerland (an OECD member) reforms its fiscal system – either by eliminating bank secrecy or by implementing significant withholding on crossborder payments. Is it accurate to be that blunt (is the linkage that direct)? Do any of the tax haven's commitment really hinge on Switzerland eliminating its bank secrecy?**

**A.** The OECD has negotiated all the commitments on the basis that there is no “most favoured nation treatment” concept.. The OECD would not accept a commitment to progress by any one country that is conditioned on the actions of all other countries. This project is about encouraging co-operation among as many countries as possible.

**Q20. What about the four countries that have abstained from the project?**

**A.** You have your numbers wrong here: It's only Luxembourg and Switzerland that have abstained. Belgium and Portugal signed onto the 1998 Report and the 2000 Report. Belgium and Portugal had some issues with the 2001 Report (mainly that we are too soft on the tax havens) but you need to ask them about those concerns. As for Luxembourg and Switzerland – you should ask them for their views. But I will say that they are participating in our discussions. They agreed to have some of their preferential regimes identified as potentially harmful.

**Q21. Coming back to the commitments, why does their language vary? Doesn't this lead to a lack of a level playing field?**

**A.** All of the commitments contain the same core elements. On exchange of information they contain an affirmation to achieve effective exchange on both criminal and civil tax matters – thereby bringing countries up to widely accepted standards, as many commentators have remarked. On transparency, they contain an agreement that information on beneficial ownership will be accessible and that entities must keep accounts and these must be audited or filed. Also all these jurisdictions have undertaken to get access to bank information.

**Q22 When do these commitments become operational?**

**A.** We expect these commitments to be fully implemented by January 2006, although many jurisdictions are going for a staged implementation. You may say that 4 years is a long time to wait but we believe it is only fair to give these jurisdictions time to adjust.

**Q23. Aren't these commitments going to have negative effects on some of these economies?**

**A.** Insofar as their business is driven by a desire to cheat on the taxes due by residents of other countries, yes. But making a commitment can be good for business. It enhances the reputation of the OFC and sends a strong signal to the international community that they want to play by the rules. Let's not forget that many of the jurisdictions – Cayman Islands, Bermuda, Bahamas, Gibraltar, Malta, Cyprus, the Isle of Man, Jersey, Guernsey to name but a few – have carved out market niches for themselves, and have been able to attract legitimate business. Our work in no way threatens such business.

**Q24. What happens as regards the jurisdictions' participation in the Global Forum.**

**A.** Each commitment clearly states that committed jurisdictions will participate on an equal basis with OECD countries in the OECD Global Forum on the design of internationally accepted standards for the implementation of their commitments.

**Q25. How will some of the small islands be able to implement their commitments?**

**A.** We have made a commitment to assist them in developing their information-reporting requirements and in setting up mechanisms for the exchange of information. This will be an on-going programme and one what I hope will cover not only the tax side but also money laundering and related financial issues. We will also work with them, if they so wish, to improve the effectiveness of their tax systems.

**Q26. We understand that all of the currently [31] offshore financial centres have agreed in their commitments to enter into information exchange agreements with OECD countries. Is that correct?**

**A.** Yes

**Q27. Can you explain what that means?**

**A.** Sure. It means that through such agreements tax authorities in OECD member countries will be able to ask offshore financial centres for information, including bank information, that would be relevant in connection with any ongoing specific tax investigation. Of course, such exchange of information will be subject to all the usual safeguards, for example confidentiality and no fishing expeditions.

**Q28. Why does this matter to OECD countries?**

**A.** Well, let's be very pragmatic and look at the numbers. The conclusion of these agreements permits OECD member countries to enforce their tax laws more effectively. Remember that the IRS estimates that the US government alone loses 70 billion dollars a year in taxes due to undeclared income held in tax havens.

Let's also look at this project in its context. This project means raising revenue without raising taxes. It means being able to maintain or reduce tax rates to stimulate growth and job creation and at the same shoulder the costs of public services, defence and fighting terrorism. It means treating all taxpayers equally, both in law and in practice. This, I think, is why this project matters for the average taxpayer, the honest taxpayer.

**Q29. We understand that you are developing a legal framework for the Exchange of Information:**

**A.** Correct. Exchange of Information is at the core of this project and for the last 12 months we have been working intensely with 11 committed jurisdictions to develop an instrument which could act as a model for countries working to negotiate exchange of information agreements with committed offshore financial centers. We hope to make public this instrument today.

**Q30. What is next? How will the endgame be played out? Any predictions for the future?**

**A.** The next steps are to work with our Member countries to assist them in removing any harmful features of their preferential tax regimes by April 2003 (in fact some have already made changes) and to intensify our dialogue with major financial centers outside of the OECD. Will this be an end game: no. This must be an on-going effort since there is always the risk that new tax havens will emerge. Predictions for the future. I would like to see an environment where offshore jurisdictions engage in an on-going dialogue with OECD countries. Where all jurisdictions feel engaged in the fight to promote transparency and cooperation. And where we all aim for the same objective; fairness in taxation and open and transparent competition which relies on quality of service and not strictness of secrecy

Mr. Jeffrey Owens  
Head, CTPA  
Division des Affaires Fiscales  
Organization for Economic Cooperation and Development - OECD  
France  
E-mail: jeffrey.owens@oecd.org

*Case study:*

*TOPIC 3.2*

## **THE COMBAT AGAINST HARMFUL TAX PRACTICES**

**Estelabel Piad Herbruger**  
General Director  
General Directorate of Revenues  
(Panama)

*CONTENTS: Introduction.- Tax and Financial Structure: The OECD Initiative.- Some comments on the OECD Initiative.- Panama's position in regards to the OECD Initiative.- Commitment of the Republic of Panama with the OECD Initiative.- Our commitment is supported on the following bases: Tax information exchange agreements.- Conclusions.*

### **INTRODUCTION**

The Republic of Panama is located in the Central American Isthmus. Its total surface is of 75,517 square kilometers and its total population is of 2,809,280 habitants, pursuant to the 1999 Census. It is a founding member of the United Nations.

This is a formal country, constituted as representative democracy, with independent powers.

Among the factors that condition Panama's economic and social development, we mainly have, the non-existence of natural resources, its small territory and scarce population. The globalization process and the economic freedom traditionally adopted by Panama, has mainly affected small industrial and agriculture sectors.

Notwithstanding, Panama has a privileged geographic location, the existence of the Canal and the US Dollar as legal tender since 1903, therefore, since its independence it has directed its juridical framework towards the existence of a place fit for the transaction of legal business and specially to the promotion of provision of services, obtaining in this a greater competitive opportunity in the world market; and this constitutes a fundamental element for its economic growth and to improve income allocation.

The services sector constitutes the largest portion of the Gross Domestic Product; its components reach around 80% thereof. In spite of its structural economic dependence, the country has entered into the economic globalization trend and to reduce the State's role in economic activities, this was mostly done in the 1990's, where the important privatization process of public companies (mainly in the energy, communications and port sectors) was carried out

#### **Tax and Financial Structure:**

The Political Constitution of the Republic of Panama expressively establishes the enforcement of the tax legality principle, in such manner that no decree or juridical order or administrative resolution, may alter legally established provisions.

Tax pressure reaches an average of 12% of the GDP (without including social security contributions); income tax constitutes the Central Government's main income.

The territorial source principle is applied. Said principle is applied as tax criteria exclusively for residents and non-residents. In this regard, the Panamanian tax system different from other does not distinguish between nationals and foreigners.

The progressive rate scale for individuals varies between 4% and 30%. Whereas, for bodies corporate a 30% rate applies. Said aliquots are consequential, comparatively speaking, with the rates in force in compared legislations.

As well as other countries, there legal regimes for the promotion and development of specific sectors, such as tourisms, construction, reforestation and the agriculture sector, supported on tax benefits available to residents and non residents as well.

There is a solid financial structure, supported on juridical provisions and advanced technical principles, mainly directed to prevent the use of bank entities for illegal purposes. Many of the world's most important bank entities are established in Panama through significant physical structures. Panama's international bank center includes over 80 national and foreign institutions, concentrating credit and private banking operations.

The legislation in force establishes and fines offenses in all its forms, including tax fraud.

It is important to point out that banking legislation and its regulations, have determined that banks institutions should currently comply with 23 of the 25 recommendations of the Basle Committee (extreme that has been achieved by few countries in the world), must be on their way in complying with the two pending recommendations during the current year.

With the same emphasis and by taking into consideration that money laundering generally involves fraudulent tax evasion, there is modern legislation to specially prevent and repress money laundering.

In this regard:

- The Financial Analysis Unit has been created, the same is ascribed to the Residency of the Republic, and information exchange agreements on suspicious capital whitewashing operations have been signed with homologous entities in different countries.
- We must confirm that Panama has been withdrawn from the Financial Action Task Force list of the OECD and it has been the first Latin American country to receive the approval from the US Internal Revenue Service, so that banking entities established in Panama can request from the IRS their registry as Qualified Intermediaries.
- The Inter-American Mutual Assistance Convention on Penal Issues has been ratified and different mutual legal assistance agreements on penal issues are in force, as well as reciprocal investment protection treaties.

In the strictly structural aspect of the tax system, Panama has proposed a program to modernize the Panamanian Tax System, to make it more modern, neutral, equitable, efficient and effective, that:

- Frames the administrative actions of the Government to push the Panamanian economy to new levels of well-being.
- Allows the State to thoroughly comply with its responsibilities as a nation.
- Grants to the entrepreneurial sector competitiveness conditions to continue strengthening and sustained growth.

The Panamanian Government recognizes that the central axis of the Tax System is the Tax Administration, which is undergoing a complete restructuring process, vis-à-vis its technical, examination and collection processes, as well as direction, management control and administrative support processes, human resources and information systems.

This process began in January 2000, and its main objectives are:

- Implement in the DGI sufficient controls to fight fiscal evasion.
- Implement in the DGI controls to recover its delinquent portfolio.
- Establish in the DGI efficient and effective administrative systems.
- Have integrated and efficient information systems available.

### **THE OECD INITIATIVE**

In response to a request from the governments of the seven most developed countries of the world (G-7), the OECD prepared and published in 1998 report titled "Harmful Tax Competition: an Emerging Global Issue." Said report was complemented with others published during 2000 and 2001. The same must be added to the list of "non-cooperating tax havens" and many tax information exchange model treaties, disclosed last April.



The aforementioned background contains what has been called the “The OECD Initiative” (The Initiative). The conclusions that may be extracted from the same are summarized as follows.

**(a)** The Initiative defines harmful tax competition, stated in geographically mobile activities such as financial services and others, highlighting the damages that the same causes to the tax revenue of all countries.

According to the 1998 report, harmful tax competition is developed through the existence of “tax havens” and “harmful preferential tax regimes”. The 2001 Report contained a list of 35 jurisdictions identified as “tax havens” and the other list of **47 preferential harmful tax regimes identified in 17 of the OECD member countries**. Countries that were branded as tax havens did not form part of the definition or evaluation.

**(b)** The 1998 report suggests possible measures that the affected countries could adopt (“defensive measures”), to counteract the effects of the harmful tax competition developed by other countries through tax havens and harmful preferential regimes.

**(c)** The Initiative considers that the transparency of the fiscal systems (basically through authorized access from tax administration offices to information on financial entities and beneficial owners of corporations and other entities) and international cooperation through the effective exchange of tax information, constitute the fundamental principles to counteract the effects of harmful tax competition and assure that all countries may collect their own tax revenues at greater ratios.

**(d)** Up to April 2002, the OECD kept Panama on the list of non-cooperating countries in the struggle against fiscal evasion, all this made countries such as Mexico, Venezuela, Brazil, Argentina, Peru, Italy and Spain impose a surtax on banking transactions that originated in Panama, this made the Panamanian banking system’s competitiveness decline.

**(e)** In April last year, the OECD disclosed a list of seven jurisdictions that had not formulated its commitments with the transparency and information exchange principles, branding the same as “non-cooperating tax havens”, subject to the application of future defensive measures coordinated by its member countries as from April 2003.

### **SOME COMMENTS ON THE OECD INITIATIVE**

**(a)** It may be true that harmful tax competition is a problem that affects all countries, it is very clear that it acquires greater significance for developed countries and those countries that in addition to the territorial source principle, apply to their residents the principle of domicile as a binding tax criteria.

In effect, the economic globalization process basically implies the worldwide extension, of the activities performed by transnational companies, generally these companies have their “domiciles” in countries where the domicile principle applies. It is obvious that the tax administrations of the Head Offices’ countries of said companies have difficulties to identify operations subject to the payment of taxes, since most of these operations are generally performed beyond their borders. Whereas, for countries that exclusively apply the territorial source principle to residents and non-residents, the problem does not have further relevance, since foreign revenue sources are not taxed and the antecedents to determine taxes are basically within the borders or at the reach of tax administrations. Therefore, we can see the importance that the “harmful tax competition” definition holds in different international venues. In Panama, for example, “price transfer” mechanisms are applied to this effect; we even follow the guidelines provided by the OECD.

**(b) The concept of “tax haven”.** The Initiative establishes different criterion to identify tax havens, there are authorized opinions regarding the difficulty to reach a consensus in this sense. During different CIAT meetings, top tax administration officials from OECD member countries, have highlighted said difficulties, stressing that in the practice all countries have the elements that characterize them as tax havens. Recently a draft bill from Poland, includes a clause that prohibits VAT exemption in certain transactions, when the payment thereof is directed to countries listed as “unfair tax competition” countries. The list includes countries such as Germany, Belgium, France and The Netherlands

Similarly, it is interesting to point out that the original OECD list contains 35 jurisdiction branded as “tax havens”. However, member countries such as Spain, France, Italy and Mexico and other non-member countries such as Argentina, Brazil, Peru and Venezuela, have their own “tax havens”, “no or low tax paying countries”, low taxation jurisdictions” or “favorable taxation countries” lists, which include in all

cases, many more jurisdictions than those that appear on the OECD's list. This has resulted in the fact that in the practice the OECD model to unilaterally determine a tax haven is being used by its member countries and others for the application of commercial restrictions to transactions originated in countries such as Panama. This, as we have warned on different occasions may be in violation of international trade agreements.

### **PANAMA'S POSITION IN REGARDS TO THE OECD INITIATIVE**

Panama is also aware that as a result of the globalization process, today more any ever, international cooperation is fundamental to assure the proper operation of all social and economic variables, as a necessary instrument not only to guarantee compliance with tax obligations, but and fundamentally, to reduce poverty and other scourges that specially affect developing countries, which precisely constitute, most jurisdictions included in the OECD's lists and that of its member countries. As recently stated by the Deputy Director General of the IMF, "in addition to being a moral issue, today it is well known that the reduction of poverty is a necessity for peace and security".

The National Government has affirmed on many occasions, during work meetings with the OECD that this organization had to lay the basis for its decision to include Panama in the non-cooperating countries lists in the fight against tax evasion. The National Government reiterated its firm rejection to the publication on behalf of international organizations of which it is not a party, of unilaterally prepared lists and the announcement of "defensive" measures of this organization against the national sovereignty; and in possible violation with World Trade Organization standards.

Similarly, the Government has shown its willingness to work with the international community to solve, in an agreed and equal manner, common problems, to allow the continuous social and economic development of the country, **but these should not represent a threat to Panama's economic stability.**

On April 16, 2002, the National Government sent a note addressed to the Secretary General of the OECD where it expressed Panama's commitment in undertaking the principles of transparency and exchange of information for tax issues, conditioned to the strictest equality and non-discrimination guidelines. This means that said principles must be

applied in the same context to all European, North American and other international service centers, which currently do not apply them.

### **COMMITMENT OF THE REPUBLIC OF PANAMA WITH THE OECD INITIATIVE**

Panama's commitment ratifies two fundamental elements of the State position. On the one hand, the importance of international cooperation in crime prevention in all its forms; and on the other, the need for said cooperation to be developed in a scenario of equity and non-discrimination (level playing field).

#### **Our commitment is supported on the following bases:**

**(a)** The respect to our country's autonomy to apply the tax system that is most adequate to its fundamental economic interests, in what respects to the protection of the same is a matter of public safety. In that sense, like many authorized opinions, we consider that **the unilateral application of measures against our country, constitutes a clear violation of international agreements and of International Law standards**, reason for which Panama reserves the right to file the pertinent remedies against the same.

**(b)** The compliance with the principles of transparency and effective exchange of information must be developed in a scenario of equity and non-discrimination, in other words a "level playing field" that covers all sources of the same. Like, for example;

- Panama will not be subject to the coordinated framework of defensive measures proposed by the member countries.
- Panama will be invited to participate in conditions of equality, in the discussions of the Global Forum or in other similar forums of the OECD member countries and of non-member countries and jurisdictions, that deal with the design of internationally accepted principles for the implementation of the same and whichever other similar commitments.
- Those jurisdictions, including OECD member countries and other countries and jurisdictions to be identified that, either do not enter into similar agreements or do not meet the standards

of the 1998 OECD report, will be subject to a coordinated framework of defensive measures by the OECD member countries.

- It is fundamental that the OECD in agreement with all the member and non-member countries and jurisdictions involved in the matter, develop the procedures aimed at verifying:
  - (i) On the one hand, the effective compliance with the commitments assumed, not only by the OECD member countries and by the jurisdiction of the 2000 list, but also by the jurisdictions not included in said list before 2000 and others that be identified in the future, particularly taking into account jurisdictions that are included in the current lists of OECD member and non-member countries; and on the other.
  - (ii) The effective application of the coordinated defensive measures by the member countries.

Without these safeguards, the OECD initiative would frustrate and the harmful tax competition would become a truly “unfair” tax competition, particularly for countries that substantially compete in the rendering of services in the international market.

Just like it is evident in practically all commitments made before the OECD, Panama’s will be conditioned to the pertinent approval of the legal standards that be necessary for their implementation and that will be proposed to that effect by the Executive Branch.

### **TAX INFORMATION EXCHANGE AGREEMENTS**

The tax information exchange agreement constitutes the instrument that makes the effective compliance of the transparency and exchange of information commitments possible.

The OECD’s information is important in what respects to the formulation of information exchange models that serve as a reference framework for the negotiation of treaties, even though the process for its elaboration was not open to all countries and jurisdictions included in the 2000 list.

**It seems important to us that**, as part of the “level playing field”, with the participation of all countries and jurisdictions **involved the formulation of a multilateral treaty could be arrived at**, which would include the juridical approval of all of them, avoiding the need for each bilateral agreement to possibly be subject to approval by the law, as required by the constitutional precepts of many countries.

In the meantime, we believe that the bilateral agreement model constitutes a basis for the negotiation of treaties that particularly take into account the singular characteristics of each contracting party, particularly including the very important difference the exchange has for countries that apply different binding tax criteria.

In this sense, we believe that the key elements for the success of any bilateral treaty negotiation, are the following:

- Possibility of agreeing upon definitions of the taxes and taxation matters covered by the agreement. It is particularly important, that each agreement contains a definition of “criminal tax evasion” (as there is one for example, in the information exchange treaties entered into by the U.S. with Cayman Islands and British Virgin Islands and in the comprehensive treaty in force between said country and Switzerland). It is also very convenient that a precise definition of “other tax matters” (civil tax matters) is arrived at.
- With the main purpose of eliminating the possibility of “fishing expeditions”, the relevance of the information required must be proved in each application, to which effect it would be very convenient that there be a precise definition of the term “relevance”. It must be pointed out to that effect, as is pointed out in some commitments with the OECD, that many countries currently count with international agreements in force on diverse matters, through which information is exchanged that could be considered as information related to tax issues.
  - Expressly establish the reasons why a country can deny a reply to a request;
  - Ensure the confidentiality of the information supplied, avoiding undue use of the same by the requesting party;
  - Establish full reciprocity in concessions agreed upon;

- Without detriment to the possibility of unilateral withdrawal from the agreement by whichever of the contracting parties, which is foreseen in all treaties, there must be provisions in every agreement, which allow for the revision of the same when the transparency and information exchange commitments established in the agreement, are not equally assumed by other countries or jurisdictions with which the parties are in substantial competition in the international market.

## **CONCLUSIONS**

The position of the commitment assumed by the National Government is the result of a sensible and responsible evaluation of the endogenous and exogenous factors that have a bearing in the relations as part of the international community.

In a note sent to the Secretary General of the OECD on April 16, 2002, the National Government expressed that our commitment of embracing the principles of transparency and exchange of information for tax matters, is conditioned to the strictest parameters of equity and non-discrimination. This means that said principles must be applied in the same context to all European, American and other international service centers, which currently do not apply them.

Consequently, the commitment letter signed by Panama is based on the principle of equity and transparency, subject to equity among countries and where the necessary mechanisms will be established so that all the countries are treated equally.

Those jurisdictions, including OECD member countries and other countries and jurisdictions to be identified that, either do not enter into similar commitments or that do not meet the standards of the 1998 OECD report, will be subject to a coordinated framework of defensive measures by the OECD member countries.

The implementation of the commitments assumed by the National Government will take place in a period that will end on December 31, 2005, and those commitments that are not foreseen in the national standards in force, will be subject to the consideration and approval of the Legislative Assembly. It becomes necessary for the Executive Branch, the Legislative Assembly, other State agencies, and the civil

society to take actions aimed at preserving and promoting those conditions that allow Panama to continue lending services on a base of competitiveness and equity.

In that sense, it has been made clear that the compliance with the commitments Panama assumes must not affect the political, economic and social stability of the country. Consequently, Panama is determined to protect its economic interests and its tax autonomy, in any negotiation with the OECD and with its member countries.

Panama will be invited to participate in conditions of equality in the discussions of the Global Forum or in other similar forums of the OECD member countries and of non-member countries and jurisdictions, that deal with the design of internationally accepted principles for the put into practice of the same. Likewise, Panama will not be required to collect taxes on behalf of foreign countries, nor establish legal procedures with that purpose and shall therefore not be subject to the coordinated framework of defensive measures by the OECD member countries.

In its responsibility for carrying out the execution of the agreement with the OECD in a level of the most absolute equity, Panama reserves the right to decline the fulfillment of the commitments when the compliance of the respective commitments by the OECD member countries and of the jurisdictions included in the "tax haven" lists prepared by the OECD have not been implemented, as well as those of other countries and jurisdictions that could be identified in the future.

The signing of the commitment with the OECD supposes for Panama, the beginning of a new stage where its international image is consolidated as a sovereign and serious country that reiterates to the international community, its capacity as a first-class financial center.

Ms. Estelabel Piad Herbruger  
General Director  
General Directorate of Revenues  
Panama  
E-mail: [epiad@mef.gob.pa](mailto:epiad@mef.gob.pa)



*Case study:*

*TOPIC 3.3*

## **INFORMATION SYSTEMS TO SUPPORT INTERNATIONAL COOPERATION**

**Antonio Seco**  
Consultant  
CIAT Executive Secretariat

*CONTENTS: Introduction.- National and International References.- VIES (VAT Information Exchange System).- SINTEGRA (Integrated System of Information Exchange on ICMS). Objectives of the i-taxXML system.- Basic Functions.- Operational Model.- Technological Model.- Exchange Mechanism.- N-tier structure.- Modeling of the i-taxXML Vocabulary.- Structure of the Vocabulary.- Elements of Control, Actions and Reactions Implemented.- Coupling Syntax of the XML Elements.- Steps for Modeling Documents.- Examples of Information Exchange Using i-taxXML.- On-line Inquiry of Elements of the Taxpayer File.- Security Considerations.- Final Comments.*

### **Summary**

The growth of international electronic commerce and economic globalization require that the national tax authorities expand mutual assistance in order to improve the effectiveness of tax management, with the systematic exchange of information being essential in this context. This paper proposes the architecture for an international system of information exchange between tax authorities called, **i-taxXML**, based on nonpersistent XML documents, Internet and associated standard technologies. International treaty models and similar regional systems are examined, that result in the proposal of an operational and technological model and a simplified vocabulary based on XML elements, initially structured by means of oriented graphs, subsequently modeled through the use of the standard W3C

*XML Schema*, with the presentation of examples of ***i-taxXML*** documents. Also discussed are aspects of security and additional works which may strengthen the proposed architecture are identified.

### **Password**

Electronic commerce, Economic globalization, Taxation, Exchange of information, ***i-taxXML***

### **INTRODUCTION**

The growth of electronic commerce and economic globalization pose great challenges to the tax authorities, which, along with the new information technologies, also represent opportunities for improving the tax management processes. A study on information technologies applicable to taxation of electronic commerce may be found in [Seco,2001]. One of the potential improvements identified is based on the need to expand and generalize international assistance agreements between tax authorities for the systematic exchange of information, to thus avoid or minimize the intentions to commit fraud, evade or avoid taxes in international commercial operations.

Such vision is corroborated in the list of recent international specialized seminars, such as the “CIAT Technical Conference - 2001<sup>1</sup>”, which counted on the participation of tax authorities from throughout the world, in addition to representatives from international organizations, held in October 2001 in Spain. The Conference’s program proposed the discussion of the topic: “New technologies and exchange of information between Administrations”, as essential aspect for an effective tax management.

An alternative for implementing this requirement would be the structuring of an international information exchange system, which would be open and easily expandable and would use the Internet and standard technologies associated thereto.

This paper presents an architecture proposal for a system called ***i-taxXML***, based on a common vocabulary and organized under the

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<sup>1</sup> *Inter-American Center of Tax Administrations – Conference Program available at <http://www.ciat2001.aeat.es/restemarios/home.html>*

form of XML (*eXtensible Markup Language*)<sup>2</sup> documents. The functions of the system were developed in accordance with successful regional experiences and recommendations of specialists which resulted in proposals of management model and technological model.

The technological model defines “actions” (service requirements) and “reactions” (responses to each requirement), implemented in XML documents and transported in HTTP (*Hyper-Text Transport Protocol*). The required XML documents are modeled through the W3C<sup>3</sup> *XML Schema* standard, with the support of oriented graphs and descriptive techniques. Some *i-taxXML* documents for implementing some functions are given as examples. To conclude, security aspects are discussed, as well as possible future requirements for strengthening the architecture and expanding the system’s purpose.

## NATIONAL AND INTERNATIONAL REFERENCES

In international tax management of conventional trade the need was already felt for mechanisms of cooperation and information exchange between tax authorities of different jurisdictions. Bilateral and multilateral agreements between countries or groups of countries with common interests, were signed for promoting mutual assistance in tax management. The forms of information exchange are mentioned in [Lozano,2001]:

- Sporadic exchange: the competent tax authority asks a specific question;
- Automatic exchange: agreed information is sent in a systematic manner;
- Spontaneous exchange: information deemed of interest to another State is sent thereto;
- Simultaneous examinations: the examination of businesses is organized with the participation of officials from different States.

Model agreements of this nature were developed by the OECD (Organization for Economic Cooperation and Development) and UNO (United Nations Organization), which, although intended for specific tax information, may be used for a broad information exchange. More

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<sup>2</sup> Description and specifications at <http://www.w3.org/xml>

<sup>3</sup> World Wide Web Consortium – <http://www.w3.org>

recently, CIAT (Inter-American Center of Tax Administrations<sup>4</sup>) disseminated the “CIAT Model Agreement for Tax Information Exchange”, proposed for adoption by the member countries of the organization. The model includes procedures for requesting the exchange of information and for specific and simultaneous examination. The information to be exchanged and the details of the examination procedures are not part of the model, but are rather the subject of negotiations between the parties involved.

In this respect, two regional agreements are important, since they deal with the periodic delivery of specific and fully identified information and are formally based on computerized systems and communications networks.

### **VIES (VAT INFORMATION EXCHANGE SYSTEM)**

The VIES system was adopted by the countries of the European Community in 1993, for the exchange of information on Value Added Tax. Following the elimination of physical barriers between those countries, it was necessary to count on a system that would continue to provide information on the purchase and sale of goods and services, since the consumption tax continued to be fully absorbed by the country of destination or consumption of the good or service.

This system was based on an X.25 data communications network, built and operated by third parties, which connects the tax administrations of the member countries of the Community. Two basic services are offered through this network:

- On-line access to some cadastral data of companies registered in the member countries;
- Periodic exchanges of batches of invoices of trade transactions carried out between each pair of countries.

The request for information or interventions not included in the system are negotiated by other means (FAX, e-mail, etc.), there being no standard or recommended language.

The network and system are operated at the central level, at the headquarters of the Community in Brussels, by an independent

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<sup>4</sup> <http://www.ciat.org>

company with no access to the data exchanged in the network. Management of the system has been entrusted to a Management Committee formed by representatives of the participating tax administrations who periodically meet in Brussels. [Neves&Rodrigues,1997].

### **SINTEGRA (Integrated System of Information Exchange on ICMS)**

The main tax in Brazil, as regards collection, the ICMS (Tax on the Circulation of Goods and Services), is administered by the Brazilian states and because of its characteristics, it requires constant mutual assistance between the state tax administrations, for interstate trade management. The forum for discussing issues relative to the tax is CONFAZ (National Council of Finance Policy), formed by the Minister of Finance and the Secretariats of Finance of the 27 Units of the Federation (States and Federal District). Since 1995, there was a provision in force requiring taxpayers carrying out interstate trade operations to send diskettes with specific information to the corresponding state tax administrations (Agreement ICMS 57/95). Only a few taxpayers complied with this provision, while the Finance Secretariats did not demand its compliance either, mainly because they lacked the administrative and operational capacity for dealing with the information requested.

In 1997, the creation of SINTEGRA was decided, for the purpose of automating assistance between the Brazilian state tax administrations. The SINTEGRA was conceptually structured according to the VIES model. It expanded the services offered between tax administrations, provided new services to the taxpayers and upgraded the level of technology used.

This system is based on an Intranet in VPN (*Virtual Private Network*), mounted on a governmental network of national scope, although maintaining the constitutional autonomy of the Units of the Federation. In computer terms, this autonomy is represented by the nonexistence of a central data base and therefore, each Unit has its data bases and exchanges data with the others through the network. Taxpayers may access the services intended for them via Internet. Services offered between tax administrations through Internet are:

- On-line access to cadastral data of companies registered in the States and the Federal District;
- Periodic exchanges of batches of invoices of trade transactions carried out by each pair of States;
- Standardized system for requesting fiscal actions, including follow-up;
- Standardized system of examination of exchanged information for detecting indications of fraud;

Taxpayers are allowed to consult, via Internet some tax file data on companies registered in each of the 27 Units of the Federation, verify and recover algorithms for generating tax file numbers and access to specific legislation. The public *site* for accessing these services and obtaining additional information on the system is <http://www.sintegra.gov.br>

The system is managed by a Working Group formed by representatives of the participating States, in the sphere of CONFAZ.

Both systems presented are examples of successful cooperation between the tax administrations. The development of electronic commerce and globalization aggravate this need for mutual assistance, now at the international level.

The XML technology is also gaining importance in the sphere of information exchange between the tax administrations and the taxpayers. The taXML system, promoted by the IRS, will allow this modality of exchange and the respective vocabulary is currently in the final phase of definition.

### **OBJECTIVES OF THE *i-taxXML* SYSTEM**

The ***i-taxXML*** system's main objective is to allow the exchange of information between national tax authorities serving as support for the implementation of multilateral assistance agreements. It is based on the following premises:

- Use of Internet as communications network;
- Use of international technological standards;
- Based on the exchange of XML documents;
- To allow modular expansion (gradual inclusion of new documents);

### **Basic functions**

After the analysis of the aforementioned national and international references, the following functions to be included in version “0” of the **i-taxXML** architecture were selected:

- On-line inquiry of predetermined elements of national taxpayer files;
- Request for tax examination (auditing), it being possible to attach invoices and images of relevant documents;
- Follow-up of request for tax examination;
- Sending of result of request for tax examination;
- Sending of unrequested information (spontaneous exchange), it being possible to attach invoices and images of relevant documents.

To avoid interruption of a tax authority’s operation due to excessive requests for tax examination, the assistance agreements to be entered into may specify maximum periodic numbers of requests, which must be controlled by the computerized system.

These functions must be implemented through mechanisms ensuring the confidentiality and integrity of the data and identification of the tax authorities involved.

### **OPERATIONAL MODEL**

It is advisable that **i-taxXML** be operated by a special administrative unit created in each tax authority.

This operational unit, generically called INTERNATIONAL LINKING UNIT (**ILU**), would be responsible for:

- Maintaining the system in operation, according to the previously specified standards;
- Analyzing the requests received and directing them toward the pertinent local administrative unit for attention;
- Providing the system with information on status of progress and definitive responses to each request received;
- Compiling statistical and performance data;
- Interacting with the local information technology team to ensure effective operation of the system;

- Making the necessary contacts with the other ILUs to guarantee adequate functioning of the system.

**Figure 1** graphically represents the operational role of the ILUs and their main interfaces.

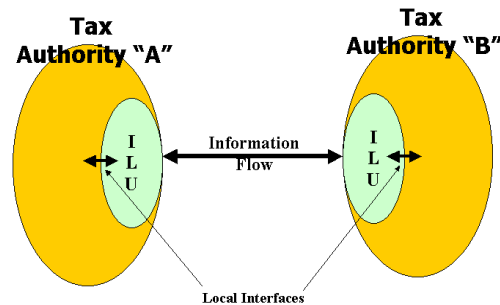


Figure 1: The role of the ILUs

It would be desirable to integrate ***i-taxXML*** to the computerized tax system of each participating country, to better automate some functions of the system.

Since ***i-taxXML*** is a system for exchanging information between national tax authorities, it requires an encompassing management structure with representation from all the participating countries. Such management structure, represented by a Managerial Committee, could be created within the sphere of an international organization which would have the adequate organizational infrastructure, in addition to experience in the establishment and support from similar groups. The main responsibilities of the Managerial Committee would be:

- Disseminate the standards adopted;
- Render feasible an adequate forum for the exchange of experiences in relation to the use of the system;
- Determine model agreements for adherence to the system;
- Propose financial support mechanisms to be assumed by the participating tax authorities;
- Propose security and privacy policies to be adopted by the participating tax authorities for the protection of information dealt with in the system;
- Evaluate proposals for modifications or expansions;
- Promote technological evolution.



## TECHNOLOGICAL MODEL

The *i-taxXML* proposal is based on the use of Internet and standard technologies linked to it, to facilitate the exchange of information between national government authorities in a typically G2G (government-to-government) system. The information exchanged appears on nonpersistent XML documents, transported in HTTP protocol.

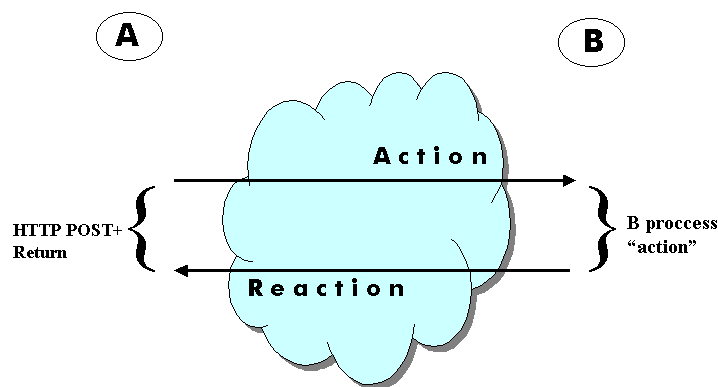
The architecture of the system was influenced by technological models developed for B2B electronic commerce *frameworks*, based on XML documents, such as cXML [Ariba,2001] y RosettaNet<sup>5</sup>.

### Exchange Mechanism

The exchange will take place through simultaneous action/reaction transactions whereby an *action* document sent to an *i-taxXML* server must immediately respond with a *reaction* document, which informs the transmitter whether “action” requested is accepted or not and, if the “action” were for an immediate response, it also sends the information requested.

The action/reaction scheme based on the HTTP protocol, is represented in **Figure 2**.

FIGURE 2: *i-taxXML* “action” / “reaction” Model

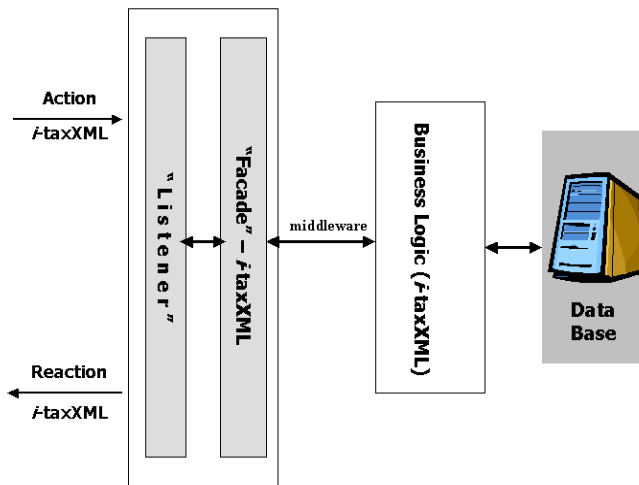


<sup>5</sup> <http://www.rosettanet.org>

### ***n-Tier Structure***

The service may be implemented on the basis of the generic architecture for services on the Web, proposed in [Vasudevan,2001], and represented in **Figure 3**.

FIGURE 3: Architecture proposal – ***i-taxXML*** service



In this representation, the "listener" would be a general use routine for receiving / sending messages through Internet; the "façade" of the business logic represents a preliminary validation of messages received (it being possible that a reformulation could exist or not) and the direction for treatment by the "business logic". The ***i-taxXML***'s "business logic" supports the proposed "action" and "reaction" mechanism and its interface with the data base system used. Since the ***i-taxXML*** is oriented toward messages (nonpersistent data), information may be stored in relational or native XML data bases.

The *n-Tier* (functional multilayers) is the structure recommended for developing the applications related to the ***i-taxXML***.

The proposed architecture is independent from specific programming languages and data bank systems. The servers to be used and the location of layers in each of them depends on the local context of each tax authority and the expected load on the system.

## MODELING OF THE *i-taxXML* VOCABULARY

The adoption of a common vocabulary renders feasible the semantic uniformity in the exchange of information within a community which, in this case, consists of tax authorities from different countries. The modeling of an XML vocabulary comprises the definition of the elements used, their specification in terms of attributes and types of data, and the structuring of possible links between them for the composition of XML documents.

### Structure of the Vocabulary

The proposed vocabulary for *i-taxXML* is represented by XML elements and their attributes, organized under the form of XML documents. The information exchanged is included in an *i-taxXML* (root element) envelope, which leads to a request for “action” or the respective “reaction”. Since it is a system oriented to international usage, the elements of the documents (vocabulary) will be primarily given in **English**.

The structure adopted for the documents takes one of the following two general forms:

#### Action-type documents:

```
<i-taxXML>
  <Header>
    <!--Header information -->
  </Header>
  <ActionType...>
    <!--Action information -->
  </ActionType...>
</i-taxXML>
```

#### Reaction-type documents:

```
<i-taxXML>
  <Reaction>
    <Status>
      <!--Status information -->
    </Status>
    <ReactionTaxFileInfo>
      <!--only in reaction to request for file data -->
      <! .... elements containing file information ....>
    </ReactionTaxFileInfo>
  </Reaction>
</i-taxXML>
```

Given the nature of the transport mechanism used, the “reaction” document does not require a header since it travels in the same HTTP connection.

The formal modeling of *i-taxXML* documents was based on the W3C *XML Schema* standard. This approach is inherent in the XML language and more appropriate for the dissemination of the vocabulary and for the automation of the documents validation process.

### Elements of control, actions and reactions implemented

The control elements define general characteristics related to an action or reaction. The main ones are described in **Table I**.

TABLE I

Control elements proposed for implementing the “0” version

Element	Description
<i>i-taxXML</i>	Envelope transporting “actions” and “reactions”; unequivocally identifies the document, local schedule and language used
<i>Header</i>	Information on the tax authorities who are the addresser and addressee in an “action”
<i>Reaction</i>	Gathers other elements in a “reaction”
<i>Status</i>	Always associated to a “reaction”, contains information on the acceptance and/or processing of the “action” that preceded it.

The proposed actions to be implemented in this “0” version of the system were identified in keeping with the basic functions previously mentioned and are summarized in **Table II**, which also includes the expected reactions. The name of the XML element which implements the action or reaction is shown in *italics* immediately below.

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<sup>6</sup> <http://www.w3.org/TR/2001/REC-xmlschema-2-20010502/>

TABLE II

Actions and reactions proposed for implementation in version “0”

Action	Reaction	Type
Tax Examination Request (auditing) <i>ActionFiscalVerification</i>	Response of acceptance or not <i>Status</i>	N/D
Request for Status of Progress of Tax Examination <i>ActionQueryFVStatus</i>	Response on status of progress of Tax Examination <i>Status</i>	N/O
Sending of Tax Examination Result <i>ActionResultFV</i>	Response of acceptance or not <i>Status</i>	N/O
Spontaneous Sending of Information <i>ActionSpontaneousInformation</i>	Response of acceptance or not <i>Status</i>	N/O
Request for File Information <i>ActionQueryTaxFile</i>	Sending of File Information <i>Status + ReactionTaxFileInfo</i>	N/O
Request for confirmation of activity of <i>i-taxXML</i> service in server <i>ActionPing</i>	Response with service activity code <i>Status</i>	C/O

The “type” column has the following meaning:

- “N” identifies actions related to the business, and “C” control actions;
- “D” identifies actions which, once accepted, will be dealt with in deferred time, through technical and administrative procedures, and “O” identifies actions which must be definitively answered on-line.

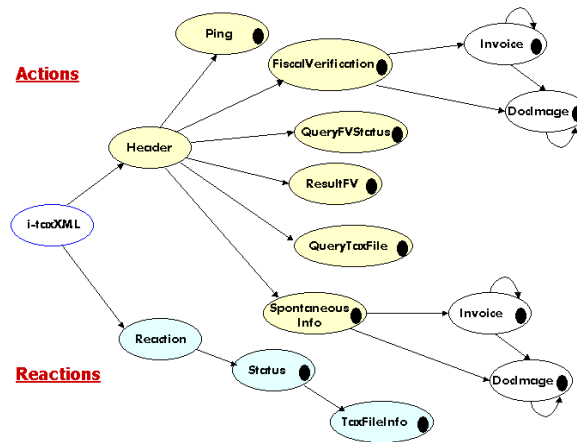
Two additional elements are used by the *ActionFiscalVerification* and *ActionSpontaneousInformation* actions:

- *Invoice*, which represents the information included in an invoice. An adaptation of the standard model proposed within the OECD sphere [OCDE-PDA,2000] was made to the elements that constitute an invoice.
- *DocImage*, which affords the possibility of including digital images of documents of interest for analyzing the proposed action.

### Coupling Syntax of the XML Elements

The syntax for coupling the XML elements defined, in order to set up an *i-taxXML* document, may be graphically represented through an “oriented graph” (Figure 4). In this graph, the main elements that constitute the *i-taxXML* are represented by nodes and the edges indicate the paths allowed. The black dots within the nodes indicate the paths allowed. The black dots within the nodes indicate the possibility of finalizing the path.

FIGURE 4: Oriented graph representing the development of an *i-taxXML* document



A path always originates in the *i-taxXML* node and, in each node visited, the element represented is added to the document being developed. The degenerated paths (self-connected nodes) mean that the element may be included in the document several times.

Shown below are some examples of the structuring of *i-taxXML* elements, originating from paths in the graph shown on Figure 4:

*i-taxXML* / Header / ActionSpontaneousInformation / Invoice / Invoice.  
*i-taxXML* / Header / ActionResultFV.  
*i-taxXML* / Header / ActionFiscalVerification / Invoice / DocImage.  
*i-taxXML* / Reaction / Status.

This approach is not sufficient for the creation of a valid document, although it contributes to visualize the possible alternatives during the conception process.

Steps for modeling documents

The *i-taxXML* elements were specified by using a descriptive text approach which facilitates initial understanding. **Table III** describes, as example, the text specifications of the *Invoice* element.

TABLE III: Description of the “Invoice” element

Invoice (*) Element	L	Description	Data Type		Length	R	Example
			min.	max.			
<i>InvoiceNumber</i>	1	Number/series of invoice	s	10	10	R	09874Y/001
<i>InvoiceDate</i>	1	Date of issuance	da	1	10	R	2000-12-27
<i>SupplierName</i>	1	Name of issuing company	s	1	---	R	Libreria Tempo S/A
<i>SupplierAddress1</i>	1	Complete address of issuer	s	1	---	R	
<i>SupplierAddress2</i>	1	Additional address of issuer	s	1	---	O	
<i>SupplierCountry</i>	1	Country of issuer (ISO 3166)	s	2	2	R	BR (Brazil)
<i>SupplierTaxId</i>	1	Tax identification number (in Brazil, CNPJ)	s	2	20	R0	12345678901
<i>CustomerName</i>	1	Name of purchaser	s	1	---	R	
<i>CustomerAddress</i>	1	Complete address of purchaser	s	1	---	R	
<i>CustomerCountry</i>	1	Country of purchaser (ISO 3166)	s	2	2	R	PT (Portugal)
<i>CustomerTaxId</i>	1	Tax identification number (if the taxpayer were a company)	s	2	20	O	
<i>CurrencyUse</i>	1	Currency used (ISO 4217)	s	3	3	R	BRL (real)
<i>TotalValue</i>	1	Total value of transaction	d	3	14	R	123.50 ou 645
<i>TaxValue</i>	1	Value of tax collected	d	3	14	R	87.20 ou 67
<i>InvoiceDetail (**)</i>	1	Detail of items (#items)	-	-	-	-	
<i>DetailLevel (***)</i>	2		---	-	-	-	
<i>DetailDescription</i>	3	Description of item	s	1	---	R	
<i>DetailProductClassification</i>	3	Classification code CPCS (ONU)	s	15	15	O	15 digitos
<i>DetailQuantity</i>	3	Quantity of item	i	1	9999	R	
<i>DetailUnitCost</i>	3	Unit cost	d	3	14	R	
<i>DetailTaxRate</i>	3	Tax rate	d	1	3	R	17 (17%)
<i>DetailDeliveryNoteNumber</i>	3	Receipt number	s	1	20	O	

\*) attribute: id="" (number of sequence of invoice)

(\*\*) attribute: qty="" (number of items of invoice)

(\*\*\*) attribute: seq="" (number of sequence of item)

Thereafter, a formal modeling of these elements was undertaken, based on *XML Schema*.

The *XML Schema* is an XML document modeling standard being developed by W3C, which allows for defining the syntax and semantics of the documents. The current version, of May 2, 2001<sup>6</sup>, is classified as “recommendation”. The types of data used in modeling were also extracted from that standard.

In addition, the following ISO (International Organization for Standardization) standards were adopted:

3166	Country Code (2 characters)
4217	Currency Code (3 characters)
639-1	Language Code (2 characters)

To support the ***i-taxXML*** specification through *XML Schema* and the validation of some test documents, the XMLSPY version 4 beta 2 tool was mainly used.

A prototype model of all the elements proposed in version “0” of ***i-taxXML***, in *XML Schema*, is available at the following electronic address:

<http://www.itaxxml.hpg.com.br/VocabularyExample-itaxxml.pdf>

## EXAMPLES OF INFORMATION EXCHANGE USING *i-taxXML*

Below is an example of the implementation of the “action” function and the respective “reaction”.

### On-line Inquiry of Elements of the Taxpayer File

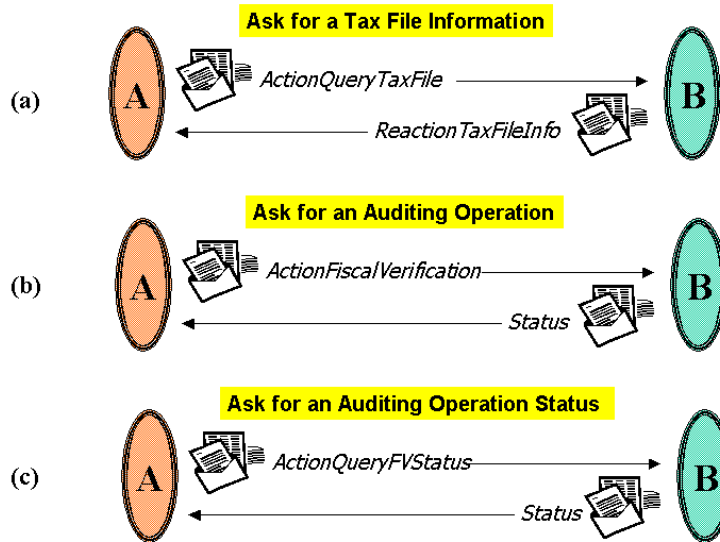
This function allows the tax authority of a country to consult some data from the tax file of another country. It is the only function requiring definitive on-line response, being implemented through the *ActionQueryTaxFile* action and the *ReactionTaxFileInfo*, reaction, schematically represented in **Figure 5**, example “a”.

Shown below are examples of documents sent in each phase, duly validated through the *XML Schema* developed for ***i-taxXML***:

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<sup>6</sup> <http://www.w3.org/TR/2001/REC-xmlschema-2-20010502/>



FIGURE 5: Graphic representation of *i-taxXML* document exchange

**EXAMPLE OF *i-taxXML* DOCUMENT FOR REQUESTING FILE INFORMATION (*ActionQueryTaxFile*)**

```
<?xml version="1.0" encoding="ISO-8859-1"?>
<!-- edited with XML Spy v4.0 beta 2 build Jul 26 2001 (http://
www.xmlspy.com) by Ferreira (mf01) -->
<!-- -->
<!--EXAMPLE OF DOCUMENT (REQUEST OF FILE INFORMATION)
ActionQueryTaxFile -->
<!--only action requiring on-line result -->
<!-- -->
<i-taxXML version="0" idEnvelope="1234455@TUCUNARE"
dateTime="2001-09-12T13:20:00.000" lang="pt"
xmlns:xsi="http://www.w3.org/2001/XMLSchema-instance"
xsi:noNamespaceSchemaLocation="C:\schemas\#schema-i-taxXML-
v0.xsd">
  <Header>
    <From>
      <OriginTaxAuthority>SRF</OriginTaxAuthority>
      <OriginCountry>BR</OriginCountry>
      <OriginContact> João da Silva - tel. 55 61 4122000 </
OriginContact>
```

```

    </From>
      <To>
        <DestinationTaxAuthority>AFIP</DestinationTaxAuthority>
        <DestinationCountry>AR</DestinationCountry>
      </To>
    </Header>
    <ActionQueryTaxFile taxId="6478916798700"/>
  </i-taxXML>

```

**EXAMPLE OF *i-taxXML* DOCUMENT ANSWERING A REQUEST FOR FILE DATA (ReactionTaxFileInfo)**

```

<?xml version="1.0" encoding="ISO-8859-1"?>
<!-- edited with XML Spy v4.0 beta 2 build Jul 26 2001 (http://
www.xmlspy.com) by Ferreira (mf01) -->
<!-- -->
<!--EXAMPLE OF DOCUMENT (SENDING FILE INFORMATION) -
RESPONSE TO AN ACTION "ActionQueryTaxFile" -->
<!-- -->
<i-taxXML version="0" idEnvelope="9276500631@SANMARTIN1"
dateTime="2001-09-12T13:20:35" lang="es"
xmlns:xsi="http://www.w3.org/2001/XMLSchema-instance"
xsi:noNamespaceSchemaLocation="C:\schemas\#schema-i-taxXML-
v0.xsd">
  <Reaction>
    <Status code="200" description="OK"> texto opcional
  </Status>
    <ReactionTaxFileInfo taxId="6478916728700">
      <Name> Vinicola Santa Juliana </Name>
      <Address1> Haciendas Santa Juliana </
Address1>
      <City> Mendoza </City>
      <State> Mendoza </State>
      <Country>AR</Country>
      <TaxStatus>1</TaxStatus>
      <StatusDate>1999-11-30</StatusDate>
      <ActivityDescription> production of fine wines
    </ActivityDescription>
  </ReactionTaxFileInfo>
</Reaction>
</i-taxXML>

```

## SECURITY CONSIDERATIONS

Security in the exchange of tax information requires authenticity from the parties involved, confidentiality, integrity and nonrepudiation of the information sent. At the technological level, these requisites may be implemented through the use of digital identify certificates for the tax authorities and the SSL (*Secure Socket Layer*) protocol in the communication channel. In this alternative, all messages exchanged during a session are completely encrypted, without distinction of elements or fields.

In the ***i-taxXML*** documents, due to requirements of tax secrecy, it may additionally be required that the confidentiality, integrity and, in some cases, the authorship of certain fragments of the document be guaranteed not only during transit through Internet, but also in its storage at the institution for which it is intended, it being disclosed only to an authorized addressee. In this context, a preponderant role is played by the application of technological digital signature and cryptography standards for fragments of XML documents, currently being developed by W3C. A summary of the current situation of these works may be found in [Reagle,2001].

## FINAL COMMENTS

The ***i-taxXML*** proposal represents a practical example of the applicability of modern information technologies in tax management, vis-à-vis the new challenges posed by the growth of electronic commerce and economic globalization. It is also flexible enough to be adopted in a regional environment, by using specific vocabularies. To become effective, it must be discussed at a forum with the participation of tax authorities and international organizations, allowing for the definition of a broader vocabulary and validation of critical aspects, such as the management model and adequacy of the proposed services.

Some additional research is necessary for strengthening the architecture presented. The first refers to the establishment, in the future, of agreements for the massive exchange of tax documents. To support this facility, other more efficient transport mechanisms must be analyzed, in addition to the HTTP proposed in this version.

The second would deal with the standardized transformation of the **i-taxXML** documents to other formats, by expanding their use and practical applications. Particularly noteworthy in this respect is the transformation for the presentation of documents, mainly in Internet navigators and the export of these data for use in legacy systems. Potential prospects for this task are the tools based on the XSLT<sup>7</sup> standard.

Finally, the modeling of **i-taxXML** documents through UML (*Unified Modeling Language*) may be used as a means for achieving greater strictness in the specifications and integration to a unified modeling environment. In [Carlson,2001] there are proposals regarding the feasibility of modeling XML documents with UML.

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<sup>7</sup> More information in <http://www.w3.org/TR/xslt>

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Mr. Antonio S. Seco Ferreira  
Consultant  
UCP/PNAFE  
Brazil  
CIAT Executive Secretariat  
E-mail: [antonio.seco@ieee.org](mailto:antonio.seco@ieee.org)

*Case study:*

*TOPIC 3.3*

## **INFORMATION SYSTEMS TO SUPPORT INTERNATIONAL COOPERATION**

**Luigi Ambrosio**

Dirigente

Ministry of Finance

(Italy)

Communications in general have acquired, during the past years, a central role in functional and operative strategies of public institutions and, as a consequence, there has been an increase in the interest and attention with relation to the subject of “information technology” applied to public administrations.

However, variable technology on its own is not enough to drag the whole administrative apparatus towards a future of efficiency and efficacy.

The problems, new and complex, linked to the so-called “electronic commerce” is already requiring from tax administrations of countries mostly interested in such phenomenon, a projection and prevision capacity, apart from operative flexibility and a professional adaptability greater than in the past.

The *information highways* allow information to travel with greater ease, and at more convenient costs, from one country to another, consequently strengthening economic relations more and more. That is why, nowadays, capitals move extremely quickly, required due to the demand for optimizing performance, while only a modest part of them is directly related to commercial transactions.

A road to be followed, necessarily, is the one of international cooperation, through which a more intense information exchange takes place, capable of conferring a strategic importance to the singular tax policies.

A high degree of integration in economic matters has been achieved in the European Union, favored by factors such as the continuous development of the internal market and its fundamental liberties, the revolution in communications and the introduction of the Euro.

In an analog fashion, national administrations have progressively adapted themselves to this new Community and to the multilateral framework establishing closer links at several levels, since the classic territorial power principle must take into account the new reality of the European construction and of the globalization of economic relations.

Member States, however, have realized that the simple existence of instruments that provide a juridical basis to cooperation, although important, is not enough in itself. There is a lack, in effect, of an adequate reciprocal personnel training, knowledge and understanding of administrative practices, exchange of ideas between the administrations, use of modern information technology and communications, all of these elements considered as essential components of the very juridical instruments available.

The information exchange between the diverse Member States constitutes a very important administration cooperation mechanism in the struggle against tax fraud.

However, there are several types of obstacles that hinder and make the information exchange difficult.

One of these is, undoubtedly, the lack of a community administrative culture, but the same discourse is also valid at the international level.

In effect, there are still officers that are not sufficiently informed or even worse, without information and above all scarcely sensitized by the problems of administrative cooperation.

What happens in practice, then, is that inspectors in some Member States tend to pay lesser attention to the cooperation and assistance requests from other Member States with respect to their tasks of an internal nature.

As a consequence, many times, replies are slow, inadequate or incomplete and, also, the speed and efficacy required in cases of fraud is not achieved, taking into account that the time factor plays an important role in the fraud mechanisms.

The “ad hoc” Group on tax fraud regrets, for example, insufficient spontaneous and automatic information exchange, particularly in specific cases or operations that generally represent a higher risk of tax fraud or evasion, such as the sale at a distance or the sale to private citizens of new means of transportation.

Likewise, the information exchange on new fraud models and typologies is also used very little in the Member States.

Therefore, it will certainly be necessary for the diverse tax administrations to carry out every effort to adequate to the new economic, commercial and social conditions, equipping themselves and enjoying, themselves as well, the same possibility provided for by information systems but his time, to exchange data and news on the taxpayers.

The information exchange also presents advantages for the taxpayers, in the measure that it allows for a correct application of the tax agreements, as well as the possibility of avoiding double assessment of the revenues and the equity.

The efficient operation of the measures relating to the information exchange contributes to ensure, on the other hand, that taxpayers that have had access to foreign markets do not have a greater possibility to commit acts of tax evasion or avoidance with respect to taxpayers that only operate in the domestic market.

In effect, if globalization allows taxpayers, be they companies or citizens, to transfer their assessable items where more favorable conditions rule – and not only in terms of aliquots, but also under the profile of the efficiency of the systems-countries – it becomes absolutely indispensable, for example, to carry out an efficacious coordination of the tax policy in the European Union, because only thanks to coordinated options countries in singular will be able to put a halt to unfair competition from which evident signs are already arising, with serious risks for the stability of public financial systems.



### TOPIC 3.3

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In the community environment, the suppression of the tax and customs barriers, as of January 1<sup>st</sup>, 1993, has made it necessary to strengthen administrative cooperation, for which, in the Value Added Tax sector, an intensified information exchange system has been adopted, only for the community supply and acquisition of assets.

The main innovation in Regulation No. 218 of 1992 consists in the creation of an electronic database (VIES) and in the automatic communication to all other Member States, of the total amounts of the intercommunity supplies made to passive individuals identified in said States, as well as the corresponding VAT identification numbers.

It becomes important to highlight that data exchanged automatically or at request, coming from the summarized statements of passive individuals, are not yet available in a sufficiently brief time and cannot be exchanged with the necessary speed. This, therefore, does not allow for an efficacious fight against fraud while the “a posteriori” control is frequently carried out too late. Besides, the provisions of EEC Regulation No. 218/92 never had, as their objective, interventions related to individual fraud cases that, due to their nature, are developed “here and now”.

On the other hand, the field of application of the Regulation does not include all operations that could give rise to fraud.

As a legal basis for their cooperation against fraud, Member States mainly use directive No.77/798/EEC. This text, initially conceived to facilitate the information exchange related to direct rate of taxation, was not adopted afterwards, in such a way to better satisfy the demand for a strengthened cooperation in the VAT field after the introduction of the transitory VAT regime of January 1<sup>st</sup>, 1993.

In the Commission’s report to the Council and the Parliament, drafted and dated January 28, 2000, regarding the application conditions of Regulation No. 218/92, it is written that, with relation to information systems control, “even the capacity of Member States to adopt new technologies was examined.

Many of them make available to the officers themselves, advanced instruments that allow access to non-elaborated data or to fine-tuned products, where VIES data is consolidated with other control data to provide the reviewer a more orderly view of the passive individual’s

status. This type of evolution is still in its beginnings in many Member States, but the growing use of information systems in companies will force them to equip themselves with the new technology.

The new technology is already operative, but, as it can be seen, Member States are, in general, quite delayed in the process to adequate themselves to the new context. Currently, only 3% of those that abide by the controls are in conditions to use computerized control techniques, and this could create serious problems in the future. On the other hand, it is evident that computerized controls would allow administrations to achieve a greater efficiency while reducing costs at the same time.”

When estimating, due to series of reasons, the aforementioned existing legal provisions (Regulation No. 218/92 and directive 77/799), as not adequate for the challenges of the domestic market, the European Community’s Commission has proposed, on June 18 this year, a proposal for the European Parliament and Council Regulations related to administrative cooperation in matters of value added tax, and a proposal of the Council’s Board of Directors or of the European Parliament that modifies Directive 77/799/EEC of the Council related to reciprocal assistance between competent authorities of the Member States in the direct and indirect taxes sector.

This although the Commission considers that the existence of two different legal bases is detrimental to the resource of cooperation in the VAT control field.

Therefore, the Commission proposes a sole and strengthened legal framework, with the purpose of creating the conditions for an intensification of cooperation, absolutely indispensable nowadays, to fight VAT-related fraud.

The objective of such reform is the creation, among administrations responsible for the application and control of the VAT, of a synergy that allows for the elimination of the frontiers between tax administrations and to make their officers collaborate as if they belonged to the same administration.

At first sight, this objective may seem ambitious, but it represents an absolute need in view of the swindlers for whom, certainly, there are neither frontiers nor links.

### TOPIC 3.3

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Therefore, the proposal contains a provision that allows the presence of agents from the tax administrations of a member State in the territory of another member State when both States consider it timely.

This provision constitutes the legal basis that frees the tax administration from the obligation of obtaining consensus (highly unlikely due to predictable reasons) of the passive individual.

The proposal foresees, on the other hand, the obligation for Member States, to resort to simultaneous controls in consideration of the fact that a simultaneous control is essentially structured for the information exchange among more tax administrations, particularly since controls of this type are more efficacious than national controls.

In the proposed Regulations, finally, reference is made to electronic media, being these understood as electronic equipment for the treatment and storing of data using wire, radio, optical media or other electromagnetic media, through which the information exchange takes place.

To that end, it must be noted that the information exchange related to intercommunity transactions happens through the use of standard models adequately prepared and used by the Member States.

Recently, a new version of the so-called standard model for the information exchange was finalized and, likewise, the information to be requested through that model was defined.

Such model must be adopted by all member countries no later than January 1<sup>st</sup>, 2003.

As of that date, the information exchange will only be done on the computerized base, through a protected message exchange system, based on the common communications/interface common Network of the already existing systems (CCN/CSI), that supports the VAT Information Exchange System (VIES).

Such model must not be considered "immutable" since only with experience will it be possible to determine if the current requests on the models are more or less appropriate or sufficiently clear for the officers in charge of control.

Also, consideration must be given to the fact that technology is under continuous development and that the ideal situation would be that of being able to use a technology that is not based on models but rather on the exchange of the requests.

However, the need to foresee and intensification of the information exchanges does not represent a demand from only the European Union but also from the OECD.

In effect, the final OECD report "*Harmful tax competition: an emerging global issue*", that limits its field of application to the geographically mobile activities, such as financial activities and service rendering ones, concludes with 19 recommendations identified regarding three specific lines of action, one of which was precisely constituted through international collaboration to counteract harmful tax competition, even through the creation of new forms of direct assistance.

Likewise, in another very recent report related to banking secrecy matters, "Improving access to bank information for tax purposes", the OECD underscores the need to carry out controls abroad, an ever more notorious need in view of the effective and always speedier internationalization of markets and, more in general, of the economy, through a more ample international collaboration, even for tax purposes, to be carried out with the information exchange instrument.

Likewise, one of the main objectives for the Inter-American Tax Administrations Center is to promote and develop mutual administrative cooperation and establish a "forum" for the exchange of experiences between member and associated countries, assisting them in the improvement of the administrations themselves and taking into account the needs expressed respectively.

According to what is foreseen in strategic Directive No. 1, CIAT promotes the signing of the information exchange agreements between tax administrations of member countries.

In the environment of the technical cooperation agreement between CIAT and Italy, a Work Group was established composed of the tax administrations of Argentina, Brazil, Canada, Mexico and the United States, which also has among its objectives, to promote an advantageous tax information exchange, favoring the stipulation and the operation of the information exchange agreements.

In effect, as was previously highlighted, information exchange represents the most immediate way of administrative assistance between tax Authorities and is relevant both for the domestic and the international scenarios. On the other hand, it must be noted that the information exchange agreements are considered of vital importance to counteract tax evasion and avoidance and that, undoubtedly, are not yet fully made use of by CIAT member countries, particularly by those that belong to the Latin-American area.

Nowadays, even more, the globalization process makes it essential for tax administrations, the possibility of exchanging between them, data and information for an efficacious control of tax obligations.

Therefore, a “model” has been prepared for the bilateral or multilateral information exchange and that disregards, on the other hand, the existence of at least one agreement to avoid double taxation of revenue and over equity, drafted, above all, for the use of the tax administrations of the countries belonging to CIAT, but which will also be able to be used by the tax administrations of other countries.

The Model will soon be replaced by an information system through which the information exchange can be carried out in a simple but efficacious way.

Such system, whose architecture was illustrated during the last meetings of the aforementioned Work Group, which took place last March in Panama, is called CIES (CIAT Information Exchange System).

The system proposed by the Italian tax Administration and by the SOGEI, Society that manages the information system if the Ministry of Finance, does not interfere at all with the autonomies of the national systems and favors the opportunities offered by the new information technologies, that nowadays make the objective possible respecting the economy of the proposed solutions, in architectural simplicity and in the relative speed to implement.

Certainly, however, it will be necessary that the carrying out of the information exchange is effectively desired and, therefore, administrative cooperation, also facilitating the advantages offered by the new technologies, since in the aforementioned Commission’s

report to the Council and to the European Parliament, it was also said that “it happens that, although favoring the intensification of the pertinent information exchange, Member States rarely proceed to such exchange, even after having entered into bilateral agreements”.

Once more, then, the problem does not arise from the lack of instruments that allow for the use of new technologies, but from the fact that the structure of contemporary tax systems is still formally based on old paradigms that take into account their circumscribed geographical boundaries.

Mr. Luigi Ambrosio  
Dirigente  
Ufficio per le Relazioni Internazionali  
Ministry of Finance, Italy  
E-mail: [Luigi.Ambrosio@finanze.it](mailto:Luigi.Ambrosio@finanze.it)

*Case study:*

*TOPIC 3.3*

## **INFORMATION SYSTEMS TO SUPPORT INTERNATIONAL COOPERATION**

**Andrea Paventi**

Consultant

Società Generale di Informatica - SOGEI  
(Italy)

*CONTENTS: 1. Introduction.- 2. Internet and the Selection of an Architecture.-  
3. The System's Users.- 4. The System's Applications.- 4.1 Application  
for the end-user – the operational functions.- 4.2 Administrator's  
applications – system's management.*

### **1. INTRODUCTION**

Thanks to the liberalization of exchange and financial markets, the fiscal evasion problem has acquired international relevance. In effect, if on the one hand companies are already operating at a worldwide scale, often Tax Administrations are not adequately equipped and the risk of evasion on behalf of taxpayers has noticeably increased.

The exchange of information is the main instrument foreseen for all Agreements to allow collaboration among Tax Administrations as a means to continue struggling against fiscal evasion and avoidance, as well as perform a more equitable application of the tax in the country of resident on those taxpayers that receive income abroad.

Currently the juridical instrument used in Italy as the basis for the exchange of information has its legal base in bilateral Agreements against double taxation stipulated among the OECD countries and article 25 of the OECD Fiscal Agreement Model on income and equity.

The exchange of information that initially only took place through letter communications, presented problems such as lack of homogeneity and frequently there was noticeable delay in regards to the demands of the competent Tax Administration.

The standards established in the OECD in regards to exchange of information activities, has allowed the delivery of the mentioned data on magnetic means allowing Tax Administrations in this manner to have homogeneous information, to be able to punctually identify the individual subject to tax and automate verification activities carried out inside the country; however, we still have to solve the timeliness problem. Therefore it is necessary for Tax Administrations to have an instrument that guarantees timeliness of the information received and control the efficiency of international cooperation.

This problem must be solved internationally.

Sogei, based on framework Model Agreement for the exchange of information of fiscal nature approved by CIAT, is carrying out, under the responsibility of the Italian Ministry of Economy and Finances, a computerized system called CIES (CIAT Information Exchange System), developed with the purpose of achieving the abovementioned objectives and based on the potential offered by the Internet.

## 2. INTERNET AND THE SELECTION OF AN ARCHITECTURE

The selection of the Internet as a platform for the exchange of information represents a mandatory option if you wish to use a pre-existing means on which data will travel among individuals without having to resort to costly dedicated transmission instruments. The Internet and the web technology, may guarantee maximum accessibility in an entire range of services even for the Tax Administrations of those countries that are not in conditions of procuring high-cost instruments.

The so called web applications, in effect, are available to the end-user through the use of a "Browser", a program available to all operational systems commonly used in the market and at no cost in regards to the former (eventual) cost of the operational system.

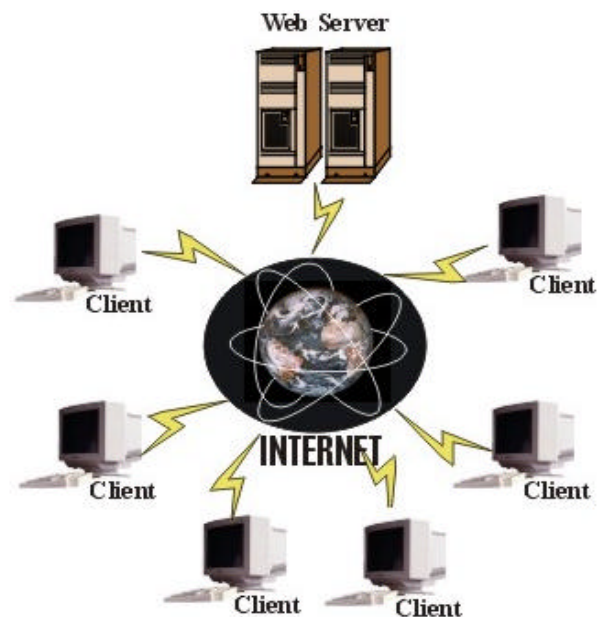
The exchange of data through a public network, such as the Internet, is the target of course, of obvious security concerns, since the information that is purpose of the exchange among Tax Administrations contains **sensitive data**.



The current technological level offers a series of solutions, essentially based on encryption to guarantee that no information in transit through the public network is evident. The user and the system, prior to beginning the exchange of data, must be assured, in a preventive manner, from the respective entities, using for such purpose, identity “Certificates” issued by a renowned “Authority”. Once they have mutually recognized each other, the parties shall establish common encryption criteria, and in this manner they will be able to commence the passage of data.

The CIES system, based on the use of the Internet, adopts a “Web Oriented” architecture type and consists of:

1. A **web server**, that is, a centrally managed machine and in which the Applications and the Database reside. Such Database is assigned to contain fiscal information exchanged as well as all the necessary data for the operation of the Applications.
2. Many **clients**, that is, remote workstations located near the user of the application, who uses any browser and is connected to the Internet.



**Figure 1 - Web Oriented Architecture**

### 3. THE SYSTEM'S USERS

Two types of users that correspond to each of the different tasks are recognized:

1. **System Administrator**, that is a centralized structure located inside the sub-national entity who shall be in charge of having updated the data necessary for the operation of the Applications and guaranteeing a constant service level: it must on the other hand, be in charge of the security system that manages the certificates, access policies and authorizations.
2. **End-User**, that is, the competent authority to manage the exchange of fiscal information in each country.

According to the operations developed, **the End-User** may perform four different roles:

- **sender**, when he/she inputs the information into the system making it available to the addressee Tax Administration;
- **addressee**, when he/she receives the information put at his/her disposition in the system;
- **the requesting party**, when it directs to another Tax Administration an information request;
- **the requested party**, when another Tax Administration requests information.

The user that initially performs the role of requesting party, shall be at the same time the **addressee** of the information requested; in an analogous manner, the requested user, at the time of making the information available through the system, will have the role of **sender**.

### 4. THE SYSTEM'S APPLICATIONS

CIES has present two different applications: one at the disposition of the **End-User** for the development of operational functions, the other directed to the **Administrator** for the management of the system.

#### 4.1. Application for the End-user – The Operational Functions

When a country has a series of tax information that based on the agreement result to be relevant to the other Administration, it must place it at the disposition of the country of competency. In this case, the end-user, performing the sender role, must introduce such information into the web server. The insertion modalities vary according to the global amount of data to be inputted:

- In the case of a limited amount of data, pertaining only to one receptor, it may be used as a punctual introduction, providing singular data through the fields proposed by the appropriate mask; the application, once it has controlled the formal exactness of the information and the validity in regards to what has been provided for in the agreements in force, shall proceed to store it in the system;
- In the case of an amount of relevant data, the modality described obviously results inadequate; shall therefore have to proceed to the massive introduction thereof, however, it presupposes on behalf of the sender, the organization of the data in a text file, in a standard format. Once the file has been prepared, the sender must indicate the name of the application so that the party requesting the information may open it, read the contents and prepare information based on the contents. The activity for the preparation of the information shall consist of the execution of the same controls foreseen for the punctual introduction, in the acquisition of the correct information, in the creation of a file that contains the list of the information disregarded to be placed at the sender's disposal, which shall be in conditions of performing timely modifications.

As support for the information sent, the sender may attach documents in a format previously agreed with the **addressee**.

Regardless of the introduction modalities, whenever the messenger system acquires new information, it proceeds to notify its presence to the **addressee** user.

The **addressee** may, in a first analysis, inquire this information, however, later it may seem more useful to download it to put it at the disposition of the competent authorities. To face these demands, the

application offers information display features, as well as the possibility of downloading it directly to the **addressee's** workstation. When requesting the download, the user may choose between two alternatives:

- To definitely delete from the system the information that is to be downloaded;
- To leave it for future queries.

In this second case, a new feature of the Web Server appears: it does not assume the role of a simple means for the exchange of information, but that of a **Repository**, with obvious benefits for the Tax Administration that does not have its own file system.

For such purpose, however, it is necessary to consider that the total space that the system dedicated to the storage of the information, cannot be limited, therefore, a space quota shall be previously assigned to each Administration, and a process will control in a cyclic manner how much space is still available. In the event that a certain threshold is surpassed, a message will be sent to the user, where he/she will be invited to eliminate non-relevant information, which by hypothesis it refers to the elapse of one tax year.

When a country, during inherent verification activities, discovers that it requires further information on a resident, it may carry out the proceedings to perform a proper request to the other Administration. The application allows the **requesting party** user to introduce into the system a formal document request, and it sends to the **requested party** country.

The **requested party** user, as soon as he/she connects to the application, receives a message from the system, where he/she is informed of the presence of a new information request. The application provides the possibility of downloading the document received and, once the information required is gathered, it may attach to the latter the response document and send the information as a **sender** to the **addressee** Administration.

The addressee user will be notified by the system of the presence of the response and will be in conditions of downloading it to put it at the disposition to the competent authorities.

Therefore, any request submitted to an itinerary, supervised by the system, that performs the steps through different states follows a flow that is analogous to e-mail:

- **inputted:** formulated but has not been sent yet, that is, it is still not available to the requested Administration, while it remains in this state, it may be modified;
- **sent:** that is, put at the disposition of the requesting party;
- **read:** the requesting Administration has seen the message;
- **dispatched:** the requested Administration has put the response document at the disposition to be consulted by the requesting party.

During the description of the operational functions, you may evidence how the system must keep the user continuously updated in regards to the verification of determinate events, such as:

- the presence of new information,
- the arrival of new information requests;
- the rejection of massively inputted information;
- the availability of a response to a request sent previously;
- the scope of the space available occupation quota.

However, the preset message flow and that travels from the System to the end user, is not the only one conjecturable. The application, in effect, makes available some features that allow users exchange messages that contain information that are outside the exchange provided for by the agreements, but which may be complementary thereto. These features involve an e-mail system for Administrations, similar in concepts to the preexisting systems, but different to them in that any message exchange will be done in an encrypted manner.

#### **4.2. Administrator's Applications – System's Management**

The Administrator is in charge of directing the countries adhered in the use of CIES system and guaranteeing the necessary technological support as well as managing system access authorizations pursuant to the established security requirements.

The features reserved to this feature are the following:

- **The management of a Database where the characteristics of the tax systems of the countries adhered to the CIES system are coded as well as the information contained in the Bilateral Agreements in force.**

Each country must communicate to the Administration the prescription terms pertaining to the fiscal verification in the use of the inherent tax system, the ordinary dates of the fiscal years and the type of currency that it intends to use in information exchange activities; it must also indicate the country or countries with which it is to install the reciprocal relation for the exchange of data and provide the details established in the agreement stipulated with the countries indicated. The Administrator proceeds to input all the information received in the Database. The presence of such coded data in the system will allow the commencement of automatic controls on the use of the system itself on behalf of the countries adhered, which are qualified to verify that the exchanges take place pursuant to the modalities and on the times agreed. Furthermore, the messenger system, will notify the users up to the approximation of the expiration indicated in the Agreements.

- **Database Backup and Restore administration processes.**

The Administrator, in order to face eventual problems that may arise on the physical support on which the Database resides, is in charge of periodically saving all information present in the system, by copying the same on another support through the Backup process. Such Backups may take place in such manner that they prevent data saved from being read or intercepted by unauthorized individuals. To face this event, the Backup must be done in an encrypted manner. The Restore process is required by the Administrator to allow the reestablishment of previously saved data.

- **Authorized Users' Database Administration.**

Each country that adheres to the CIES system may request that one or more users are qualified for the use of determinate operational functions and for such purpose, it shall send to the Administrator the necessary data. Therefore, the Administrator will be in charge of inputting into the Database the pertinent information on the users, as well as the different profiles, that is, the operating level to be attributed to them.

- **The management of the Certificates.**

Certificates represent, as mentioned in the introduction, the instrument to reciprocally guarantee, to the end-user and the System with which he connects to (Web Server), the identity of the data source

Each end-user, in order to meet the requirements for the connection of his/her workstation to the Web Server, must proceed to associate to that position, a certificate that will allow him/her to verify his/her identity, and that the same be capable of recognizing an analogous certificate installed in the Web Server. The Administrator may be in charge of issuing the certificates in first person or resort to the support of an Certification Authority, that is, an internationally renown reliable entity.

In the first case, it must have the appropriate machine that can create the certificates and software to manage the same; in the second case, the Certifying Authority will perform these tasks and the Administrator will only have to manage the updating function in the system for the recognition of the certificates that are in effect valid.

The certificate is generally installed in the workstation or at the place typically used for the connection; however, this solution present a disadvantage, whoever works in that workstation may in theory be capable of connecting to the central system at the time on which the password to access the system is made available.

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A more secure solution will be to issue a Smart Card, that is, a card in a format similar to the common credit card, which contains the certificate; such solution requires the user's workstation to have a Smart Card reader and the pertinent software that guarantees the operation; it also creates links in the event that a decision is to be made on deciding whether if a Certifying Authority should handle the management and distribution of the Smart Cards or not.

Mr. Andrea Paventi  
SOGEI Consultant  
Società Generale di Informatica  
Italy  
Email: [apaventi@sogei.it](mailto:apaventi@sogei.it)



## **GENERAL REPORT**



## **GENERAL REPORT**

***Michele del Giudice***

Advisor

Ministry of Finance

(Italy)

On the first day the subject of the interaction between the tax administrations and the private sector has been examined within the general theme of the Assembly. In this field we can say that, generally speaking, the more a tax administration tries hard to analyze the real needs of the private sector and, after all, of the citizen-customer, endeavouring to meet such needs, the more the citizens tend to appreciate the activity of the administration and to increase the level of the voluntary compliance. On the other hand, the tax administration, achieving a positive result following its action towards the citizens, endeavours more and more to achieve better relationships with the taxpayers.

The result is a virtuous circle that brings benefits both to the private sector, which receives a more adequate service as regards its needs, and to the public sector (i.e., the tax administration), which in consequence of a greater compliance with tax obligations sees a decrease in the need of enforcement actions.

It is however clear that the process acceleration factor is in the hands and responsibility of the tax administrations that cannot think their task to be a defined one in terms of ways and times, and once adopted certain solutions they can remain static, but instead must have a dynamic attitude, in continuous evolution, as in continuous evolution are, in current society, the needs of the taxpayer-customer.

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Correct and careful was therefore Mr. Serrano Lopez's (Spain) statement that in dealing with the subject stressed the need that the tax administrations adopt a flexible and open organizational model, which ensures continuous adjustments, and that their action is inspired by basic principles, such as:

1. Order and comfort in the setting up of the procedures to be followed in the fulfilment of tax obligations;
2. Speed by the Administration in providing the answer to the problems arising in the relationships with the taxpayer-customer;
3. Simple procedures for the fulfilment of the obligations by the taxpayers;
4. Use of technological innovations;
5. Security in the relationships between tax administration and taxpayers, in terms of confidentiality of data and information provided.

Following these basic principles the Spanish Agency developed many initiatives to make the tax fulfilment by the citizens easier, initiatives marked by the success of the tax administration.

Such initiatives in particular concerned:

- the preparation and the processing of the fiscal returns;
- the submission of the returns by Internet;
- the collaboration of some financial institutions in the tax collection procedure;
- the automation of the customs dispatch.

For the preparation and the processing of the tax returns, the Spanish Administration validated a series of programs that are at the citizens' disposal for filling almost all the tax returns; among such programs the best known is the Income Tax Return Help Program (PADRE - Programa de Ayuda a la Declaración de la Renta). The program is used by citizens who have to fill the Individual Income Tax return, as also by entities cooperating with the tax authority in order to bring this service nearer the citizens; many are the entities, also in the private sector, that are called to cooperate and among these the financial institutions, the regional authorities, the municipal entities, the unions, the Chambers of Commerce, the business associations and others. The success of the programs is represented by the available data: in 1992 the returns filled with the aid of the program were 12% of the total, while in 2001 they accounted for 88%.

Also the use of Internet for the submission of the returns concerning to Value Added Tax, Individual Income Tax and special taxes gave positive results, both from the point of view of quantity (497,789 in 2001) and quality of the program, the users of which have declared themselves to be "satisfied" or "very satisfied".

In the sector of collaboration in the tax collection the Spanish Tax Agency authorized a large number of financial entities to carry out an activity of collaboration in the sector and the relative system set up implies important advantages, not only for the citizen, in that it multiplied the points of payment, but also for the tax administration under the profile of the reduction of the collection costs.

Finally, equally effective was the action carried out in the field of automation by the Customs Department, where the initiatives adopted followed three main routes destined to speed up the transit of goods and tending to increase the so called one-stop window system, the revision of the customs procedures, as also the increase of the cooperation with the foreign trade operators, a sector in which the use of the electronic data interchange system has been continuously expanded.

On this matter, I believe that what has been said by Mr. Serrano López and the resulting discussion allow us to say that the Spanish Administration addressed the problem of the interaction with the private sector, and more in general, of the relationship between tax administration and taxpayers, in the right way.

Many tax administrations of CIAT countries have started –or are starting– maybe at different levels of development – similar initiatives achieving satisfactory results. Certainly there are differences in the carrying out of such initiatives, but they depend a great deal on the differences in the social/economical realities of the countries concerned, and this must be taken into account when evaluating the interaction models to be carried out.

Also my country (Italy) has since long committed itself to the carrying out of initiatives similar to those emerging in this Assembly or in previous Assemblies, and a long way has been covered in recent years, and we are satisfied of it, especially in the sector of the assistance provided to citizens in the fulfilment of their tax obligation and of the cooperation with the different sectors of society; much has been done using the means that have been made available by new technologies.

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Certainly it is essential to take into proper consideration the technological innovation, even if keeping up with the technological evolution requires much under the profile of economic resources and of specialized human resources.

The tax administrations must give a special attention to the timely adjustment of their organizational model to the continuous evolution of the needs of the taxpayer-customers, in the belief that this is a fundamental factor to increase the voluntary compliance.

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There is no doubt that in the framework of the actions that may favour the voluntary compliance a particularly important role is played by the actions carried out by mass communications media that in the current society are the most important instrument for forming an opinion.

The adoption of a useful strategy to achieve a correct interaction between communications media and tax administration is certainly an essential factor for tax Authorities.

During the 1<sup>st</sup> parallel session held last Monday this subject has been addressed by the Guatemalan (Mr. Perez Ordoñez) and Portuguese (Mr. Victor Sancho) delegates and the development of the presented reports and of the discussion has clearly highlighted on one side the criticality of the problem, and on the other the need that the tax administration be able to play a more incisive role to improve the relationships with media.

These subjects have been reviewed by pinpointing the sensitive points of the action of tax Administrations in the different, though interdependent, sectors mentioned above.

For instance, the need has been pointed out (Mr. Perez Ordoñez) that highly professional officers carry out the relationships with media, as also it has been stated that such relationships must be characterized by a marked transparency.

In addition, the adoption of strategies leading to an objective improvement of quality and efficacy of public services has been defined as a must.

Mr. Victor Sancho (Portugal) has underlined the importance of explaining more in detail the image of the tax administration to the press, which in turn shall report it to the citizens. Making use of examples drawn by his experience the speaker indicates the necessary interventions to improve the image of the tax administration, dividing such interventions into three levels which are complementary and connected with one another:

- the first level concerns the changes of the citizen taxation system;
- the second level concerns the changes of the infrastructures which are able to stir up immediate positive impressions;
- the third level pertains to the improvement of the realization by the taxpayer customer of the actions of the tax administration.

Mr. Sancho (Portugal) ended up by expressing his opinions on the strategies to be adopted for presenting “products” to the taxpayers and on the management of the relationships with the media, focusing, for this latter subject, on the preference to be given to a decentralization of the relationships with social-communication media at local and regional level.

The relationships with communications media is certainly an important and delicate issue to manage; the reports and the resulting discussion have proved it.

In general, the tax factor does not seem to enjoy a good press, and the reasons for it may be evident. However, tax administrations cannot avoid improving the relationships with media taking into account, according to their needs, the suggestions expressed in this Conference.

A fundamental element is to build, set up or improve an environment of reciprocal trust between media and tax administration, something that is easy to say but difficult to achieve. In my opinion, one of the fundamental elements to this end is the transparency, which has been mentioned several times on Monday.

The lack of transparency gives the negative impression that the administration wants to hide from the public opinion facts and acts that are not justifiable for a proper management of this sensitive sector.

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In the second parallel session of the first day of the Assembly the relationship between the amount of tax burden and tax compliance was examined; Mr. Luiz Villela (IDB) gave a valuable contribution dealing in succession with the examination of the so called tax potential, of the effective tax rates, of the taxation constraints and of their description by the Laffer curve and with the phenomena of tax aversion, evasion and avoidance.

A particular passage of the intervention of Mr. Villela dealt with the effects of globalization and economic integration on fiscal matters. Such effects may also increase the possibility of tax avoidance and evasion.

The conclusions reached by the speaker, according to whom the level and the distribution of the tax burden affect compliance in a globalized world economy, may be shared, as also the observation that the erosion of the tax bases derives from the circumstance that the actions of international cooperation in such sector are rather few and are taken essentially through bilateral agreements, where instead it should be necessary to have recourse to multilateral international agreements, hopefully at world level and with a wide base of application.

Mr. Carlos Silvani (IMF) presented a very detailed report on the same subject, where he mentioned the different impacts of the tax rate in relation to different taxes (income tax, value added tax, excise duties, customs duties, etc.) He also examined the effects of the increase or decrease of tax rates on the tax perception. In general, we may check that the modifications of tax rates normally determine some modifications on tax perception but not always in the same manner. These modifications have to be observed not as isolated from its specific context, but taking into account the nature of taxes, the economical situation and other elements. We could say that the increase of tax normally produces a tax perception that is lesser than the percentage of tax increased.

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The third parallel session examined the topic of cooperation of business and professional organizations making use of the contributions submitted by Mr. Baker of Canada Customs and Revenue Agency and by Mrs. Nolan of Internal Revenue Service of the United States; both speakers reported the experiences made and the activities carried out in the sector in their respective countries.



Both interventions put in evidence the special attention that the respective institutions (CCRA and IRS) gave to the relationships and the cooperation with the Business and Professional Organizations.

Mr. Baker (Canada) reviewed the goals pursued by his institution in the relationships with Business and Professional Organizations, the activities carried out in order to achieve such goals, the procedures for executing the dedicated programs.

The resulting examination, starting from the analysis of the reasons of the non-compliance and going through the activity of educating the taxpayer- customers, ends up by reducing the burden of fiscal fulfillment; moreover, the positive influence is pointed out of the relationship with industrial and professional organizations for the purpose of improving and redesigning the programs of CCRA, of the assistance provided by such organizations in the development of administrative procedures and of the directives to impart, also in other sensitive sectors of the administrative life of the Canadian Tax Administration.

Finally a description is given of the future initiatives that Canada shall adopt in the sector.

During this session it is impossible to develop the above-mentioned subjects, but I avail myself of this opportunity to draw the Assembly's attention to at least two initiatives enacted in Canada:

1. The industry specialist program;
2. The Advisory Committees.

In the first case, we are dealing with a group of 17 specialists whose main functions are those of dialoguing at a very high level with the private sector and in particular with the representatives of industrialists to identify the procedures of a successful joint work.

In the second case it has been reported that in addition to the already described contacts the Canadian Agency has created more than 30 Advisory Committees, which deal with specific sectors, such as, for example, large and small business, collection, international affairs and electronic commerce.

These Committees express opinions after having consulted the representatives of the sectors concerned, in order to guide the action of CCRA as regards to the needs of the said sectors.

## GENERAL REPORT

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Mrs. Nolan (USA) presented a careful and comprehensive report. In particular on the way in which the Internal Revenue Service currently addresses the problem of cooperation of business and professional organizations.

In the US contribution there are very interesting arguments both from the point of view of the organization on the basis of the different needs of the different sectors of the business and professional community and of the guide lines and principles inspiring the activity of the Internal Revenue Service in their contacts with the said community. Of course, one of the basic principles inspiring the action of IRS is that of understanding the customer's point of view and using such understanding to prevent and solve problems and provide quality services.

In the United States reality, cooperation of business and professional organizations is a since long well established factor and the experience of IRS shows that the opportunities to improve service and compliance are many; many Advisory Committees are active, starting with the Federal Advisory Committee established centuries ago, to the Electronic Tax Administration Advisory Committee established in 1998, which plays an important role also in advising the IRS on ways to increase the number of electronically filed tax returns.

In addition, there are meaningful contacts with the private sector and among these the direct meetings of business and professional organizations with the IRS Commissioner; the advantage of such direct meetings is that the relative issues are brought forward at the highest level of the organization without going through intermediation stages at a lower level.

In short, the contribution of Mrs. Nolan (USA) pointed out the great importance that the US Administration attaches to the collaboration provided by the Business and Professional Community since –it is stated– such collaboration, through the years, allowed the Administration to improve the voluntary compliance by improving the tax products and the necessary procedures to meet the need of the taxpayers.

In turn, the private sector has had the possibility to make itself heard in determining tax policy and operations, and accordingly it has been motivated to voluntarily comply with tax laws.

I think it is clear that the collaboration of business and professional organizations is a very important factor within the action that a tax administration can develop to improve voluntary compliance by the citizens.

Such collaboration should however be fostered through a real and not apparent dialogue on the many problems that inevitably arise in the complex tax field.

The tax administrations cannot do without such collaboration, which is extremely useful to both parties. A correct partnership is to be pursued at different levels, including the top levels of the organization, and must be permanent and substantial.

In addition, tax administrations have to develop as much as possible the contacts with the private sector, being aware that such contacts allow an updating and an improvement of the relationship between tax administration and taxpayer, sometimes preventing behavioural mistakes, sometimes allowing to update the tax application procedures and to meet the needs of specific taxpayer-customers.

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I think that all of us are convinced that an adequate level of interaction between political institutions and public authorities plays a relevant role in the improvement of tax compliance; obviously the problem is to establish whether we are in the face of an appropriate level of interaction. In principle we could say that the more we get close to the maximum percentage of tax revenues deriving from voluntary compliance with tax obligations, the more the level of interaction becomes adequate.

The fact that this subject was treated by the representative of a country (Canada) that has a very high level of voluntary tax compliance (in Canada more than 95 percent of the tax revenue are collected without having to recourse to any enforcement action) means in my opinion that the Canadian experience is particularly interesting for the majority of the Countries that are here represented.

Mr. Alain Jolicoeur (Canada) has drawn the attention of the Assembly to the content of six basic principles, the observance of which may encourage the voluntary compliance, and that are since long well established in the action carried out by the Canadian administration.

## GENERAL REPORT

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I wish to recall them one by one, also because my experience of public administrator, recently ceased, brings me to share them all. They are:

1. A tax system based on an open dialogue and consultation encourages compliance;
2. Compliance is promoted where there is no political interference in individual tax cases;
3. Clear accountability for the administration of taxes increases confidence in the tax system and enhances compliance;
4. Tax and benefits as part of an integrated wealth redistribution system promote tax compliance;
5. Cohesive coordination of intergovernmental tax policy and administration encourages tax compliance;
6. A commitment to taxpayer confidentiality increases taxpayer confidence and taxpayer compliance.

As we noted during these days the above said principles underlie the themes treated in detail and the actions suggested to increase the voluntary tax compliance, as for instance the need to achieve a continuous and open dialogue with the representatives of the economic sectors or with the communications mass media.

Mr. Jolicoeur's presentation showed us in which way, from the juridical and administrative point of view and in practical applications, the Canadian political institutions and the public administration have put into practice the above recalled principles.

Obviously, the General Reporter does not have the task to examine in detail the process that developed during the years and that brought to the positive results we mentioned before, however it can be his task to point out some crucial points of the process.

Certainly, any statement on this matter must be evaluated in relation to the context in which the action was taken, and therefore taking into account the Canadian political, social and economical conditions.

That being said and regardless of the organization of the various institutions of the State and of the powers conferred to them (Parliament, Government, and then Minister of National Revenue, Public Administration and, as a consequence, Canada Customs and Revenue Agency, etc.), whose responsibilities are those of a correct democracy and similar to those provided for in the systems of other Countries, I would like to underline two points that have been made by Mr. Jolicoeur, leaving aside others not because they are less important, but because

some of them – as the cooperation of business and professional community – have already been dealt with.

The first of these points concerns the tax decentralization (in my Country the so called tax federalism is under discussion), that shows the high level of partnership existing between the central Government and the provincial and local Governments that allows us to share the opinion that the ten provinces and the three territories forming Canada have more governmental authority than any sub-national government in any other country.

In effects, the provinces –in addition to the exclusive jurisdiction in important areas as that of public health and of education and not only that– have also unrestricted taxation powers, so much so that it can be said that there is no area of taxation not open to provinces. They have their own natural and legal person income tax systems and separate provincial excise taxes; however, through regular consultations and a common administration in various sectors, the federal and provincial tax policy and the tax administration are very well coordinated. In particular, in the sector of the tax administration there is a high level of cooperation showing, for instance, in the fact that the federal Government has agreements with all ten provinces through which the reciprocal collection of taxes is effected.

The second point concerns the confidentiality of taxpayer information, which is another element that encourages the voluntary compliance and that is ensured by the Canadian tax legislation (as also by other tax legislations, the Italian one included). The Canadian tax administration gives the utmost importance to the confidentiality of information concerning taxpayers, so much so that for the only reason of supporting voluntary compliance CCRA places great restriction on sharing this information. This does not mean, of course, that information that is useful for assessing taxes is not given, especially in the sector of international cooperation.

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During the first parallel session on the 21<sup>st</sup> (May) the mechanisms of coordination and cooperation among agencies of central government were examined; this theme was first addressed by the Dutch speaker, Mr. Alink, who illustrated the different initiatives adopted in his Country in the specific sector, the results obtained and the future developments.

## GENERAL REPORT

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The cooperation among the different Ministries and central entities in the sectors of common interest was obviously emphasized; such cooperation shows in the collaboration on matters of legislation, prevention, control and investigation. Many are the programs of joint works that are being put into practice, or that are developing, and they concern various sectors: the harmonization of legal terms, joint control on large business, multidisciplinary investigations.

Substantially, in many fields the Dutch Tax Administration is called to cooperate, and many are the interventions that it carries out in collaboration with other State Agencies.

The second speaker on this subject has been Mr. Parent (France) who explained us that in France the cooperation of the D.G.I. (General Directorate of Taxes) with other agencies of the central government started for tax control purposes, and has since developed the cooperation with public entities such as other Ministries, the courts, the police services, the local communities, Social Security entities, financial institutions and others. Furthermore, the French tax administration is adopting new initiatives to improve existing cooperation.

So said, we may conclude that essential to the good functioning of the whole structure of the State is the setting up of a coordination and a collaboration among the different public institutions; the fields of action can be many, but some I believe are common to many Countries. For instance, in Italy there is a close cooperation between the tax administration and INPS (National Institute of Social Security) that allows a wide exchange of information and useful data to cope with both tax and social insurance contribution evasion. Obviously the forms of cooperation may be different, also with regard to the structure of the national system, but all of them contribute to a better working of the state machinery, and arouse in the citizens an appreciation that positively affects the tax compliance.

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The theme of interaction between Executive, Legislative and Judicial bodies was under examination during the second parallel session on the 21<sup>st</sup>. This is a topic with peculiar characteristics, that shows as the type and nature of interaction among entities belonging to the different powers of a State (executive, legislative and judicial) are connected in

many cases, even if not always, to the Constitution of the State. Thus, even the action of the tax administrations, obviously belonging to the executive power, has precise limits within the legislation ruling their activity. The resulting wider or stricter limits, set up by the legislator also for what concerns the procedure of the action in the specific sector, must be respected by that the tax administrations.

The valuable contributions to the subject that have been presented by Mrs. Lamagrande (Argentina) and Mr. Lara (Chile) confirm the assumption that on account of the different system of the two Countries, also different is the role played respectively by the two tax administrations in their relationship with the other bodies concerned. Not that the differences are so fundamental, but at times they can have their importance.

A subject we can only hint to at this moment is that concerning the contribution required of the above tax administrations, which in my opinion has a different importance when it concerns the action of proposal of modifications to the Tax legislations.

Indeed in Chile the legislative initiative pertains exclusively to the President of the Republic and tax laws may only originate in the Chamber of Deputies, whereas the public Administrations, among which is the Internal Revenue Service, are required to supply specific reports and background information that may be requested by the Chamber or by internal bodies duly authorised.

In Argentina, instead, the tax administration, within the regulative frame in which is authorized to act, seems to have greater autonomy in the proposal of modifications to tax laws, which, obviously, cannot be sent directly to the Congress, but must undergo the examination of the executive power through the Minister of Economy.

That being said, it must be added that many could be the points for further reflection and discussion arising during the examination of this subject; however, they cannot be dealt with at this time. Summing up, in my opinion it can be said that it is difficult to indicate common actions of the tax administrations, considering the differences in the systems of the various Countries, but certainly – within the limits provided for by such systems – the various Administrations shall have to pay attention to the sector in order to create a climate of non conflicting relationships, able to spur the citizens to appreciate the action carried out by the Tax authorities, a fact that cannot but encourage the voluntary compliance.

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The mechanisms of cooperation between the tax administrations at different government levels were examined in the third parallel session within the framework of Topic 2.

One of the speakers on the subject has been a representative of Canada, Mr. Miller who highlighted a situation in which the cooperation between the central Government and the provincial and territorial ones has been developed through specific agreements for the collection of taxes of a different kind (income taxes, capital taxes, excise duties, customs duties, etc.). The speaker also described some elements drawn from experience that must be considered in order to achieve better and more efficient arrangements with provincial and territorial administrations in Canada. The review of such elements has been certainly useful for the participants in the Assembly that may face the same problem.

Equally useful was the report presented by Mrs. Lemgruber (Brazil) who explained the mechanisms of cooperation among the tax administrations at the different levels in his country, i.e. federal government, 26 federate entities and a federal district, in addition to as much as 5,500 municipalities.

The competence of Tax collection is rather spread at different levels, with a transfer mechanism that, by force of circumstances, cannot be very simple; on the other hand, it must be considered that Brazil's territory is very large (it's the fifth country in the world for the extension of its territory), is a federal country with a marked decentralization, and its decentralization developed through a long and difficult process, which went through periods of centralism and periods of decentralism.

However, the cooperation mechanisms among the different levels of tax authorities are at an advanced stage, considering the complexity that their accomplishment involves, also in relation to the claimed local autonomies.

Obviously, the goal pursued in determining the relationships among the different levels of the concerned Administrations (central, territorial or regional, provincial, town authorities) is to provide in all cases a better and better service to the citizens, so that they have a positive perception of the system of relationships among the different authorities.



In my opinion, one of the means to achieve such end is to make known the reasons underlying the choice of distribution of competences among the different authorities and the ability to fulfil the relative tasks.

This implies that both the choices made and the system of task distribution are marked by the utmost transparency, and equally clear must appear the benefits in the matter of taxes and for the citizens.

The latter, being able to evaluate the positive aspects of the cooperation system, are spurred to carry out a greater compliance with tax obligations.

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The third and last topic concerning the international cooperation to improve tax compliance was then addressed as a logic development of the basic theme of this general Assembly; Mr. Diaz (Mexico) presented the basic report and he has first of all made reference to the works carried out at international level to face the harmful tax competition and then gave a particularly interesting picture of the measures adopted in his Country to cope with harmful tax practices.

Under the first profile Mr. Diaz (Mexico) reviewed synthetically (and could not be otherwise) but very effectively the work done and the conclusions reached within the Tax Affairs Committee of OECD, reminding us that in the first stage that organization, through the Forum on harmful tax competition, devoted itself to the setting up of criteria to identify the jurisdictions that make use of a harmful tax competition, taking into account in particular the following aspects:

1. Identification of jurisdictions with no or minimum taxes;
2. Lack of effective exchange of information;
3. Lack of transparency
4. Identification of countries without significant business activities.

Such first stage, summarized in a report in June 2000, led to:

- The identification of 47 potentially harmful tax systems;
- The drawing up of a list of 35 countries or territories considered as tax havens;
- The proposal to start joint works with countries indicated as tax havens in order to remove their harmful tax practices.

## GENERAL REPORT

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A second, extremely important stage followed, which, through the Forum on harmful tax practices, led to the involvement of countries and territories considered as tax havens in order to eliminate the causes at the origin of their inclusion in the above list; the choice of a permanent dialogue with the said jurisdictions allowed to clear up some misunderstandings, to reach the noteworthy result of obtaining from many of them the important commitment to eliminate the cause of harmful tax practices within 2005.

On the other side, it has been possible to identify the so-called preferential tax regimes of the OECD member countries that must be amended or eliminated within 2003.

Finally, the extension has been made possible of the dialogue to a large number of OECD non-member countries, which is certainly a very important factor on the international level, as also very important is the other considerable result under the circumstances, that the topic of harmful tax competition was in several ways addressed by other international organizations of a regional character, including CIAT.

The second stage we are dealing with developed also the basic criteria and the definition of systems that adopt harmful tax practices that have been so well described by Mr. Diaz in his report.

A few weeks ago we learned that what we called the second stage of the OECD works ended with the production of a list of only 7 countries that qualify as fiscal havens, as all other countries have publicly committed themselves to eliminate the measures that had induced OECD to qualify them as such; equally, there seems to be an agreement on the draft agreement on the objective exchange of information.

Mr. Diaz illustrated the actions taken by his Country against the harmful tax competition, that have resulted in amendments to the Mexican legislation tending to discourage investments in countries adopting harmful tax practices. Such measures are of various nature and some of them are peculiar, as for instance the notice to the tax authorities of the investments effected in countries considered as territories with a privileged tax system, or the penalty varying from three months to 3 years of imprisonment for subjects who do not file for more than three months the report concerning the investments effected or maintained in territories with preferential tax systems.

It is to be noted that the list of such territories includes 93 countries.

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As in previous cases, the discussion on the theme of international cooperation went on in the parallel sessions, where the specificity of the subjects dealt with kept all the attention of the public, also due to the contents of the papers.

The first parallel session treated the theme of mechanisms and actions for mutual administrative assistance with the intervention of Mr. Henriksson (Sweden) and of Mrs. Haseena Ali (Trinidad and Tobago).

Mr. Henriksson (Sweden) reviewed the commitments of his Country in the field of administrative cooperation, that involve the participation to multilateral agreements, such as the Nordic convention on mutual assistance in tax matters, the joint Convention on mutual administrative assistance in tax matters developed by the Council of Europe and the OECD; in addition, as a member Country of the European Union, Sweden enforces the relative Directives and Regulations on mutual assistance. On the other hand, Sweden concluded bilateral tax treaties with as much as 80 countries, the majority of which – except for Switzerland – includes a clause on the exchange of information drawn on the basis of article 26 of the OECD convention model on matters of double taxation. In many cases the international agreements include the assistance for the enforced collection and recovery of taxes.

Mrs. Haseena Ali (Trinidad and Tobago) in making reference to the various instruments that are being used at international level to enact the reciprocal administrative assistance (Conventions to avoid double taxation, Agreements on the exchange of information, Agreements on reciprocal assistance) underlined the objective difficulties that the tax administration of a small country like his faces in providing the necessary administrative assistance abroad.

It is true that in addition to countries that have a series of juridical instruments available and are able to carry out sophisticated activities to fully enact the international cooperation on tax matters, there are other countries that have difficulties in meeting the obligations deriving from agreements on matters of exchange of information.

## GENERAL REPORT

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In this respect, I believe that first of all it should be acknowledged that the administrative cooperation is an activity involving in any case reciprocal benefits, and therefore every effort must be made in order that it can be correctly enacted. Now, if an agreement on the matter involves two tax administrations with different levels of development, the more developed tax administration must take into account the objective situation. An example can explain this concept.

Considering that the exchange of information is based on the principle of reciprocity also in fact, the tax administration with a lower grade of development may find itself to be essentially debtor of information for a specific kind of information, for instance the automatic exchange; thus the other administration, on the basis of a in fact global reciprocity, can endeavour to provide spontaneously all the information it has concerning subjects residents in the other contracting State, as also provide all general information on a specific economic sector, or sectors of activity or category of taxpayers, or even, if required, carry out programs of technical assistance.

This means that remedies to some unbalances can be sought, also within the same field of international administrative cooperation, which makes us reassert the need of a wide spread administrative cooperation on tax matters.

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As I said previously, the Mexican speaker dwelled on the action carried out by OECD on the matter of harmful tax competition and harmful tax practices; this subject has been further discussed and completed by the OECD representative Mr. Owens, who gave us an updated picture at today's date of the works carried out within his organization involving a considerable commitment, both by the member Countries and the cooperative jurisdictions, and by other Countries.

The arguments of his intervention should be all remembered, but we have a time limit, and therefore at this time I wish to point out the achievement of an agreement model on effective exchange of information, the drawing up of which is a result of the dialogue with eleven so-called cooperative jurisdictions; this project may be used for the conclusion of agreements among OECD member Countries and the committed jurisdictions.

Mrs. Piad from Panama, described the positions of this country in relation to the problem of harmful tax competition and of the commitment with OECD. She concluded that the signing of the commitment with OECD supposes for Panama, the beginning of a new stage where its international image is consolidated as a sovereign and serious country that reiterates to the international community, its capacity as a first-class financial center.

An article published on an Italian newspaper in commenting the results of OECD works against harmful tax practices, hinted to "OECD's victory"; certainly the Paris organization has done its best, as we know well, in these recent years in the sector of harmful tax competition, and we have to acknowledge it, but if we want to talk of "victory", I believe we have to talk of victory of common sense, that permeated the action of OECD and of its Member and Non-Member Countries, and of Countries and Territories with a privileged tax treatment.

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The experience made in the years on matters of administrative cooperation among tax administrations and the observation of the information exchange management at international level have pointed out on one side the benefits that can be gotten from the setting up of suitable juridical instruments and the correct application of such instruments; on the other side, the need has become clear in the present time, characterized by a continuous growth of electronic trade and by a stronger and stronger economic globalization, to perfect the exchange of information among Tax Authorities having recourse, also in this sector, to the new technologies.

The last parallel session of this Assembly moved along this line, and was devoted to the review of information systems supporting international cooperation; two important contributions have to be mentioned, one by the CIAT Executive Secretariat, and one by the Italian representatives.

The contribution presented by Mr. Seco Ferreira of CIAT is a further evidence of the working and studying skill of the Executive Secretariat with a view to favouring the growth of our organization. A draft structure of an information system for the exchange of information called j-tax HML was presented, which, taking account of the experiences made in the sector (VIES: E.U. and SINTEGRA in Brazil) and after the necessary adjustments, may be used in the field of international tax cooperation.

## GENERAL REPORT

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The solution presented by the Italian Tax Administration and by SOGEI, which recalls the CIAT Model on information exchange, consists in an information system called CIAT Information Exchange System; such system is at the same time flexible and independent of existing information platforms, and in addition it achieves the goal of providing easy to use services at a very low cost, and finally, ensures a high degree of security and confidentiality of exchanged data.

I think that we are all convinced that the tax administrations should accept the challenges represented by technological innovations, in order to improve the management of taxes, having recourse to new technologies also in the sector of international cooperation.

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It is now time to conclude this intervention with a few words that are:

- words of appreciation both for the perfect organization, for which we must thank the Canadian friends, and for the contents of the reports presented, abounding in proposals and remarks, and for the quality of the discussion, for which we thank the speakers, the commentators and all the participants in the Assembly;
- words of personal apologies, if there have been deficiencies in my exposition;
- words of many thanks to the Board of Directors and the Executive Secretariat who invited me to deliver this general report, as also to all CIAT friends.

Thank you!

**RESOLUTION OF THE  
36TH CIAT GENERAL ASSEMBLY**

Resolution of the 36th CIAT General Assembly

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## **RESOLUTION OF THE 36TH CIAT GENERAL ASSEMBLY**

### **OPPORTUNITIES FOR IMPROVING TAX COMPLIANCE THROUGH INTERACTION AND COOPERATION**

#### **Whereas:**

A fundamental strategic objective to be achieved by the tax administrations in compliance with their goal is to improve compliance with their tax obligations.

Among the various actions that should be undertaken by the tax administration for achieving better compliance, worth noting are the actions that involve interaction between said administration and other entities and especially, the actions of a cooperative nature.

In interaction and cooperation between the tax administration and other entities for promoting compliance with tax obligations, one may differentiate two main objectives: facilitating compliance and fighting against noncompliance in all its forms, for which reason such interaction and cooperation may consist of the establishment and strengthening of schemes in support of the taxpayers, as well as for controlling compliance by those same taxpayers.

Interaction and cooperation between the tax administration and other entities comprise the relationships with citizens and private entities, as well as with political institutions and other public organizations of the country and, also, with the tax administrations of other countries, which allows and renders it convenient to anticipate specific actions in relation to each of these spheres, namely: the national private sector, the national public sector and the foreign tax administrations.

The General Assembly,

**Resolves:**

To recommend to the tax administrations of its member countries:

***FIRST: To interact with the private sector for improving tax compliance.***

1. By establishing a strategy for optimizing interactions with the mass communications media, in order to transmit, through them, positive messages to society, as regards the function of taxes and the image of the tax administration.
2. By ensuring, the correct application of tax norms and by ensuring that the costs of compliance be reduced to the minimum essential amount.
3. By establishing mechanisms of contact with business organizations, with chambers that group areas of economic activity and with professional and union organizations for obtaining information on taxpayers subject to the tax obligations and areas of economic activities, in order to become aware of, and take into consideration their viewpoints and receive suggestions on tax issues, as well as for the diffusion of tax information.

***SECOND: To interact with political institutions and other public authorities within their country for improving tax compliance.***

1. By establishing mechanisms of coordination and cooperation between different central government agencies, through the adoption of common guidelines with respect to systems that may expand the information available for the tax administration, as well as with respect to procedures that may facilitate the processes to be undertaken by the taxpayers.
2. Endeavoring to bring the tax administration closer to the powers: with the legislative power encouraging, through the pertinent channels, proposals for reform based on the feedback obtained from the execution of the legislation in force; with the executive, wherein the tax administration is framed, receiving the resolute

support to its management from the top level authorities; and with the judicial power developing initiatives that may favor understanding of the importance and social implications of tax credit among the judges, as well as showing faithful abidance by taxpayer rights and guarantees.

3. By entering into agreements on mechanisms of cooperation between tax administrations of different government levels, to facilitate taxpayer compliance as well as strengthen the control of such compliance, by means of the establishment of simplified systems that cover taxes of different tax spheres, by setting up centers for shared taxpayer assistance and information, sharing data bases, adopting a single file number, etc.

***THIRD: To promote international cooperation for improving tax compliance.***

1. Entering into international cooperation agreements with tax administrations from other countries that may allow for expanding actions beyond the national borders, as regards obtaining information, as well as, in certain cases, exercising actions such as, for example, examinations abroad, notification of documents and enforced collection of tax debts.
2. Adopting certain criteria and mechanisms, coordinated at the international level, for effectively combating harmful tax practices of certain countries, such as the establishment of “tax havens” and preferential regimes.
3. Developing and using information systems that may support the exchange of tax information, through modern communications and information technologies that may render possible, for example, the use of shared data bases or access to data bases of other countries, the use of equivalent and compatible parameters in the information systems, etc.

## **CLOSING SESSION**

## CLOSING SESSION

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**STATEMENT BY RUBEN AGUIRRE PANGBURN,  
DEPUTY SECRETARY OF REVENUE,  
TREASURY AND PUBLIC CREDIT SECRETARIAT OF MEXICO,  
ON BEHALF OF THE PARTICIPANTS**

Ladies and Gentlemen:



Mr. RUBEN AGUIRRE PANGBURN

On behalf of all delegates, I would like to thank the organizers of this General Assembly.

Fifteen years ago, Ottawa hosted CIAT's General Assembly. On this occasion the Canadian Government selected Quebec to hold the 36<sup>th</sup> General Assembly. This has decision allowed us to gather in the "Belle Province" and realize that the City of Quebec and its surroundings honor this appeal.

A while ago the General Rapporteur presented us the results of the Meeting, which were undoubtedly strongly influenced by the efficiency of the organizers and their warm welcome.

This warm welcome was manifest from the onset, during the reception held on Sunday evening as well as on Monday during the General Assembly of Quebec, and at the Stone Cottage and the expedition to the regions of Charlevoix and Saint Laurent. These activities allowed us to rekindle old friendships and establish new ones, but, above all, to better know Canada and our Canadian friends.

## CLOSING SESSION

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We are all especially grateful to Mrs. Elinor Caplan, Minister of National Revenue, Mr. Robert Wright, Commissioner of Canada Customs and Revenue Agency, Mr. Alain Jolicoeur, Deputy Commissioner, Mr. William McCloskey, Assistant Commissioner Policy and Legislation, and Mrs. Elisabeth Chatillon, Assistant Commissioner Quebec.

I take this opportunity to ask the following persons, members of the Organizing Committee to step forward to bestow them special recognition:

Enrico W del Castello, Director, International Affairs and General Event Coordinator: "who did everything possible and succeeded"

Sheila Watson, Deputy Director, International Affairs, Right hand of the Coordinator.

Michel Bastien, Senior Advisor, International Affairs, Information Technologies Team Leader.

Denise Albert-Lanthier, Administrative Assistant, International Affairs and Assistant to the Organizing Committee Directorate.

Christiane Lavoie, Senior Advisor Quebec, Coordinator of the Secretariat of the Event.

Esther Foster, Team Leader of the City of Quebec.

Kris Mullen, Team Coordinator, Information Technologies Support.

Finally, I would like to cordially invite you to CIAT's 37th General Assembly, which will be held in the Riviera Maya in Mexico, during April 2003.

The Riviera Maya is located in the Peninsula of Yucatan, sharing its Airport with Cancun and is located between this City and the Maya site at Tulum.

We will be expecting you in Mexico.

QUEBEC, Canada, May 23, 2002

## **TECHNICAL PROGRAM**



## TECHNICAL PROGRAM

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**DAILY SCHEDULE OF ACTIVITIES OF THE  
36TH CIAT GENERAL ASSEMBLY**

**Main theme: Opportunities for Improving Tax Compliance  
Through Interaction and Cooperation**

**Monday, May 20**

**Inaugural Session:**

09:00-10:00 Inauguration of the General Assembly

10:00-10:30 Official photograph and coffee

Plenary Session

10:30-11:15 **Topic 1. Interaction with the private sector for improving tax compliance**

**Moderator:** Juan Toro Rivera, Director of the Internal Revenue Service of Chile and CIAT's President.

**Speaker:** Roberto Serrano López, Director, Human Resources & Economic Administration Dept., State Agency of Tax Administration of Spain.

11:15-11:45 **Commentators:** Pedro Spielmann, General Directorate of Taxation of Uruguay.

Teófilo Quico Tabar, Director General, General Directorate of Internal Taxes of the Dominican Republic.

11:45-12:30 Open discussion

## TECHNICAL PROGRAM

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12:30-14:00 Lunch

**Parallel sessions:**

14:00-15:00 Presentations

**Topic 1.1**      **Strategies for achieving greater acceptance of taxes and of the tax administration. (Interaction between communications media and the tax administration).**

**Moderator:** Juan José Rubio Guerrero,  
Director General, Institute of Fiscal Studies of Spain.

**Speakers:** René H. Pérez Ordóñez,  
Superintendent, Superintendency of Tax Administration of Guatemala.

Victor Sancho  
Public Relations General Directorate of Taxes Portugal.

**Topic 1.2**      **Relationship between the amount and distribution of the tax burden and tax compliance.**

**Moderator:** Roy May, Director, Directorate of Taxes of Suriname.

**Speakers:** Luiz Villela, Tax Specialist, Fiscal Division, Inter-American Development Bank- IDB.

Carlos Silvani, Deputy Director, International Monetary Fund - IMF.

**Topic 1.3**      **Cooperation of business and professional organizations**

**Moderator:** Guillermo Romero Domínguez, Director of Examination, General Directorate of Taxes of El Salvador.

TECHNICAL PROGRAM

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**Speakers:** William Baker, Assistant Commissioner, Verification, Enforcement and Compliance Research, Canada Customs and Revenue Agency.

Deborah Nolan, Deputy Commissioner, Large & Midsizes Bussines, Internal Revenue Service of United States of America.

15:00-16:00 Guided discussion

**Tuesday, May 21**

08:30-09:00 Reports on parallel sessions of previous day

**Plenary Session:**

09:00-09:45 **Topic 2. What is the appropriate level of interaction between political institutions and publica uthorities to improve tax compliance?**

**Moderator:** Everardo Maciel, General Secretary, Secretariat of Federal Revenues of Brazil.

**Speaker:** Alain Jolicoeur, Deputy Commissioner, Canada Customs and Revenue Agency.

09:45-10:15 **Commentators:** Clive Nicholas, Director General, Tax Administration of Jamaica.

Trino Alcides Díaz, National Superintendent, National Integrated Customs and Tax Administration Service of Venezuela.

## TECHNICAL PROGRAM

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10:15-11:00 Open discussion

### **Parallel Sessions:**

11:00-12:00 Presentations

**Topic 2.1**      **Mechanisms of coordination and cooperation between agencies of the central government (The adequacy of the data bases and information systems for internal cooperation between public organizations).**

**Moderator:** Jorge Eduardo Zegada Claire, Executive President, National Service of Internal Taxes of Bolivia.

**Speakers:** Matthijs H. Jacob Alink, Deputy Director International, Ministry of Finance of The Netherlands.

Bruno Parent, Deputy Director General, General Directorate of Taxes of France.

**Topic 2.2**      **Interaction between executive, legislative and judicial bodies.**

**Moderator:** Mario Duarte Caballero, Director, Executive Directorate of Revenues of Honduras.

**Speakers:** María Lamagrande, Chief of the Tax Legal Division, Federal Administration of Public Revenues of Argentina.

Bernardo Lara, Legal Deputy Director, Internal Revenue Service of Chile.

**Topic 2.3**      **Mechanisms of cooperation between the tax administrations at different government levels.**

TECHNICAL PROGRAM

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**Moderator:** Armando Arteaga Quiñe, Deputy Superintendent, National Superintendency of Tax Administration of Peru.

**Speakers:** David Miller, Canada Customs and Revenue Agency.

Andrea Lemgruber Viol, General Coordinator of Tax Policy, Secretariat of Federal Revenues of Brazil.

12:00-12:45 Guided discussion

12:45-14:00 Lunch

**Wednesday, May 22**

FREE DAY

**Thursday, May 23**

08:30-09:00 Reports on parallel sessions of previous day

**Plenary Session**

09:00-09:45 **Topic 3. International cooperation to improve tax compliance**

**Moderator:** Bruno Parent, Deputy Director General, General Directorate of Taxes of France.

**Speaker:** Eduardo Enrique Díaz, General Administrator of Large Taxpayers, Tax Administration Services of Mexico.

## TECHNICAL PROGRAM

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09:45-10:15 **Commentators:** Consuelo Caldas Cano, Director General, Directorate of National Taxes and Customs of Colombia.

William Layne, Permanent Secretary of Finance, Ministry of Finance & Economic Affairs of Barbados.

10:15-11:00 Open discussion

### **Parallel Sessions:**

11:00-12:00 Presentations

#### **Topic 3.1 Mechanisms and actions for mutual administrative assistance**

**Moderator:** Haleyxa Tandrón Castillo, Director General, National Office of Tax Administration of Cuba.

**Speaker:** Mats Henriksson, Tax Director, National Tax Board of Sweden.

Haseena Ali, Commissioner and Chairman, Board of Inland Revenue of Trinidad and Tobago.

#### **Topic 3.2 The combat against harmful tax practices**

**Moderator:** Alberto Barreix, Tax Specialist, Fiscal Division, Inter-American Development Bank- IDB.

**Speakers:** Jeffrey Owens, Principal Administrator, Organisation for Economic Co-Operation and Development - OECD.

Estelabel Piad Herbruger, General Director, General Directorate of Revenues Panama.

Topic 3.3 Information systems to support international cooperation

**Moderator:** Elsa Romoleroux de Mena, General Director, Internal Revenue Service of Ecuador.

**Speakers:** Antonio Seco, Consultant CIAT Executive Secretariat

Luigi Ambrosio, Ministry of Finance of Italy.

Andrea Paventi, SOGEI Consultant, Italy.

12:00-12:45 Guided discussion

12:45-14:00 Lunch

14:00-14:30 **General Report** - Michele del Giudice, Ministry of Finance, Italy

14:30-16:00 Closing ceremony



## **LIST OF PARTICIPANTS**

## LIST OF PARTICIPANTS

---

**36TH General Assembly**

**Quebec, Canada  
May 20-23, 2002**

**AATA**

Pascal-Baylon Owona  
Secretary-General  
Association African Tax Administrators  
A.A.T.A.

**ARGENTINA**

Mario Francisco Cigoj  
Director Secretaría General, AFIP  
Administración Federal de Ingresos  
Públicos

Marina Claudia Lamagrande  
Jefa División Legal Tributaria  
Administración Federal de Ingresos  
Públicos, AFIP

**BARBADOS**

William Layne  
Permanent Secretary of Finance,  
Government of Barbados  
Ministry of Finance & Economic Affairs

Sabina Walcott-Denny  
Commissioner of Inland Revenue  
Department of Inland Revenue

**BELGIUM**

Ghislain Vandercapellen  
Director General  
Ministry of Finance

**BERMUDA**

Michael Crichlow  
Senior Tax Auditor  
Office of the Tax Commissioner

**BOLIVIA**

Sergio Pascual Avila  
Gerente General SI  
Servicio de Impuestos Nacionales

Oscar Vázquez  
Director General  
Programa Asistencia Técnica  
Internacional  
Servicio de Impuestos Nacionales

Jorge Eduardo Zegada Claure  
Presidente Ejecutivo  
Servicio de Impuestos Nacionales

**BRAZIL**

Luciana Mesquita Cussi  
Secretária Adjunta  
Secretaria da Receita Federal

Gilson Oliveira Lariu  
Director-Superintendente  
Serviço Federal de Processamento de  
Dados-SERPRO

Andrea Lemgruber Viol  
Coordenadora-Geral de Política Tributária  
Secretaria da Receita Federal-SRF

Everardo Maciel  
Secretario  
Secretaria da Receita Federal

María Fátima Pessoa de Mello Cartaxo  
Diretora-Geral  
Escola de Administração Fazendária-  
ESAF

Luciano Pietracci  
Chefe Departamento Segurança da  
Informação  
SERPRO- Ministério da Fazenda

Luiz Tacca Junior  
Secretário-Executivo Adjunto  
Ministério da Fazenda

**BRAZIL - STATES**

Paulo Fernando Machado  
Secretario Adjunto SEFA  
Secretaria Executiva da Fazenda

## LIST OF PARTICIPANTS

---

### **CAMEROON**

Marthe Chantal Mbajon  
Sous-directrice  
Direction des Impôts, MINEFI  
Ministère des Finances

### **CANADA**

William V. Baker  
Assistant Commissioner  
Canada Customs and Revenue Agency

Elinor Caplan  
Minister of National Revenue  
Canada Customs and Revenue Agency

Elisabeth Châtillon  
Assistant Commissioner  
Canada Customs and Revenue Agency

Enrico del Castello  
Director  
Canada Customs and Revenue Agency

Barbara Fulton  
Assistant Commissioner  
Canada Customs and Revenue Agency

Alain Jolicoeur  
Deputy Commissioner  
Canada Customs and Revenue Agency

William McCloskey  
Assistant Commissioner Policy & Legis  
Canada Customs and Revenue Agency

David W. Miller  
Assistant Commissioner  
Canada Customs and Revenue Agency

John Murphy  
International Relations Coordination  
Office and CIAT Correspond  
Canada Customs and Revenue Agency

Robert Wright  
Commissioner  
Canada Customs and Revenue Agency

### **CANADA - APFF**

Gilles Bernier  
Directeur des Relations Internationales  
Association de Planification Fiscale et  
Financière-APFF

Yvon L. Caron  
Président Directeur Général  
Association de Planification Fiscale et  
Financière

### **CATA - Commonwealth Association of Tax Administrators**

Zahir Kaleem  
Executive Director  
Commonwealth Association of Tax  
Administrators

### **CHILE**

Alfredo Echeverría Herrera  
Subdirector Contralor Interno  
Servicio de Impuestos Internos

Javier Etcheberry Celhay  
Ministro de Obras Públicas  
Ministerio de Obras Públicas

Bernardo Lara Berríos  
Subdirector Jurídico  
Servicio de Impuestos Internos

Juan Toro Rivera  
Director  
Servicio de Impuestos Internos

Jorge Trujillo  
Director Grandes Contribuyentes  
Servicio de Impuestos Internos, SII

### **CHINA**

Wenhui Ding  
Spanish Interpreter  
State Administration of Taxation

Lizeng Feng  
Deputy Division Director  
State Administration of Taxation

Hongwei Fu  
Deputy Division Director  
State Administration of Taxation

Bangjing He  
Deputy Commissioner  
State Administration of Taxation

Yang Li  
Division Director  
State Administration of Taxation

## LIST OF PARTICIPANTS

---

### **CIAT - Inter-American Center of Tax Administrations**

Mónica Alonso Ros-Zanet  
Head of International Meetings Unit  
Inter-American Center of Tax  
Administrations

María Raquel Ayala Doval  
Research and Training Manager  
Inter-American Center of Tax  
Administrations

Francisco Javier Beiner Lavanderos  
Regional Operations Manager  
Inter-American Center of Tax  
Administrations

Jorge Cosulich Ayala  
Executive Secretary  
Inter-American Center of Tax  
Administrations

Francisco Da Cunha  
Tax Computerization Manager  
Inter-American Center of Tax  
Administrations

Claudino Pita  
Programming and Studies Director  
Inter-American Center of Tax  
Administrations

Antonio Sergio Seco Ferreira  
Consultant UCP/PNAFE

Ayín Sucre de  
Translator  
Inter-American Center of Tax  
Administrations

### **COLOMBIA**

Consuelo Caldas Cano  
Directora General de Impuestos  
Dirección de Impuestos y Aduanas  
Nacionales - DIAN

### **COSTA RICA**

Ronald Solórzano Vega  
Coordinador de Proyectos  
Dirección General de Tributación  
Ministerio de Hacienda

Giovanni Tencio Pereira  
Director, División de Gestión  
Dirección General de Tributación  
Ministerio de Hacienda

Adrián Torrealba Navas  
Director General  
Dirección General de Tributación  
Ministerio de Hacienda

### **COTA - Caribbean Organization of Tax Administrators**

Marva Lee  
Executive Secretary  
Caribbean Organization of Tax  
Administrators

### **CREDAF - Centre de Rencontres et d'Etudes des Dirigeants des Administrations Fiscales**

Alain Gerbeaud  
Secrétaire Général  
Centre de Rencontres et D'Etudes des  
Dirigeants des Administrations Fiscales

### **CREDAF-CAMEROON**

Polycarpe Abah Abah  
Directeur et Président  
Ministère des Finances

### **CUBA**

Armando Lopetegui Martínez  
Vice-Jefe  
Oficina Nacional de Administración  
Tributaria - ONAT

Haleyxa Tandrón Castillo  
Directora General  
Oficina Nacional de Administración  
Tributaria - ONAT

### **CZECH REPUBLIC**

Michal Svorec  
Director of Legislation Department  
Ministry of Finance

Robert Szurman  
Director General, Central Fin & Tax Dir  
Ministry of Finance

## LIST OF PARTICIPANTS

---

### **DOMINICAN REPUBLIC**

Zeneyda Bautista  
Sub-Directora General  
Dirección General de Impuestos Internos

Víctor Leonardo Rodríguez  
Sub-Secretario de Estado de Finanzas  
Secretaría de Estado de Finanzas  
Dirección General de Impuestos Internos

Teófilo Quico Tabar  
Director General  
Dirección General de Impuestos Internos  
Secretaría de Estado de Finanzas

Nieves Vargas Collado  
Enc. Depto. Programación Económica  
Dirección General de Impuestos Internos  
Secretaría de Estado de Finanzas

### **ECUADOR**

Oswaldo Aguirre  
Director Nacional de Desarrollo  
Institucional  
Servicio de Rentas Internas

Raúl Martínez Burbano  
Coordinador Regional Gestión Tributaria  
Servicio de Rentas Internas

Elsa Romo-Leroux de Mena  
Directora General  
Servicio de Rentas Internas

### **EL SALVADOR**

Guillermo Antonio Romero Domínguez  
Director de Fiscalización de Impuestos  
Internos  
Ministerio de Hacienda

### **ESTONIA**

Aivar Soerd  
Director General  
Estonian Tax Board

### **FRANCE**

Renaud Gace  
French Customs Counselor  
French Customs/ French Embassy  
Washington DC

Edmond Lacroix  
Head of French Mission at CIAT  
Inter-American Center of Tax  
Administrations

Josiane Lanteri  
Director for the International Coop. U.  
Direction Générale des Impôts

Jean-Pierre Lieb  
Sous-directeur de Législation Fiscale  
Direction Générale des Impôts, DGI

Christiane Maréchal  
Attachée Fiscale  
Embassy of France- Washington DC  
Embassy of France

Bruno Parent  
Directeur Général Adjoint, DGI  
Direction Générale des Impôts

Hugues Vilaplana  
Directeur Adjoint Dep. Cooperation  
Internationale  
Direction Générales des Impôts

### **GERMANY**

Christoph Habammer  
Deputy Director of Organization and  
Computerization  
Baviera's Ministry of Finance

### **GERMANY - GTZ**

Matthias Witt  
Sector Specialist Public Finance  
Caribbean Custom Law Enforcement  
Council  
Zusammenarbeit (GTZ) GmbH

### **GUATEMALA**

Raúl Berríos  
Director  
Superintendencia de Administración  
Tributaria, SAT

Jorge Borstcheff  
Director, SAT  
Superintendencia de Administración  
Tributaria

## LIST OF PARTICIPANTS

---

Juan Carlos Garavito  
Gerente de Informática  
Superintendencia de Administración  
Tributaria, SAT

Rodrigo Montúfar  
Director  
Superintendencia de Administración  
Tributaria, SAT

René Humberto Pérez Ordóñez  
Superintendente  
Superintendencia de Administración  
Tributaria

### **HAITI**

Jean Emmanuel Casséus  
Directeur de l'UGCF  
Direction Générale des Impôts

John Emmanuel Desroches  
Directeur Général  
Direction Générale des Impôts

Lemaire Polynice  
Directeur des Opérations  
Direction Générale des Impôts

Jean-Baptiste Télémaque  
Conceiller  
Direction Générale des Impôts

### **HONDURAS**

Mario Duarte Caballero  
Director Ejecutivo de Ingresos  
Dirección Ejecutiva de Ingresos

### **IBFD - International Bureau of Fiscal Documentation**

Victor van Kommer  
Head Government Consultancy  
Department  
International Bureau of Fiscal  
Documentation

### **IDB - Inter-American Development Bank**

Alberto Barreix  
Regional Economist  
Inter-American Development Bank

Jorge Febres  
Economist, State and Civil Society Division  
Inter-American Development Bank

Luiz Villela  
Specialist in Taxation  
Inter-American Development Bank  
IMF - International Monetary Fund

Carlos Silvani  
Assistant Director  
International Monetary Fund

Teresa Ter-minassian  
Director of Western Hemisphere Dept.  
International Monetary Fund

### **IOTA - Intra-european Organization of Tax Administrations**

Raits Averats  
Executive Secretary  
Intra-European Organization of Tax Adm.

Andrejs Sonciks  
President  
Intra-European Organisation of Tax Adm.

### **IRELAND**

Frank Daly  
Chairman, Revenue Ireland  
Revenue Commissioners

Frank Mullen  
Assistant Secretary, Head of Direct Taxes  
Revenue Ireland

### **ITALY**

Luigi Ambrosio  
Dirigente  
Ministero delle Finanze

Carlo Anderlini  
Dirigente  
Ministero Economia e Finanze

Michele del Giudice  
Conseiller  
Ministero delle Finanze

## LIST OF PARTICIPANTS

---

Alessio Nardi  
Maggiore  
Guardia di Finanza

Luigi Pacifico  
Dirigente Generale  
Ispettorato Generale D'Informatica

### ITALY - CESTEC

Vicenzo Fortunato  
Coordinator  
Centro Europeo Studi Tributari e  
Electronic Commerce

### ITALY - SOGEI

Andrea Paventi  
SOGEI Consultant  
Società Generale di Informatica

Annunziata Surico  
SOGEI Consultant  
Società Generale di Informatica, SOGEI

### JAMAICA

Cherry Gordon  
Senior Director  
Ministry of Finance & Planning

Gay Mitchell  
Deputy Commissioner  
Inland Revenue

Clive Nicholas  
Director General for Tax Administration  
Ministry of Finance and Planning

### JAPAN

Yoshiyasu Okada  
Deputy Commissioner (International  
Affairs)  
National Tax Agency

Shinji Tauchi  
Professor  
National Tax College

### KENYA

John Paul Munge  
Commissioner General  
Kenya Revenue Authority

Jack Ranguma  
Commissioner of Income Tax  
Kenya Revenue Authority

### KOREA

Chul Gun Hong  
Director of International Cooperation  
Division  
National Tax Service

Seong Tae Kang  
Secretary to the Commissioner  
National Tax Service

Young Lae Son  
Commissioner  
National Tax Service

### MALAYSIA - SGATAR

Zainol Abidin Bin Abd. Rashid  
Chairman SGATAR/Director General of  
Inland Revenue  
SGATAR/Inland Revenue Board

Mohd Zaid Bin Ismail  
Assistant Director General  
Inland Revenue Board

Tengku Kamarulzaman Bin Tengku Ahmad  
Director  
Inland Revenue Board

### MEXICO

Rubén Aguirre Pangburn  
Subsecretario de Ingresos  
Secretaría de Hacienda y Crédito Público

Consuelo Arce Rodea  
Coordinadora General de Asesores del  
Subsecretario de Ingresos de SHCP

Eduardo Enrique Díaz Guzmán  
Administrador General de Grandes  
Contribuyentes  
Servicio de Administración Tributaria  
(SAT)-SHCP

María Teresa Gutiérrez Ayala  
Administradora General de Innovación y  
Calidad  
Servicio de Administración Tributaria



---

LIST OF PARTICIPANTS

---

**MOROCCO**

Rachida Chhah  
Inspecteur Divisionnaire en Chef  
Direction des Impôts

Brahim Chiguer  
Chief of National Auditing Unit Service  
Direction des Impôts

**MOZAMBIQUE**

António Luis Pale  
Chairman Administrative Tribunal  
Administrative Tribunal

**NETHERLAND ANTILLES**

Jamila Isenia  
Deputy Head of Inspectorate of Taxes  
Directie der Belastingen

**NEW ZELAND**

Richard Philp  
Service Centre Manager  
Inland Revenue

**NICARAGUA**

Santos Santiago Acosta Acevedo  
Subdirector General de Operaciones  
Dirección General de Ingresos

Róger Arteaga Cano  
Director General  
Dirección General de Ingresos

**OECD - Organisation for the  
Economic Cooperation and  
Development**

Stuart Hamilton  
Head, Tax Administration  
Organisation for the Economic  
Cooperation and Development

Jeffrey Owens  
Head, CTPA  
Division des Affaires Fiscales

Richard Parry  
E-commerce OECD-DAFFE  
Organisation for the Economic  
Cooperation and Development

**PANAMA**

Nelson Gutiérrez  
Coord. Prog. Modernización Sist. Trib.  
Dirección General de Ingresos  
Ministerio de Economía y Finanzas

Estelabel Piad  
Directora General  
Dirección General de Ingresos

Maribel T. Sousa de Moreno  
Asesora Despacho de Asesoría  
Tec. Tributaria.  
Dirección General de Ingresos

**PERU**

Armando Arteaga Quiñe  
Superintendente Nacional Adjunto  
Superintendencia Nacional de  
Administración Tributaria, SUNAT

Carlos Drago Llanos  
Intendente Nacional de Sistemas de  
Información  
Superintendencia Nacional de  
Administración Tributaria, SUNAT

Nahil Hirsh Carrillo  
Intendente Nacional de Cumplimiento  
Tributario  
Superintendencia Nacional de  
Administración Tributaria, SUNAT

**PORTUGAL**

Víctor Sancho  
Relaciones Públicas, DGI  
Direção-Geral dos Impostos

**SLOVAK REPUBLIC**

Ondrej Mráz  
Director General  
Slovak Tax Directorate

Jana Petrová  
Interpreter to Slovak Director General  
Slovak Tax Directorate

**SOUTH AFRICA**

Pravin Gordhan  
Commissioner, SARS  
South African Revenue Service

## LIST OF PARTICIPANTS

---

Gene Ravele  
Assistant General Manager, Compliance  
South African Revenue Service

Vuso Shabalala  
General Manager Customs  
South African Revenue Service

### **SPAIN**

Luis Cremades Ugarte  
Director Escuela de Hacienda Pública  
Instituto de Estudios Fiscales, IEF

Fernando Díaz Yubero  
Presidente del Grupo de Trabajo de  
Coordinación de la AEAT  
Agencia Estatal de Admón. Tributaria

Raúl Junquera  
Jefe de la Misión Española ante el CIAT  
Inter-American Center of Tax  
Administrations

Juan José Rubio Guerrero  
Director General IEF  
Instituto de Estudios Fiscales

Salvador Ruíz Gallud  
Director General  
Agencia Estatal de Administración  
Tributaria

Roberto Serrano López  
Director Dpto. Recursos Humanos  
y Admón. Económica  
Agencia Estatal de Administración  
Tributaria, AEAT

### **SURINAME**

Roy May  
Directeur  
Directoraat der Belastingen

Joan Veldhuizen  
Deputy Inspector  
Directoraat der Belastingen

### **SWEEDEN**

Mats Henriksson  
Tax Director  
National Tax Board

### **TAIWAN R.O.C.**

Li-Chien Kuo  
Senior Specialist  
Ministry of Finance

### **THE NETHERLANDS**

Matthijs Hendrik Alink J.  
Deputy Director International  
Ministerie van Financien

Pieter J. Vogelaar  
Deputy Director  
International Tax Policy and Legislation

### **TRINIDAD & TOBAGO**

Haseena Ali  
Commissioner and Chairman  
Board of Inland Revenue  
Inland Revenue Division

### **UNITED NATIONS**

Suresh N. Shende  
Interregional Adviser in Social Mob.  
Department of Economic & Social Affairs

Jerzy Szeremeta  
Chief, Public Policy Analysis and  
Development Branch  
United Nations

### **UNITED STATES**

Elvin Hedgpeth  
Deputy Director International Programs  
Internal Revenue Service

Joe Hook  
US Treasury Representative  
US Treasury

Deborah Nolan  
Deputy Commissioner, Large & Midsize B.  
Internal Revenue Service

Paul Rolli  
Manager, Overseas Operations  
Internal Revenue Service

Socorro Velázquez  
CIAT Correspondent  
Internal Revenue Service

Bob Wenzel  
Deputy Commissioner  
Internal Revenue Service

## LIST OF PARTICIPANTS

---

### **URUGUAY**

Pedro Spielmann  
Director de División Interior  
Dirección General Impositiva

### **URUGUAY - BPS**

Mario Enrique Menéndez García  
Director Empresarial  
Banco de Previsión Social -BPS

### **VENEZUELA**

Luis Alvarado  
Director de la Oficina de Planificación  
Servicio Nacional Integrado de  
Administración Aduanera y Tributaria -  
SENIAT

Trino Alcides Díaz  
Superintendente Nacional Tributario  
Servicio Nacional Integrado de  
Administración Aduanera y Tributaria -  
SENIAT

Elias Eljuri  
Intendente Nacional de Tributos Internos  
Servicio Nacional Integrado de  
Administración Aduanera y Tributaria -

### **SENIAT**

Juan Ramón Rivas Rojas  
Gerente de Tributos Internos-Reg.  
Los Andes  
Servicio Nacional Integrado de  
Administración Aduanera y Tributaria -  
SENIAT

### **VENEZUELA - ENAHP**

Elías López Latorre  
Director General ENAHP  
Escuela Nacional de Administración y  
Hacienda Pública - ENAHP

Nerio Ramón Olivares Navas  
Director de Postgrados y  
Adiestramiento -ENAHP  
Escuela Nacional de Administración y  
Hacienda Pública

### **WORLD BANK**

Michael Engelschalk  
Head, Tax Policy and Tax  
Administration Group  
World Bank

## LIST OF PARTICIPANTS

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All the material contained in this publication was prepared, set up and printed at the Publications Center of the CIAT Executive Secretariat, P.O. Box 2129, Panama 9A, Rep. of Panama. 60 copies were printed