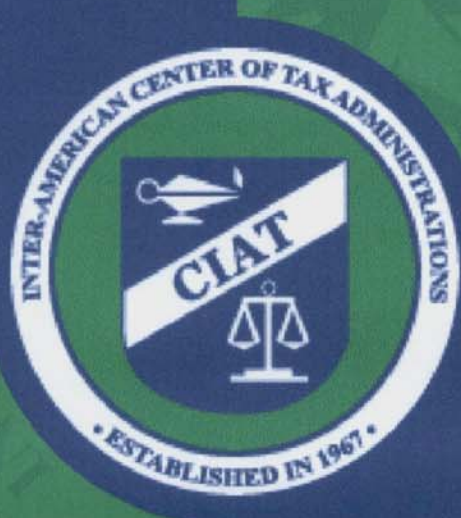




Service of National Taxes

38th CIAT General Assembly

The Examination Function of the Tax Administration



BOLIVIA

Cochabamba, Bolivia
March 8-11, 2004

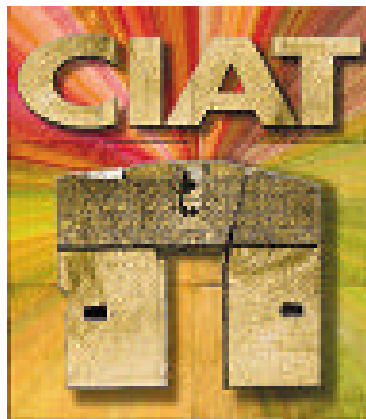


Inter-American Center of Tax Administrations - CIAT

Service of National Taxes - SIN



38th CIAT General Assembly



The Examination Function of the Tax Administration

Cochabamba, Bolivia
March 8 - 11, 2004

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PRESENTATION ON CIAT

Presentation on CIAT

CIAT is a public international organization established in 1967 to promote the improvement of the tax administrations through: exchange of ideas and experiences; technical assistance and training; compilation and distribution of information; and promotion of technical research.

The Center is formed by 29 countries from the Americas and five European countries as Associate Members. The Minister of Finance or Treasury of each country designates the positions in his tax administration, the incumbents of which are the Representatives at CIAT.

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Presentation on CIAT

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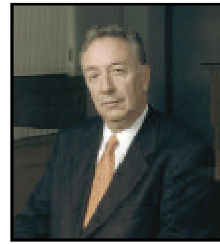
Cochabamba, Bolivia, March, 8 - 11, 2004

INAUGURAL CEREMONY

Welcome statement by

**Ruben Aguirre Pangburn
President of the CIAT Executive Council
Deputy Secretary of Revenues
Secretary of Treasury and Public Credit
(Mexico)**

As President of the Directive Council of the Inter-American Center of Tax Administrations, I wish to thank on behalf of all the member countries of our Organization, the valuable demonstration of shared unity, and the spirit of solidarity of the Bolivian authorities, upon offering us their country and their renowned hospitality in hosting our General Assembly.



Ruben Aguirre Pangburn

Having as scenario the beautiful City of Cochambamba, which as few is representative of Bolivia's culture and its people, we begin our work sessions and social activities, which, is usual during the meetings of the Center, and this will give us the opportunity to enrich ourselves twice over: as tax administration professionals and as people concerned with serving the citizens of your countries better every day as well as promoting frank and ample cooperation among all tax administrations.

The international organization which we belong to, is about to close a phase, that although is similar as far as a successful culminations concern, to those administrations that preceded, through its 37 years of existence, acquires special relevance because of two facts: the profits reached and the future challenges that appear as from now, including between the latter, the difficult and important task of starting up a process for the selection for a new Executive Secretary.

INAUGURAL CEREMONY

Among the many achievements attained during the phase that we began over a decade ago and which now allow us to have a consolidated and internationally renowned organization as the most important organization in the field of the tax administration, I would like to highlight two of these, which are representative of our advances in strengthening CIAT, achievements that are reflected in the modifications that are introduced the bylaws.

First, it meant an institutional consolidation, upon modifying its denomination and its direction, transitioning from Center of Tax Administrators to Center of Tax Administrations, in this manner, giving a clear signal of the conversion of an organization of individuals to an organization of institutions.

Second, it broadened its geographic scope, although it continues maintaining its American roots, it opened an opportunity to get countries above other continents as members of plenary sessions. This initiative was made to recognize the valuable contribution led by European countries that had been participating in the organization as associated members, and this had an immediate effect in them, choosing Spain, France, Italy, the Netherlands and Portugal to participate fully as member countries, which honors and satisfy us.

As far as the future challenges that we can already glimpse, we must firstly place the road traveled to date successfully by our Organization, which commits us to maintain our efforts in favor of cooperation and the cohesion among our tax administrations. This is the only way we will be able to generate the essential synergies to face victoriously an internationalized and complex environment, wherein most actors already have developed strategies that lead them to realize their interests.

Also let us design together a strategy, therefore, lets take advantage of a path that was already outlined and proven to be successful, strengthening our ties of mutual cooperation and CIAT as a meeting point to exchange experiences and search for solutions, through a typical form of consensus, that is, to consider in a balanced manner the interests of each of our member countries and the respect of their opinions.

In this fiscal year that comes to an end and during which I was in charge of chairing Executive Council, we can consider that the goals and the targets proposed in Cancun, Mexico, have been fulfilled. The Executive Secretariat, based on the high professionalism and degree of commitment with the institution, which characterizes all its personnel, accurately executed the Plan of Activities and the Annual Budget, also approved at that time.

INAUGURAL CEREMONY

I do not wish to conclude without briefly referring to the main topic of this Assembly: "The Examination Function of the Tax Administration."

The examination function accomplishes an essential role in the tax administration; as it includes the fundamental actions of fighting evasion to safeguard the fair application of the tax system and in this manner achieve an adequate level of tax revenue by promoting spontaneous compliance with tax obligations.

The set of topics referring to the examination function, which form the program of the meeting that we begin today, will allow us to analyze that function from the three most important trends or approaches: strategy, operation and evaluation and control of examination activities. As always from these deliberations, we hope ideas to arise to offer us the opportunity to know the experience of other countries that, when resuming our functions, allow us to have new elements to improve the performance of tax administrations.

I would like to express once again my appreciation to the Tax Administration of Bolivia, by recognizing all the effort made for the organization of the General Assembly. At the same time, we must congratulate the National Tax Service for the exemplary and significant advance that it has been achieving in the modernization and improvement process, which began recently and is the reason why it is being observed by other tax administrations.

Finally, let us give a warm welcome to all the participants of this 38th General Assembly of CIAT.

Ruben Aguirre Pangburn
President of the Executive Council
Inter-American Center of Tax Administrations

Speech of the Executive Secretary of CIAT

JORGE COSULICH AYALA

Ladies and Gentlemen

The General Assembly that we begin today has a profound significance for CIAT and for me personally as an individual, as a citizen of this country that has welcomed us so generously, therefore, I want to give you a warm welcome to this garden city and of eternal spring, and, I wish to express our deep esteem and gratefulness to the Bolivian authorities and in a very special manner to Don Jorge Eduardo Zegada Claure and his team of collaborators of the Organizing Committee for sponsoring and organizing CIAT's 38th Assembly.



Jorge Cosulich Ayala

I was saying that for CIAT, this meeting has a special meaning, because it once again manifests, the support and identification of its member countries with our institution and through the course it has maintained since its creation, leaving aside situations and limitations that may be affecting them and putting the best of all us for the organization and realization of events such as the present one.

In this opportunity, this gesture demonstrates its high sense of solidarity towards all our member countries and that we recognize and deeply thank, has corresponded to Bolivia, through SIN, to receive us and to make it possible to give continuity to the fundamental objective of CIAT, which is to make mutual cooperation closer and narrower among all our tax administrations, giving us therefore in the organization, the proper environment and the warm welcome from its people.

INAUGURAL CEREMONY

Also, I want to emphasize that the realization of this Assembly in Bolivia, obeys to the intention of all our member countries to recognize and acknowledge the valuable efforts that Bolivia is developing to modernize and make more professional its tax administration, under the leadership of Executive President of the National Tax Service, Don Jorge Eduardo Zegada Claure and with the decisive participation of all the officials that form part of that Service.

In effect, Bolivia began almost three years ago, a profound and radical reengineering process and changed its tax administration by removing politics and giving it a technical, administrative and budgetary autonomy that has allowed within the framework to afford managerial continuity, which is historical in Bolivia, and to undertake an in-depth process of professionalism of its human resources and the search of high levels in its management capacity.

On the other hand, it is important to mention that efforts of this nature, which also took place in other CIAT countries, transcend in its results to merely tax issues, since the existence of a respected and efficient tax administration means a key factor for the governance and consolidation of the democratic institutions of our countries.

Finally, I wish to highlight the international presence of our Center, not just its quality of forum of the highest technical level for the consideration of tax issues, but in the advances obtained through the constitution of working groups as well, which have given and continue giving excellent products, which may be characterized as a solidarity and agreed response of our member countries, to the new challenges for the tax administration coming from the dynamic international context.

This same presence in the international scope of CIAT, determined that the number of countries interested in becoming part of our promotion of international cooperation actions continues to increase among the tax administration, be it through the exchange of experiences, or be it through the joint search of solutions for problems in common. In this regard, we are honored by the interest manifested by the Czech Republic and South Africa, which incorporation requests into CIAT, as associated member countries will be considered at this General Assembly.

Thank you.

TOPIC 1

THE EXAMINATION STRATEGIES

Lecture

TOPIC 1.

THE EXAMINATION STRATEGIES

Rolando López López
General Manager
Service of National Taxes - SIN
(Bolivia)

CONTENTS: 1. Introduction.- 2. General Considerations Prior to the Design of the Examination Strategies.- 2.1. Conceptual framework of strategic planning.- 2.2. The examination process.- 3. Analysis of the Environment.- 3.1. Analysis of the external environment.- 3.2. Analysis of the internal context.- 4. Design of the Examination Strategies.- 4.1. Selection of the taxpayer universe subject to examination.- 4.2. Examination processes.- 4.3. Support instruments.- 5. Experience of the Tax Administration of Bolivia.- 5.1. Background.- 5.2. Examination strategy.- 6. Conclusions.

SUMMARY

The development of an adequate strategy for one of the most technical and complex functions of the Tax Administration, such as examination, requires an integral and detailed analysis, even more so, if one takes into account the fact that examination is the action that induces or persuades taxpayers to declare and pay what is actually due.

Topic 1

For this purpose, in order to determine examination strategies, an analysis of the external and internal environment is initially required. The first deals with the economic characteristics of the countries, among others, the strategic sectors, legal framework, internationalization of the economy and over which the Tax Administration has no control. On the other hand, the internal conditions over which the Tax Administration does have control, include human and financial resources, infrastructure, as well as the design and development of standards and procedures.

Both aspects are essential for adequate strategic planning, which should also take into account the directions determined in the Tax Administration's mission and vision.

Within said context, the intensive use of internal and external information under tax intelligence criteria constitutes an essential element for the success of examination actions, which is used as basis for selecting the taxpayers who will be subject to some type of examination, verification or control.

For undertaking such controls, the examination strategy should also determine the different types of examination processes which should be applied according to the taxpayers' tax fraud level or the "sensation of risk", with the scope and depth thereof being clearly established.

To conclude, it is important to highlight that the examination strategy, on being integral, should consider an evaluation system that may allow for constantly improving the strategy applied; that is, from the selection of taxpayers, up to the sanctioning and collection of tax debts, with a view to strengthening the examination work and the subsequent increase of the sensation of risk in the taxpayer universe.

1. INTRODUCTION

The current challenge of the Tax Administrations centers on determining an adequate examination strategy that will allow for optimizing the efficient use of resources to consolidate a sensation of risk among taxpayers, in order to maximize collection in the tax system.

To this end, it is very important to analyze the variables that comprise the external and internal environments which condition institutional management, even more so, since most of the countries have opted for implementing the voluntary filing tax systems, without direct intervention from the Tax Administration and under the premise that most of the taxpayers fulfill their tax obligations according to the risk which the Tax Administration generates through the examination actions and sanctioning of detected noncompliances.

2. GENERAL CONSIDERATIONS PRIOR TO THE DESIGN OF THE EXAMINATION STRATEGIES

2.1 Conceptual framework of strategic planning

The strategic planning process to be used in designing the examination strategies must necessarily consider the Tax Administration's Strategic Framework which consists of the following components:

- a) The Vision, which establishes the direction toward which the Administration is headed and represents the challenges that are to be faced.
- b) The Mission, which is the reason for the Institution's existence and establishes the objectives to which our efforts will be devoted.
- c) The Values and Principles which should be instilled in the human resources and institutional management.

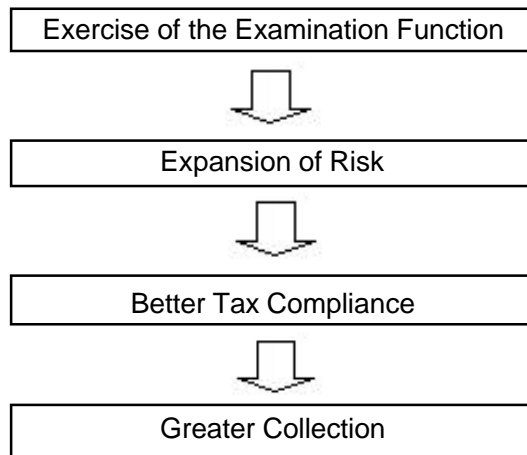
This Strategic Framework will be developed through the definition of the plans and budgets necessary for the activities, which should be carried out by the organization through institutional management.

Likewise, the organization should count on a management control and management information system that may allow for having an idea as to the progress and performance of the institution.

Finally, this information will be used for carrying out the monitoring and evaluation tasks that will provide feedback at a level lower than the examination strategies.

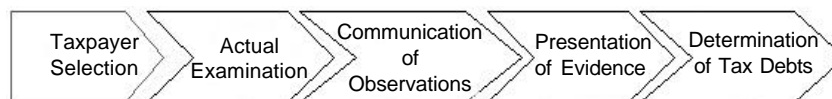
2.2 The examination process

To answer the question as to what is expected from the examination actions we will use the following chart:



As a result of the examination actions there will be an increased effect in the taxpayers' "sensation of risk", whereby the latter will improve voluntary compliance with their tax obligations thus increasing the level of collection.

In general, the examination process consists of the following stages:



a) Selection of Taxpayers

It is the first stage where one determines which taxpayers will be subject to some examination, verification or control process. To this end, the Administration has tax intelligence as the main tool. It will be useful in identifying the taxpayers showing the highest levels of evasion. At this stage, one will also determine the scope as regards taxes, periods and intensity of examination actions.

b) Actual Examination

Consists of all actions carried out by the examiner, from the notification at the beginning of the examination, requests for documents and information, the analysis, assessment and proof of the possible tax debts. At this stage, the Administration applies all the powers of investigation and examination that are assigned to it by the Tax Law.

c) Communication of Tax Observations

At this stage, duly based observations are made known to the taxpayer.

d) Presentation of Evidence

After having determined the observations and in order to guarantee in a transparent manner the rights of the taxpayers, the rule provides for a period wherein the taxpayer will present all the evidence related to the observations made by the Administration.

e) Determination of Tax Debts

This is the final instance where the taxpayer is informed about the tax debts determined by the Administration and which may be appealed according to the norms provided in each country's legislation.

It is important to note that, depending on the way each country manages examination, the stages indicated will not necessarily be carried out. What is more, some countries even carry them out by means of computerized applications and systems.

3. ANALYSIS OF THE ENVIRONMENT

In order to arrive at an adequate examination strategy, an analysis of the aspects listed below is essential. They are in no case excluding, but rather respond to a complementary analysis.

3.1. Analysis of the external environment

3.1.1. *Economic activities and characteristics of the taxpayers*

a) Characteristics of the economy

In structuring the examination strategies, it is important to initially consider the variables of a country's economic structure, such as the economic activities that determine the structure of the Gross National Product and the strategic sectors.

This analysis could determine the profile of the staff required in the examination area; for example, if the economy has a significant participation of the oil sector, it is advisable that the examination officials be familiar with the operation of the sector. This same observation can be applied to the rest of the sectors, such as the financial system, construction, trade, telecommunications, etc.

b) Magnitude or amount of the taxpayer universe

It is also important that the Tax Administration be aware of the number of taxpayers over which it will exercise its control powers. The larger the number of taxpayers, the more difficult will it be to generate the sufficient "sensation of risk" to achieve adequate tax compliance.

c) Fiscal Importance

Examination actions should be of a universal scope. Nevertheless, those taxpayers with greater economic activity, require more attention.

d) Tax Compliance Level

The levels of taxpayer compliance or the levels of tax fraud or evasion direct the Administrations in responding in accordance with the behavior of taxpayers.

In that sense, in a system with low voluntary compliance, it is recommended that review and verification not be performed in great depth, in order to carry out massive examination and control actions, with a view to reaching the largest possible number of taxpayers. If voluntary compliance reaches a middle level, the depth of review and verification of examination and control operations should likewise be at the middle level. They might last a longer period of time, but the scope as regards the number of taxpayers should be lower. Finally, the examination processes, considering the highest levels of in-depth verification are recommended for those countries with high levels of voluntary compliance.

Likewise, it is important to note that the three previously described methodologies may be combined in accordance with each country's reality.

3.1.2. Political support to the Tax Administrations

For adequate institutional management, the Tax Administrations require a strong political will that may eliminate partisan interference in decision-making, thus affording its actions greater transparency that will result in greater credibility in the Administration and increased tax awareness. Political support is likewise important for the continuity of officials in their jobs, thereby reducing the costs of staff rotation, stated in terms of training and technical knowledge of the human resources.

3.1.3. Legal framework

The tax obligation which is an essential part of tax law, constitutes or is the juridical base of the State's tax activity, for which reason the legal provisions whereby they are established will abide by the constitutional prescriptions, so as to guarantee the individual rights and establish the necessary conditions to carry out the Tax Administration's examination and collection functions.

Since the Tax Administration has broad powers of investigation, verification, control and examination, in keeping with the tax obligation, the tax law and in general, the tax system should be structured, on the one hand, according to clear and precise precepts that may facilitate the taxpayers and those responsible, voluntary compliance with tax obligations and on the other, with a view to establishing adequate examination and assessment procedures.

In the same way, the law should be a reflection of the political will for achieving the objective pursued by the State, which is no other than the common welfare of society as a whole.

3.1.4. External variables

With respect to the external variables, one cannot ignore the process of internationalization and globalization of the economy, which situation causes greater difficulty in examination actions and require highly trained human resources, as well as cooperation agreements for the exchange of information of the Tax Administrations.

Likewise, the continuous development of technology has generated a millionaire electronic trade that requires clear rules of the game with broad powers so that the Tax Administration may perform an adequate control.

3.1.5. Institutional development of other related entities

During the examination processes, as well as upon their conclusion, other public institutions from the judicial or executive bodies may be called to intervene. Some of them are the Tax Superintendence; the government attorney's office to support the fiscal investigation in the case of tax violations; the Police, to protect and ensure the security of the evidence and officials; the Ministry of Finance as entity responsible for directing the tax policies of the countries; as well as public institutions that generate the necessary

information for the examination processes (Customs, General Comptrollership of the State, etc.). For these reasons, it is important that these entities that are involved in the exercise of the powers of the Tax Administration be institutionally developed so as to allow the Tax Administration to adequately perform the examination and control actions to considerably limit political interference.

3.2. Analysis of the internal context

Institutional Development implies that the Tax Administrations have the institutional capability for complying with the role and functions entrusted to them. The factors that determine institutional development refer to clear and expeditious rules and procedures, trained and qualified human resources, necessary infrastructure and equipment as well as adequate control systems.

3.2.1. Human resources

As in every entity, the human resources of the Tax Administrations constitute the most valuable asset for achieving institutional goals and objectives. Even more so, the examination functions require of officials a high technical level, and continuous training, due to the dynamics of tax fraud and evasion mechanisms.

In view of the above reasons, the processes for selecting Tax Administration staff must be as transparent as possible so as to ensure the incorporation of qualified staff.

3.2.2. Financial resources and infrastructure

Taxpayer service requires that the Tax Administration count on adequate infrastructure for facilitating the exercise of collection and examination activities.

In the same way, one cannot disregard the use of information technology, hardware as well as software, for speeding up and simplifying the Administration's processes.

Also, the Tax Administration's budget should be sufficient to carry out its functions, so that it may finance its operational costs and provide competitive salaries in keeping with the responsibilities of the officials. Preferably, this budget should consist of a specific percentage of collection that should be automatically withheld.

3.2.3. Rules and procedures

Rules and procedures that may facilitate and afford greater transparency to the collection and examination processes should be available for an adequate management of the Administration.

In the development of these rules and procedures, it is essential to periodically evaluate their applicability, from the perspective of the taxpayer as well as of the Tax Administration, in order to promote or bring about the changes that may be deemed pertinent.

3.2.4. Management control

This is the main instrument for the control and follows up of examination tasks. If there is no adequate management control, it will be impossible to monitor and evaluate the examination strategies to undertake the required adjustments and achieve the proposed objectives. In this sense, given the number of actions in the examination area, there should be computerized applications and support for keeping record of examination actions at all levels¹.

4. DESIGN OF EXAMINATION STRATEGIES

Based on the foregoing statements, it may be observed that the examination strategy applied in each country, cannot be unique and definitive, since it must be consistent with the conditions faced by the Tax Administration. Having performed the conceptual analysis of the context and having available the information on the conditions

¹ Explained in item 2.2.

of the planning process, one must face the challenge of designing the examination strategies.

In that sense, the examination strategies determined must be compatible with the institution's strategic framework and their contents should provide answers to the following questions.

- Which taxpayers should be examined?
The answer to this question is found in the taxpayer selection stage and the success of this stage is related to the development of the Tax Administration's Tax Intelligence; the more developed tax intelligence is, the more effective will the examination processes be and vice versa.
- What type of examination processes will be applied?
After selecting the taxpayers, one must determine the depth of the examination actions as well as the periods and taxes to be examined in the process.
- What are the minimum resources required?
Finally, the examination strategy should also consider the resources which the Tax Administration should have available for carrying out its activities.

4.1. Selection of the taxpayer universe subject to examination

The following aspects must be considered in order to arrive at an appropriate answer to this question.

4.1.1. Sensation of risk

Examination actions have a direct and indirect effect. The direct effect is the result of collection following examination or the change in the behavior of the taxpayers that were examined; while the indirect effects may be observed in the increased "sensation of risk" and the impact resulting from collection in relation to returns voluntarily filed.

"Sensation of risk" is understood as the taxpayer's perception that the Tax Administration may detect, prove, sanction and enforce compliance with the tax

obligations that have not been declared by the taxpayers. Such “sensation of risk” may be expressed in terms of a statistical probability.

The importance of this concept lies in the taxpayers’ response to the “sensation of risk”, since it determines the decision as to the level of evasion which the taxpayer is willing to assume vis-à-vis a specific risk. This principle may be summarized by saying that, the greater the risk, the better the voluntary compliance.

The “sensation of risk” in the taxpayer universe is developed through the application of constant examination actions sustainable through time.

It must be noted that isolated and sporadic actions that are not continuously applied, do not generate risk. In the same way, if tax fraud situations are only identified and examined, but not sanctioned, and tax compliance is likewise not enforced, the desired impact with respect to the “sensation of risk” will not be achieved.

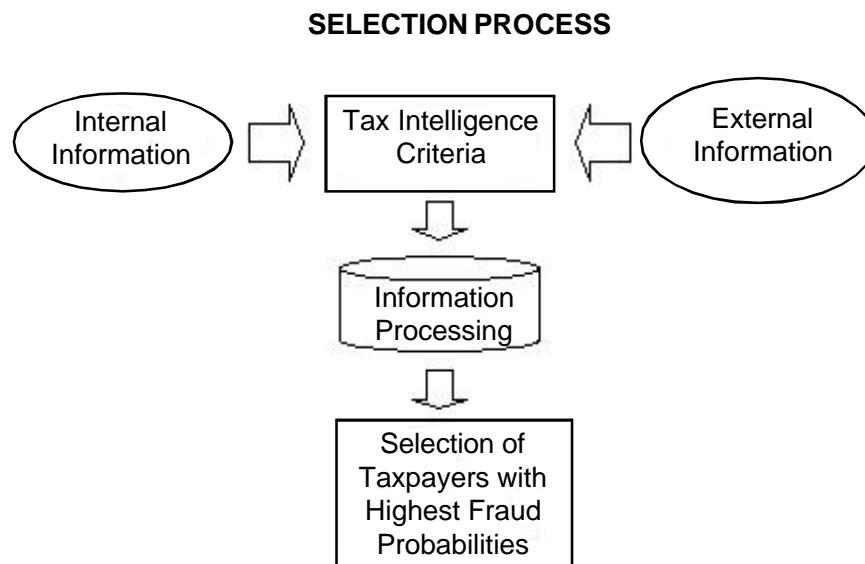
4.1.2. Tax intelligence

Tax intelligence is understood as the processing of information to identify taxpayers with the highest probabilities of tax noncompliance. This is based on previously defined tax risk “criteria” or “parameters”.

The main input of Tax Intelligence is internal and external information. The former being the set of data available in the Tax Administration which is extracted from the returns filed by the taxpayers, while the latter is information provided by other institutions or taxpayers that is related to taxable events that are being analyzed.

Given the significant amount of information that must be processed in accordance with the tax intelligence criteria, it is important to count on the support of computerized applications that may allow for achieving results in a more timely and reliable manner.

The tax intelligence process is a transversal process throughout the Tax Administration and is not only the patrimony of the examination area, but rather it may be complemented by the collection and legal areas. In the same way, it is not an exclusive function of the central level, but it may also be applied in the decentralized units.



As indicated in the chart, after having applied that tax intelligence criteria one should choose the taxpayers showing the highest tax fraud probabilities.

4.2. Examination processes

In a conceptual generic manner and in order to suggest guidelines for examining noncompliance with tax obligations to combat tax fraud and induce taxpayers to voluntarily comply with their tax obligations, described hereunder is the application of three different examination processes that may be adopted according to the level of taxpayer fraud or the "sensation of risk" to be established and which are differentiated by the depth or scope.

The processes are: massive control of formal obligations; the verification of events or economic transactions, and tax audits which are the ones with the greater scope.

The previously mentioned examination processes are of a dynamic and gradual nature. That is, as the result of a process of Massive Control of Formal Obligations, a process of Verification of Facts or Economic Transactions may be generated or finally, a process of Tax Audits may be suggested.

Each of the processes is described below in greater detail:

4.2.1. Massive Controls of Formal Obligations

In explaining this process, it is important to distinguish that tax obligations may be either material and/or formal. Material obligations are those dealing with the payment of taxes and their assessment, while formal obligations which are not less important, are established to control the tax system, but does not involve the assessment and payment of taxes. Examples of formal obligations are the obligation to declare the domicile, the obligation to file sworn returns, the obligation to provide complementary information, etc.

In this sense, the process of Massive Control of Formal Obligations involves less intensive examination actions such as visits to the taxpayer's domicile to verify compliance with his formal duties and orient and inform the taxpayer about his tax obligations.

If formal noncompliances were detected and if such were the purpose of the visit, the official may determine the respective sanction for the unfulfilled obligation.

Taxpayers subject to such controls are chosen on the basis of primary information, which does not require further processing, as criteria of the commercial zones, holidays or special activities, fairs, etc.

Officials performing this control require basic training. They do not require a high technical level, but it is advisable that they may be able to interact with the taxpayers.

This type of actions may be carried out simply and promptly, and allow for reaching a large number of taxpayers and generating a significant tax presence which, although not aimed at identifying tax fraud may establish the necessary bases for examination, verification and control.

Whenever the Tax Administration may have information showing inconsistencies in the taxpayer returns, but no decision has been made with respect to initiating an assessment process due to costs and time involved, the taxpayer will be informed of these observations. A characteristic of this type of action within a relatively short period, providing personalized or individualized information and increasing the “sensation of risk” as a result of examination actions based on information provided by them and third parties with whom they maintain direct or indirect relationships that originate taxed events.

It must be pointed out that this type of actions benefit the taxpayer as well as the Tax Administration since, considering that they only involve communications, but in no case assessment processes, the taxpayer is given the opportunity of regularizing the tax situation observed, without any monetary sanction for the tax violation. On the other hand, the Administration ensures through persuasive action that the tax obligation be fulfilled without incurring in costs and expenses that could result from an assessment process.

If the taxpayers fail to correct or rectify the aspects observed, then the Tax Administration will the verification or examination processes it may deem pertinent.

4.2.2. Verification of Specific Events or Transactions

This process has a large scope than the one indicated in the previous item and implies verifying one or more economic transactions or specific events carried out by the taxpayers, which constitute the tax base of one or more taxes.

The selection of transactions subject to control, should result from a tax intelligence process based on internal and external information available in the tax administration, which may serve to identify noncompliances with specific tax obligations and with a specific scope as regards, events, elements, transactions, taxes and periods that were not declared or were partially declared by the taxpayers.

In this case, the tax administration already is aware of tax noncompliance by the taxpayer with specific transactions and, therefore, when the examiners or inspectors notify those responsible, they are already aware of the purpose of their actions thus facilitating the examination tasks.

After identifying the observations and making them known to the taxpayer, the Tax Administration will undertake the process of assessing the unfulfilled obligation, as well determining the corresponding sanction to be applied to the tax violation.

Likewise, after the Tax Administration has determined specific events, the taxpayer may rectify noncompliances that were not considered within the scope of the examination, without a sanction for similar events or concepts.

The advantages of this type of verification are that the Tax Administration may effectively reach a significant number of taxpayers within a relatively short period of time, and likewise expand the "sensation of risk".

In addition, the human resources assigned to these processes do not require high technical knowledge, but nevertheless must be familiar with the general tax rules and procedures.

4.2.3. *Tax Audits*

These are the processes of greater scope and depth in control actions. In this process there is integral verification of compliance with a tax in one or more fiscal periods.

The taxpayers selected for these examination processes are of great tax importance. If the examinations were to cover several periods, then the most important companies of the economic activity would be considered.

This type of examination may also be undertaken when the taxpayer shows high levels of fraud, or if the companies subject to control are part of a strategic sector of the economy.

Although this type of examinations is the most effective to determine noncompliances with tax obligations, given the depth and scope of the actions, they are also the most costly processes for which reason, taxpayers must be carefully selected prior to deciding to carry out this type of actions.

Another disadvantage, in addition to the high cost of the Tax Auditing processes is that they require much more time than the rest of the interventions and cannot be undertaken massively and, therefore, the generation of risk is imperceptible.

It is advisable that such examinations not be carried out by a single official or inspector, but rather by a group of professionals from all areas with which the taxpayer is related. Likewise, the staff assigned to such examinations must be high technical level officials fully familiar with the tax rules.

Finally, in this type of examination, investigation processes are also carried out. Generally, the taxpayer's information vouches for his tax returns, for which reason it is important to resort to other sources

of information, such as the financial system, private associations, the police, imports, Government purchases, etc.

4.3. Support instruments

4.3.1. Financial resources

Examination costs are not only centered on the salaries and wages of the officials of the examination area, but also require a budget to carry out investigation activities and support examinations.

The examination area requires a budget for notifications, certifications, etc., and even for informants that may facilitate the tax fraud investigations.

In the same manner, the examination areas should have an adequate infrastructure and computerized equipment for direct and speedy access to the information that may be required for carrying out the examination process.

4.3.2. Rules

Rules and procedures constitute the general framework used for carrying out examination processes and they must establish the administrative procedures in a simple and practical manner.

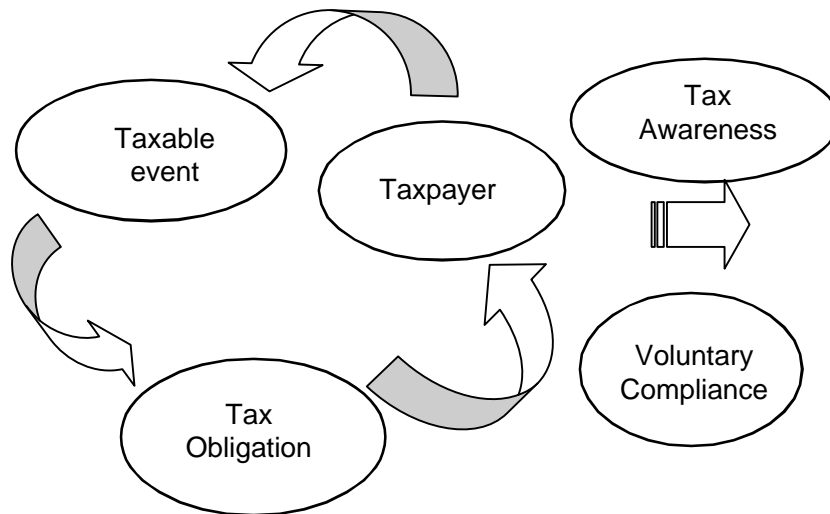
Likewise, the Tax Code should guarantee the use of examination powers, including the power to appoint information agents and access third party information.

4.3.3. Management control systems

Once the examination programs have been developed, automated systems should be available to follow up the examination actions and undertake a permanent evaluation by means of a feedback process, in order to make the necessary adjustments in the examination strategies.

4.3.4. Support campaigns in communication media

Also, examination actions should be supported through specific information campaigns, aimed at groups of taxpayers carrying out the same tax obligation generating activity and which may be oriented at relating specific taxpayer sectors to specific tax obligations, as well as disseminating the use made of tax collections, thus promoting increased awareness and the levels of voluntary compliance and ultimately, providing sufficient information so that taxpayers may be aware of which tax obligation is not being fulfilled and which are the sanctions for such noncompliance.



5. THE EXPERIENCE OF BOLIVIA'S TAX ADMINISTRATION

5.1. Background

Prior to the Institutional Reform Process of the Tax Administration of Bolivia, the examination area was facing structural problems that generated a critical situation evidenced in the following aspects:

- a) Political interference in the Examination Departments.
- b) Continuous suspicions of acts of corruption.

- c) Discretionary selection of taxpayers for examination processes.
- d) Lack of development of tax intelligence processes.
- e) Inadequate organizational structure.
- f) Unqualified staff discretionally selected through partisan favoritism.
- g) Lack of an adequate examination strategy.
- h) Nonuse of computerized applications to support the examination action.

The Institutional Reform of the Tax Administration of Bolivia began with the promulgation of Law N° 2166 of 12/22/2000, which provided for the creation of the National Tax Service, affording it its own juridical personality, in addition to powers, functions, rights, obligations and a net worth for its operation.

One of the central elements of the Institutional reform is the structuring of a human resources development system, which considers the recruitment of trained staff with a high level of ethics and transparency for carrying out its functions. This process was carried out through companies specialized in the hiring of Human Resources. At present, 90% of the staff of the examination area was selected through this process, which represents 23% of the total of Tax Administration officials. Likewise, the ratio of examination officials to taxpayers is one to 1,205.

5.2. Examination strategy

The examination strategy of the Bolivian Tax Administration is based on the definition of a new approach to examination which was developed by the Institutional Strengthening Program, the same one that was established within the framework of Agreement No. 1043SF-BO signed between the Inter.-American Development Bank and the Government of Bolivia.

The examination strategies of the Bolivian Tax Administration are oriented toward “achieving taxpayer compliance within the framework established by the rules in force with respect to taxation”. This, by means of effective control actions. That is, by directly attacking the possibility of noncompliance which is achieved by generating true risks for the evaders.

Because of the high level of tax noncompliance, induction toward voluntary compliance cannot be based on in-depth investigations and audits given the limited capacity and scope of the administration with respect to the number of taxpayers, for which reason the risk² chosen is based on the probability of selecting taxpayers in a manner directly proportional to the level of noncompliance, whereby the greater the level of relative noncompliance, the greater the probability of being selected.

In view of the above, *the administration's control action is aimed at expanding the risk among the mass of taxpayers to support voluntary compliance. This is achieved through what may be called the objective expansion of the risk, which merely involves exercising greater control over the taxpayers showing the worst relative behavior vis-à-vis the mass of taxpayers, by means of intensive use of information on their economic operations and tax intelligence criteria. The subjective risk will be expanded to the extent the rest of the taxpayers who have not been subjected to some verification or control process, voluntarily change their tax behavior due to a greater sensation of risk.*

It is thus that the control of the tax obligations of the taxpayers must be understood as a *systematic process, in terms of its sustainability and permanence in time, and an integral one, as an effort that begins with the identification of the taxpayers up to the actual request for payment of the amounts owed the treasury, which allows inducing voluntary compliance with the obligations.*

Within this context, the National Tax Service of Bolivia's control policy is based on the following strategies:

- a) Improve the capability for detecting acts of evasion by means of the intensive use of information.
- b) Implement a general control scheme that may determine the processes for using internal and third party information, as well as the types of control, verification and examination processes to be permanently applied.
- c) Carry out specific control actions within short term as phase for inducing voluntary compliance.

² The new Tax Code (Law 2492) which provides for new procedures to sanction tax violations was promulgated on 8/2/ 2003.

- d) Establish a quick, simple and expeditious³ sanctioning system.

The general examination scheme is presented. It defines the general processes of use of internal as well as third party information for the selection of taxpayers, in addition to the types of examination processes which should be carried out permanently.

The information available is classified as internal and external information. The former is that which the institution has on each of the taxpayers, that is, mainly all the information registered and administered through the computerized applications, among others: Collection through the Banks; Classification of taxpayers; Tax current account; Control of tax obligations; Bank Conciliation; Payment Facilities; Collection through District Management Offices; Authorization of Tax Invoices or Notes; Register; Assets; Management Control; Taxpayer Selection, Audit Techniques and Procedures; Jeopardy Assessment; Proceedings on Violations.

External information is that provided by information agents determined by the Tax Administration through Normative Resolutions by the Directors, businesses, associations, institutions, etc. Currently, the following sources of external information are being used:

- Main and Large Taxpayers

These taxpayers provide on monthly basis, in computerized means, the details on purchases and sales in the “VAT Purchase and Sales Software” developed by the Tax Administration. It is important to mention that the application of said software is useful for the taxpayer as well as the Tax Administration.

- Credit Card Managing Companies

These companies submit every semester, on magnetic media, the detail of transactions carried out and paid with credit cards.

³ The CS - VAT is a tax applied to individuals and undivided estates. In other countries, it is known as Individual Income Tax.

– National Customs of Bolivia

Sends monthly, on magnetic media, the detail on import and export returns (Taxpayers, Type of goods, weight value, etc.), as well as the information of the international bills of lading (Transportation company, route, weight transported, cost, etc.).

– Clinics

Submit on a quarterly basis, information on operations carried out in their operating rooms, dates on which they were carried out, the physicians intervening therein and the invoice number issued by the clinic, among others.

All this information is stored in a data base which allows its direct use through information crosschecks and automated processing, in accordance with the requirements determined; all for the purpose of detecting cases of tax noncompliance, and carrying out specific examination actions on particular taxpayer segments showing the worst relative behavior.

Under subtopic 2.3, (Specific Information Requirements) greater details will be provided on external information, as well as the explanation on the use and information crosschecks.

After obtaining the results of the information crosschecks according to the established definitions , the Tax Intelligence Department and/or the District Examination Departments are the ones determining the selection of taxpayers that will be subjected to some form of examination, verification or control, in addition to the review parameters, as regards the scope of taxes, periods and specific events or transactions.

As for the types of examination processes, the following have been basically defined: Preventive controls; Internal verifications; External Verifications; and the processes described below.

5.2.1. *Preventive, Formative and Enforced Control Processes*

These processes are aimed at controlling taxpayer compliance with formal duties by means of massive and permanent operations applied at the decentralized

levels, thus allowing the operational areas to determine the timeliness and types of operations to be carried out, under the general guidelines determined by the normative area.

They are divided into two types:

– Formative Preventive Control

In this modality, taxpayers are given information and orientation on their tax obligations. Usually, they are also given generic communiqués, pamphlets and letters of presentation of the officials. A relevant aspect to be considered is that even though violations are detected, no sanction is issued, only a visit certificate is left as evidence so that the taxpayer subject to the observation may make up for the violation within a specific time frame.

Additionally, within the preventive processes, the Bolivian Tax Administration has developed processes for communicating to the taxpayers, specific observations with respect to indications of tax fraud detected through information crosschecks based on tax intelligence criteria. Taxpayers are then invited to normalize their tax situation, as regards the omission of taxable bases and payment of taxes, without any jeopardy assessment or sanction for the tax violation presumably incurred.

To date, actions have been undertaken in relation to Value Added Tax VAT, Complementary System (CS-VAT)³, and Corporate Earnings Tax when taxpayers showed losses in three consecutive periods.

– Enforced Preventive Control

This type of control sanctions noncompliances with formal duties detected. To this end, officials in charge prepare violation records indicating the violation incurred and these are signed by the taxpayers as well as by the examining officials. In case the taxpayer would refuse to sign, another official of the administration signs as witness of the action.

5.2.2. *Internal Verification Process*

In this type of control, taxpayers are requested to approach the Tax Administration, to clarify specific aspects previously detected by means of information crosschecks based on tax intelligence criteria and which are related to the sales and corporate earnings taxable bases omitted in the return.

With this methodology, officials no longer have to visit the taxpayers' domiciles to perform the corresponding verification, with the corresponding savings in time and transportation resources for the Tax Administration.

Likewise, it allows for a more adequate control of the work of the examiners, on clearly establishing the scope of the verifications.

Some of the modalities determined for this process are the following:

- Purchases Informed vs. Declared Sales.
- Duplicated Invoices.
- Credit Cards.
- Declared sales vs. Imports Made.
- Control of tax debit originating from import commissions of customs clearance agents.

5.2.3. *External Verification*

The External Verification process involves the precise verification of specific aspects at the taxpayer's domicile, at the request of the taxpayers themselves, requests from the other units of the Institution, as well as external entities empowered for such purpose (Comptrollership of the Republic, judges, prosecutors, etc.).

Among others the modalities determined for the process are the following:

- Crossed Control of Fiscal Documents.
- Decrease in Properties.

- Control of Rectifying Sworn Returns.
- Verification of Requests for Tax Refund (CEDEIM).
- ICE Control of Tax Stamps and Commercial Labels.
- Control of Transit Permits.

5.2.4. *External Examinations*

These are processes carried out at the taxpayer's domicile. They are undertaken only in those cases showing special importance and deserving of in-depth investigations, either because of evidences detected in the information crosschecks or because of results achieved in previous processes. The percentage of this type of process is lower than that of verifications, but nevertheless it has the highest level of in-depth analysis.

a) Integral Examination

Consists of the verification of all the taxes to which the taxpayer is subjected for one or more annual periods.

b) Partial Examination

Consists of the verification of one or more taxes to which the taxpayer is subjected for one or more periods.

6. CONCLUSIONS

- 6.1.** Examination strategies should be formulated in keeping with the Tax Administration's vision and mission.
- 6.2.** The first step in the planning process is an analysis of the internal and external environment.
- 6.3.** To generate an adequate sensation of risk, examination strategies must be integral, from the selection of taxpayers to be examined, consistent assessment of tax violations, the sanctioning and collection of tax debts.
- 6.4.** A fundamental basis for the design of the examination strategies is the intensive use of internal and external information through tax intelligence processes.

- 6.5.** The design of the examination strategies should consider two basic aspects; the selection of taxpayers with the highest level of tax noncompliance, and the type and scope of actions to be applied in the examination process.
- 6.6.** According to the scope and depth of the actions, different examination processes may be applied; from massive controls of formal obligations, the verification of specific events, up to the tax audits which are those of greater scope.
- 6.7.** It is also important to consider follow-up, management control and evaluation of the strategies applied to make the adjustments that may be required for achieving greater effectiveness and efficiency in the examination actions.
- 6.8.** Finally, it may be said that in no case are the proposed strategies excluding, but are rather complementary in their application.

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Case study

TOPIC 1.1.

PROCESSES FOR THE DESIGN OF EXAMINATION PROGRAMS

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CONTENTS: 1. Planning Versus Risk Analysis. Coincidences and Divergences of Both Systems. The Opportunity Analysis and the Induced Effect as Decision Basis.- 2. The Importance of Information in Selective Controls.- 2.1. Information contributed by the taxpayer, third parties and international collaboration. - 2.2. Supply information. Main sources and data.- 2.3. Capturing information for planning. Planning information capturing. - 2.4. Treatment and management of the information. Investment in computerized resources.- 3. The Process of Design of Examination Programs.- 3.1. Analysis of results.- 3.2. Results of the Information Plan.- 3.3. Gathering of new proposals. Centralized - Peripheral – From third parties.- 3.4. Examination of means available.- 3.5. Program decision.- 3.6. Distribution of number of actions.- 3.7. Selection.- 3.8. Compliance control and results evaluation.- 4. Toward an Alternative Process of Examination Program Design. Outline of a General and Integrated Fiscal Risk Analysis.- 5.- Organization of Control Through Homogeneous Spheres of Action. A Future Proposal for Control Planning at the SATA.- 5.1. Fiscal Risk as the sum of fraud potentiality and probability.- 5.2. Fiscal risk. Contents. Elaboration of risk categories.- 5.3. Planning and selection. Risk environments.- 5.4. Fiscal risk maps. Delimitation of Homogeneous Spheres of Action.- 5.5. Relationship between fiscal risk and type of verification.- 5.6 Conclusions.

1. PLANNING VERSUS RISK ANALYSIS. COINCIDENCES AND DIVERGENCES OF BOTH SYSTEMS. THE OPPORTUNITY ANALYSIS AND THE INDUCED EFFECT AS DECISION BASIS

With respect to the decision *as to the taxpayers to which the control actions will be addressed*, currently there are two trends among the countries with the highest level of development in Tax Administration. The countries which base their organization on Positive Law tend to elaborate plans to which to subject their action, while the Anglo-Saxon countries prefer the concept of Risk analysis. In a certain way, both positions may be considered antagonistic, but we shall see how a closer analysis will show to what extent they constitute complementary visions.

The two ways of making the decision have the following similarities:

- Seek to maximize the efficiency of the system, by selecting the aspects, sectors or taxpayers showing the greater possibility of noncompliance.
- Also seek to maximize results in terms of recovery of the tax debt and also repression of illegal acts.
- Prevent the making of decisions of a random, uncontrolled or unfair nature.
- Systematize a priori the work of their Human Resources by indicating the work each one should carry out.
- Oriented toward improving voluntary compliance with tax obligations.

However, both forms of decision, likewise pose numerous differences:

- While planning tends to indicate profiles so that the selection systems may then decide where noncompliance is specifically found, the risk analysis systems begin with a generic risk analysis to make that same decision. Of course, there is an outstanding influence in the above, originating from the amount of information available and the real possibilities for processing such information.
- Risk analysis is more objective and even more scientific than planning. There are aspects of timeliness, together with others that strictly involve risk, which influence such process.
- Planning may be conceptually separated from taxpayer selection, while in risk analysis it is a continuous whole.

- The concluding point in risk analysis is the need to orient human resources toward the risks detected and such relationship is not as clear in the elaboration of Plans.

It is necessary to highlight achievements in the European countries in the past years, in order to bring together Planning systems that may assume part of the philosophy of the diffused risk. It is a matter of complementing the selection systems by considering the reality of taxpayers as a whole, thus avoiding the possible existence of shaded zones (taxpayers not specifically assisted for having escaped the priorities of the Plan).

Regardless of the system chosen or even a symbiotic merger of both systems, which should be deemed preferable, it is essential to answer a crucial question. What is the effect which an action on a sector could generate in a group of taxpayers?

The answer to the question calls for having a clear idea as to the objective of every Tax Administration: Achieving optimum taxpayer voluntary compliance. It is at this time where the principle of timeliness of action concurs: if attention should be paid to every tax noncompliance, but resources only allow for handling some of them, it is worth considering whether it should be decided to act on those taxpayers whose verification will induce greater effect in a specific sector or, on the contrary, if the decision with respect to the action program to be implemented should be guided by exclusive Fiscal Risk criteria.

In our opinion, one should discard the evaluations of timeliness of action that is, exclusively based on criteria such as amount of the Tax Debt which can probably be obtained from said action. This will normally lead to verify the "Easiest" taxpayers, leaving aside the sectors most requiring attention since their fraud continues to be concealed.

A good example of an integral Risk Management system, always oriented toward the analyses and actions aimed at better voluntary compliance is that which, before deciding the control actions to be undertaken, analyzes the following factors in relation to risk behaviors observed:

- a) Probability of occurrence of said behavior.
- b) Losses of derived fiscal revenues (estimated global amount).

- c) Effects on economic efficiency (distortion of competitiveness).
- d) Effects on the trust of compliant taxpayers.
- e) Effects on other taxpayers thereof or different sectors (contagion).

As may be seen, the sociological aspects and even the judgments relative to justice and equity in the system, are not excluded from the analysis, given that attention is paid to them, on considering the impact which noncompliance of other taxpayers has, by way of discouraging the compliant ones. Said otherwise, a measure may be motivated simply by the need that a large social sector perceives the public interest for attacking some form of fraud, even though such eradication may be complex or impossible, and may yield little in terms of fiscal regularizations.

Subsequently, after prioritizing the risk areas on which action will be taken, a whole series of tools, in addition to the audits should be used:

- a) Persuasion and advertising.
- b) Positive Incentives (carrots).
- c) Education and training.
- d) Increased perception of the risk to be detected (more audits).
- e) Sanctions (clubs).
- f) Changes in the Laws for better understanding or simplicity in the application.
- g) Changes or simplifications in the return models.

SUMMARY: The Tax Administrations should tend to find an optimum formula in order that the decisions for acting on tax noncompliance may result in better general voluntary compliance. According to this premise, the systems may be based on sectorial and thematic action plans, intended to carry out audits, or else, whenever possible, acting on other variables such as education, incentives to compliance, the simplification of the system and tax norms. Both approximations are not mutually excluding, but rather complement each other.

2. THE IMPORTANCE OF INFORMATION IN SELECTIVE CONTROLS

A fiscal control system is worth the same as the following two factors: Human and material means (possibility of detecting a specific case of fraud) and Sanctioning Legal Code (sanctions that await the defrauder who is detected). With respect to the first factor, Information is the key issue, since it will allow for directing staff efforts toward the objectives where it may be more efficient. Described below, regardless of discussions in previous topics dealing with systematically obtaining and using information, are some additional aspects to be taken into account.

2.1. Information contributed by the taxpayer, third parties and international collaboration

There is no doubt that such well processed information provides abundant data on the internal incoherence of taxpayer returns.

On the other hand, said information should be completed with what third parties know about the other taxpayers, while in very internationalized environments, reciprocal international collaboration becomes basic in this respect.

2.2. Supply information. Main sources and data

Although without being exhaustive, a modern Tax Administration should have available supply information (that is, information which third parties are obliged, through a legal norm to deliver to the Tax Administration every year, without the need for express request) from the following crosscheck sources:

- a) Third party businessmen (as suppliers and customers) commercially related to each taxpayer.
- b) Businessmen with respect to their wage earning workers and professionals. The obligation will include the identification of the worker along with the amount of his compensations and withholdings made.
- c) Financial System Entities (Banks, insurance companies, other financial intermediaries) with respect to their financial relationships, current accounts, securities management, etc. In particular, this obligation should complement the obligation to withhold on account of the financial revenues distributed.

- d) Automatic exchange of the relationships of businessmen with other businessmen from other States with which Information Exchange Agreements are signed. Undoubtedly, this source will become ever more important to the extent that an economy is internationalized and, obviously, it will be more convenient to enter into Agreements with States maintaining more commercial relationships with one's own.

2.3. Capturing information for planning. Planning information capturing

Separate mention should be made of what is known as information capturing. A distinction should be made between a single capture directly used in auditing or control procedures and another massively planned for capturing numerous data that may then be used for making decisions regarding planning or direct taxpayer selection.

The second one, since it can be carried out massively, generally turns out to be more beneficial than the first one, since the capturing of information is always complementary to the information available.

Specialized bodies. It is convenient that a Tax Administration that wishes to duly plan Information Capturing, create a centralized nucleus with National powers for such capturing. At a lower scale, the territorial bodies should consider massive capturing.

There are some countries where the separation of fiscal authorities with respect to the main direct and indirect taxes, render difficult the management and treatment of information. Such separation, in general terms, is even undesirable for those who are obliged thereto for historical reasons.

2.4. Treatment and management of the information. Investment in computerized resources

Nothing that has been said will turn out to be useful if the information contributed by the taxpayers, supplied by third parties or coercively captured by the Administration, is not conveniently stored, organized and processed for extracting therefrom conclusions that may allow for correct auditing management.

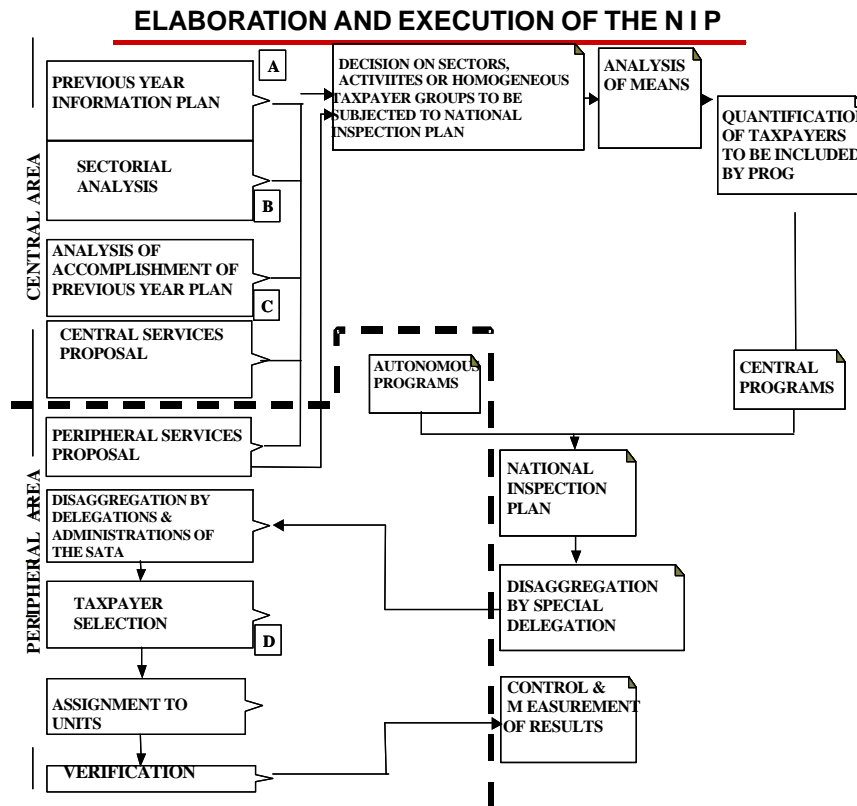
The Tax Administration should consider, with the greatest freedom allowed by budgetary restrictions, that information management in the modern world calls for having available adequate data processing equipment. If well planned, investment in software and hardware should yield one hundred to one in terms of fiscal control and, accordingly, in terms of improving voluntary compliance.

In sum, it is convenient to be very clear that Tax Control basically works with one raw material: information; that is, with the possibility of knowing the real activity of the taxpayers. The success of Tax Control then, depends to a great extent on the possibilities of obtaining and handling said raw material.

3. THE PROCESS OF DESIGN OF EXAMINATION PROGRAMS

In the determination of sectors, fraud issues, taxpayer profiles and types of operations that should be controlled throughout a specific period, all entities of the Tax Administration with a vocation to control should participate jointly: Directors and Operational, Central and Territorial staff, for extensive and intensive verification, devoted to the control of Large Taxpayers or small businessmen. Adequate balance of action can only be achieved, if one considers the contributions of the various control bodies.

The flow chart in the Planning process used in a system that shares planning and execution of the plans between the Central and Peripheral areas, as is the case of Spain, is the following:



The broken line in the graph refers to the separation of functions and responsibility between the centralized and peripheral decisionmaking levels.

3.1. Analysis of results

Every planning process must begin with the analysis of the results of the previous period's plan, to determine the convenience of giving continuity to scheduling in each of the aspects which the latter may cover. Each Plan consists of decisions that should continue for more than a year therein, along with others of a more limited duration. Planning should not be undertaken without previously considering the results obtained in the previous year's planning. Obviously, the more the aspects considered in the analysis of results, the more justified the planning decision will be.

3.2. Results of the Information Plan

Either as a consequence of the need to analyze the information available in the centralized Data Bases, or in logical correspondence with the information capturing plans undertaken for planning purposes, it is necessary to evaluate, prior to making planning decisions, which is the new information being included or how it has been organized in our system .

3.3. Gathering of new proposals. Centralized - Peripheral – from third parties

Management of the knowledge of the staff devoted to auditing and, in general, to fiscal control has turned out to be very useful, in order that the sectors or profiles covered by the Plan may be supported by minimum knowledge or previous experience.

These proposals should be accompanied with a Report to at least orient the centralized managing body which must make the decision. These reports will cover such aspects as the description of the fiscal problem of the sector, and experiences available in relation thereto. The way of systematizing the selection of these taxpayers and the scope (number of years to be verified and type of verification to be carried out). The preparation of sectorial control Guides is a task that should be taken into account in the process.

It is important that the process not exclude the initiatives of any of the agents mentioned. In that way, in addition to achieving the optimum use of ideas, internal participation is promoted, as well as the involvement of all parties of the organization in a common objective. Every one should feel that if he has a good idea, the organization will take it to the Plan. Another type of incentives, such as the economic ones , may also contribute thereto.

An unexplored field in most of the tax Administrations is the opening of the planning process to ideas contributed by Society. A priori, it turns out to be thought-provoking that society may transmit to the Administrations that look after tax compliance, their ideas as to the way to face this problem.

3.4. Examination of means available

Considering the initiatives that are going to be developed into programs, it is necessary to examine the means available in terms of human resources.

Several European States use systems for allocating human resources in keeping with the Fiscal Risk incurred in each geographical Area. Such a system, unchallengeable from the standpoint of efficiency, calls for maximum flexibility in the staffing and relocation of such means, by avoiding rigidities in administrative hiring and, to the extent possible, resistances to the change of residence of the staff available.

In every case, planning begins with given human resource situations to which it must abide. Likewise, the entire staff should devote equal efforts to the execution of the Plan.

3.5. Program decision

When ideas are obtained and the means available for carrying them out are known, these are materialized in separate action programs. The reason for this is that its follow-up is simpler, thus allowing for the analysis and control of the Plan's execution.

In general, one should avoid the proliferation of programs in favor of a simple nucleus of understanding, within which one will not prevent underprogramming or the specification of different specific actions.

Follow-up will take place with greater precision, through the use of an additional coding by economic activity superimposed to material programming.

3.6. Distribution of number of actions

Consists of the materialization for each Geographical Area of the number of actions for each program that must be carried out in that part of the territory.

3.7. Selection

The selection aspects which we will consider further on, consist of the determination of the profiles, fraud topics, fiscal irregularities or economic sectors scheduled, in identified taxpayers that respond to such characteristics in order to achieve the preventive, repressive and induced effect objectives which are pursued by planning.

Without attempting to be exhaustive, it suffices to say that the taxpayer selection systems may be classified according to:

- a) The entity adopting the decision in the centralized systems, decentralized systems and mixed systems.
- b) The means used in fully automated or computerized systems, systems supported by computerized tools, individualized information analysis systems and random systems.

It is common among developed Tax Administrations to combine computerized tools with individual decisions and the predominance of the central selection although with the subsisting possibility of territorial selection.

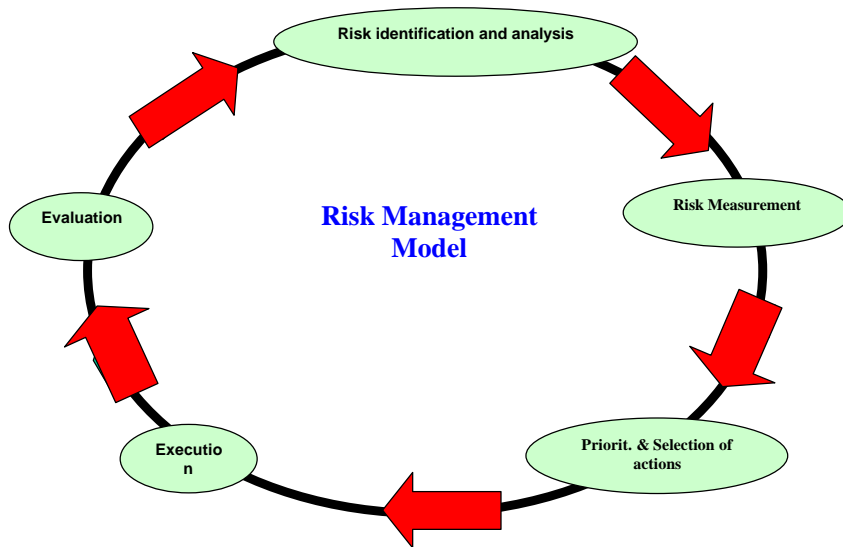
3.8. Compliance control and results evaluation

The planning cycle necessarily closes with the registration of actions and their control and analysis thus giving way to a new planning process.

4. TOWARD AN ALTERNATIVE PROCESS OF EXAMINATION PROGRAM DESIGN. OUTLINE OF A GENERAL AND INTEGRATED FISCAL RISK ANALYSIS

Although in general, European and American States adopt timeliness decisions with respect to the taxpayer groups that are preferably going to be the subject of fiscal audits, in some countries, General Planning is based on a single General Risk Analysis of the group of taxpayers and a measurement of the availability of resources to face such risks. The difference with the planning system that serves as model is that in these countries, the decision as to the taxpayers to be examined is made objectively, without evaluating their timeliness, basing it on the abstract risk of noncompliance that falls on every taxpayer.

Although this Lecture does not cover in depth a complete risk management system, we can see below what would be the planning cycle in a system of this nature:



5. ORGANIZATION OF CONTROL THROUGH HOMOGENEOUS SPHERES OF ACTION. A FUTURE PROPOSAL FOR CONTROL PLANNING AT THE SATA

5.1. Fiscal Risk as the sum of fraud potentiality and probability

A) Fraud potentiality:

A taxpayer may have a high probability of committing fraud that may affect all its income, a significant part thereof or an insignificant part thereof. In turn, that significant or insignificant part may be in absolute (large or small debts), relative (large or small percentages with respect to the total taxpayer Base) or mixed terms.

With the mere quantification of the probability of committing fraud we would have unadjusted results: A taxpayer may have a high Fiscal Risk (FR) of committing fraud with a small amount; or a low FR of committing fraud with a large amount; or a high FR of committing fraud with a large amount which, nevertheless, in relative terms, is an insignificant percentage with respect to its total base; etc. etc... It is necessary that we complete the concept of FR with the "potentiality" of fraud, the latter being understood as the "amount" thereof, in absolute as well as relative terms. Somehow it is presupposed, although indirectly, the greater the level of fiscal magnitude, the greater the probability of fraud, although this may not be the cause of its inclusion in the FR concept.

At first sight, it seems logical, because of its fairness, that the relative percentage to be represented by income with FR with respect to total income received by the individual in question, be the one to intervene mainly in the calculation of the taxpayer's individual FR. Nevertheless, indirectly, the absolute amount should also do so, inasmuch as, to the extent it is not received, the financing of public expenditures will require greater revenues which, simultaneously will increase the tax pressure on the rest of the taxpayers. Or what is the same, the revenue from large absolute debts, would reduce the PFE of taxpayers with scarce resources.

The problem of coexistence and valuation of the amount of risk (potentiality) posed, with the probability of fraud is solved by spreading out at intervals, the evaluation of risks, by elaborating charts of primary risks in HOMOGENEOUS SPHERES OF ACTION. Therefore, we are not going to determine what is the content that is to be given to the PROBABILITY of fraud, leaving for discussion further on, what is to be the main object of this paper, that is, the HOMOGENEOUS SPHERES OF ACTION (HSA).

B) Probability of committing fraud:

The probability of committing fraud is in direct relationship with the **possibility and probability** of being controlled.

The possibility of a taxpayer being controlled depends on the type of fiscal magnitude and the nature of such income or bases. There is income with much higher possibility of control than others, such as, for example, those subjected to withholding. In this case there is automatic control and there is no need for long, costly and in-depth verification actions.

The probability of control is conceptually subsequent to the possibility and in relation to the latter, is dependent on the **means** available for undertaking the control actions. The lower the possibility of control and accordingly, the more complex and costly the type of verification required by the magnitude, the lesser the probability of control.

If Planning is based on Fiscal Risk criteria, the PROBABILITY of control will most certainly be increased. It is control, the potential inspection action, which guards the vineyard of voluntary revenue. Voluntary revenue is intensified when income is controlled and decreases when the base has lower levels of control.

5.2. Fiscal risk. Contents. Elaboration of risk Categories

A) Initial assumptions.-

Fiscal Risk is in relation to the potentiality and probability of fraud, considering the premise that, *in general, whoever may commit fraud, does so.*

The first conclusion is that a well quantified Fiscal Risk may also serve to evaluate the level of fraud which should be expected from every taxpayer. Another different thing will be to be able to discover it completely. However, in principle, we may conclude that, one can anticipate the same potential fiscal fraud as the FISCAL RISK.

In this sense, two risk quantification techniques may be used: The so-called abstract or diffused Risk and the better known concrete Risk .

B) DIFFUSED RISK Techniques.- Spreading of Categories:

In accordance with the DIFFUSED RISK techniques, risk parameters are identified which, only *indirectly* may be related to the specific fiscal risk that may be individually attributed to each FISCAL MAGNITUDE.

With this technique and for the elaboration of the Homogenous Spheres of Action, CATEGORIES OF FISCAL MAGNITUDES by diffused risk are going to be determined gradually and by stages, as follows:

- a) FIRST Category: In keeping with the "POSSIBILITY OF CONTROL" INTRINSIC TO EACH FISCAL AMOUNT. Accordingly, they may be represented by the TYPE OF CONTROL ACTION required: **automatic, extensive and intensive control.**

A differentiation would be made between: 1.- Automatically controllable bases: Those subjected to withholding or on account income and, in general, all those that may allow for control by means of third party information returns; 2.- Bases with possibility of extensive control: Would cover those whose TOTAL control is possible through summary proceedings; 3.- The rest of the bases, controllable only through intensive verifications.

b) **SECOND Category:** Within each category of the previous ones and in keeping with the **economic nature**, not the fiscal ones, of the magnitudes:

- Sectorial classification according to the **GROUP OR TITLE** of the Activity.
- According to the **SUBJECT** nature of the fiscal magnitudes, for cases of nonexistence of economic activities.

The distribution would be based on economic activity sectors, with the level of disaggregation required by differences in the **probability of control** of each of them. Using as reference:

- The Code of national Activities
- One may arrive at the level of Title, if this may lead to distinguish between different levels of probability of control.

c) **THIRD Category:** Under each of the secondary categories a distinction will be made in keeping with the “**PROBABILITY OF CONTROL**” which each fiscal magnitude assumes: **Difficulty of verification, complexity of actions, means, etc.**

d) **FOURTH Category:** Within each category resulting from the previous classification, a distinction will be made according to the “potentiality of fraud” (potential amount of the debts in absolute terms) measured by the **volume of operations or amount of the fiscal magnitude**.

The corresponding differentiations will be made under the assumption that the greater the amount of fiscal magnitude, the greater the potentiality of fraud.

e) **FIFTH Category:** Within each of the categories resulting from the previous classification, the **attribution of the specific risks of each of them** will be undertaken, to the extent they may have been detected or elaborated. At this time, one generally incorporates **DIFFUSED RISKS**, but there is nothing that may prevent the incorporation as well of some type of **CONCRETE RISK**, provided that it affects specific groups of fiscal magnitudes and not specific taxpayers. Let us recall that throughout the process carried out up till now, magnitudes are being classified and not taxpayers.

- f) **SIXTH Category: Attribution of FISCAL RISKS derived from the classification of the “magnitudes” of each taxpayer.** Up till now, we have valued the FISCAL RISK of magnitudes. As of this moment, the computerized systems should be capable of telling us HOW MANY AND WHICH TAXPAYERS are in each of the previous CATEGORIES. There will be many taxpayers who may be in several categories and, therefore, they will participate in several FISCAL RISKS. The sum of all these FISCAL RISKS will afford us the INDIVIDUAL DIFFUSED FISCAL RISK of each taxpayer. Thus, in accordance with this final data we will elaborate the FISCAL RISK MAPS or ENVIRONMENTS on which to set the HSAs.

5.3 Planning and selection. Risk environments

As we have been saying, we will elaborate the HSAs with elements and techniques of DIFFUSED RISK, by means of the procedure that is analyzed further on. The HSAs are used to set the limits of the fiscal risk environments of taxpayers on which action will be taken (Planning in general and specific Control Plan).

Having set these taxpayer environments, the selection function must specify which taxpayers from each “environment” will be the subject of verification, by adding the CONCRETE RISK to the DIFFUSED one with which they have been classified.

The attribution of coefficients of FISCAL RISK to each census or magnitude, is obviously a complex task which requires above all, historical support with respect to the behaviors of the inspected taxpayers. In addition, it should not be forgotten that the values of all the coefficients of FISCAL RISK should be referenced, ensuring that they will always be relative and adjusted to the rest of the coefficients and categories.

We can give them whatever contents we wish provided that we are capable of justifying it. We can reach the complexity we consider better adjusted, either on the basis of historical data of previous actions, or data from current investigations. Nevertheless, in any case, the data used to determine the risk coefficients must be capable of being treated and assumed. For this reason, it is recommended that there be clarity, conciseness and ease of quantification which unavoidably calls for a limited number of parameters.

5.4. Fiscal risk maps. Delimitation of Homogeneous Spheres of Action

A) Delimitation of HSAs:

As we have previously said control actions oriented by FISCAL RISK call for the elaboration of a series of CATEGORIES BY STAGES, which may be used for developing a MAP OF DIFFUSED RISKS by taxpayers. Based on the fact that this MAP is elaborated in each geographical sphere into which the territory of application of the tax laws is divided, we would find ourselves with some diffused risk levels for each of these areas.

This is precisely where the main difference of the system arises. It will not be planned for each area, but rather for the sum of the risks of the areas, with the authority of each sphere carrying out the corresponding work in this general analysis.

The Homogeneous Sphere **leaves aside the territorial delimitations and adds all the taxpayers.**

The Homogeneous Sphere **takes into consideration the Human Resources available, but does not limit itself to them, and rather tends to set adequate Staffing at the Area's Risk Level.**

5.5 Relationship between Fiscal Risk and type of Verification

* The combination of the three types of possibility of control and accordingly, the three large primary groupings of fiscal risk, forces us, before continuing, to make some previous considerations on the actions required, namely:

1^a) It is necessary to get in contact with **ALL TAXPAYERS** in a single fiscal risks map, in order to verify whether the constitutional principles are being complied with and the PFE is that required by the rules. The control actions in an individual who only receives controlled income may be representing a 100% PFE when it is not improbable that other taxpayers, with uncontrolled income may be in much lower percentages. May or should the tax Administration admit some specific levels of minimum FISCAL RISK and devote its means to the struggle against fraud at other higher levels of FISCAL RISK?

2^a) **EXTENSIVE ACTIONS** should be carefully selected and thoroughly executed, because otherwise, the resulting induced effects may only lower the FISCAL RISK of the “touched” taxpayer, but on the contrary, increase that of the environment, on accommodating himself to the “intensity” which those could have in the future if he were selected to be subjected to them.

Extensive actions fall, among other Fiscal Risks, on the FRs reduced through normative agreement, wherein the Administration “waives knowing” normatively the reality of the bases and subjects taxpayers to objective base assessment systems (“forfait” or module systems). The FISCAL RISK is reduced through the application of the system itself, easily verifiable, but generates Fiscal Risks that are added for the taxpayers that relate themselves with those taxpayers that abide by the system.

3^a) Partial and intensive actions should be planned according to the Fiscal Risk (understood as a set of valuations, where the one referring to the induced sociological effects on voluntary revenue should not be the less important), but selected and executed according to the Concrete Risk incurred.

5.6 CONCLUSIONS

The ultimate objective of organization and planning by Homogeneous Spheres of Action is to arrive at the best management of Effective Tax Pressure, which is equivalent to saying that there will **strict abidance by the basic fiscal principles** of Generality, Equality, Justice, Equitable Distribution of the Tax Burden, Proportionality and Effectiveness.

In addition, the HSAs endeavor an **efficient management of human and material resources**, to the extent they are assigned where they are needed most, according to FISCAL RISK criteria and not where they are territorially requested for whatever reasons.

The Homogeneous Spheres of Action involve **planning absolutely aimed at the struggle against fiscal fraud**. To the extent one identifies FISCAL RISK with potential fiscal fraud (PFF), the eradication or decrease of the former will have the same effects on the latter, *without subjection to quantitative results*, more like indicators of possible deviations in the execution of the programs.

Never as indicators of results in the struggle against fraud. For the purpose of determining an indicator there is the level of execution of the programs and the results achieved in terms of relative improvement of noncompliance with tax obligations by the group of businessmen and professionals.

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Case study

TOPIC 1.1.

PROCESSES FOR THE DESIGN OF EXAMINATION PROGRAMS

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SUMMARY: I) Introduction.- II) Objectives of Planning.- III) The Planning Function in the Examination Process.- IV) AFIP's Annual Examination Plan (AEPF).- 4.1. Its evolution through time.- 4.2. Central developments related to the elaboration of the AEP.- 4.3. Stages and requisites necessary for the operational formulation of the AEP.- 4.4. Main characteristics of the 2004 AEP.- 4.5. Feedback and Management Control.- Annex I: Total control actions planned for the year 2004.

I) INTRODUCTION

The basic difficulty found in the examination function within the Tax Administrations involves the improvement of fiscal compliance by all the taxpayers, given the material inability to individually control each and every one of them.

This is so, given that the situation they must face is a large number of taxpayers that must comply with specific fiscal obligations, varying levels of compliance of said obligations and limited resources at their disposal, of a material as well as human nature, to carry out the activities under their responsibility.

The challenge, from this standpoint, is to determine whom to examine, how to use the human resources available and which auditing methods should be used so as to impact the noncompliant taxpayers with direct actions and/or actions to induce compliance and/or which may increase the risk perception of all the taxpayers.

In view of the global characteristics stated, it seems essential that Tax Administrations use planning and programming as regular and permanent instruments to adequately solve the low index which measures the number of taxpayers examined/number of taxpayers susceptible to examination which all Administrations have, regardless of their characteristics and their levels of efficiency.

II) OBJECTIVES OF PLANNING

As a result of the previous statement and prior to fully describing the planning and examination functions within the Tax Administration, it is deemed convenient to synthetically describe the basic objectives of tax planning:

a) Efficiently allocate the human resources.

In this regard, every organization is aware of the quantity and quality of the human resources it possesses and must establish policies to qualitatively improve their staff, either by determining requisites for new entrants, or the training and updating of agents that are already part of the staff.

Undoubtedly planning should consider the characteristics of the staff that will directly participate in the execution of the different tasks. The elaboration of the various working programs requires the efficient allocation of said resources in order to fulfill the missions and functions of the Administration, regardless of the fact that the plan itself may consider, as part of its own development, the actual performance of training activities aimed at redistributing resources among the different tasks to be carried out during its period of enforcement.

b) Reduction of operational cost.

This objective is a direct consequence of the previous one and is based on the fact that the organization will be more effective and efficient if human resources are allocated to the various operational functions on the basis of their qualifications.

A plan which anticipates the efficient allocation of agents with specific technical characteristics to tasks of varying complexity will ensure better compliance and at a lower cost, of the functions assigned to the organization.

- c) Achieve an optimum combination between the different functions of the Tax Administration.

A first essential step, prior to scheduling the examination activities, is that the central planning area of the Tax Administration objectively determine the number and quality of the human and material resources anticipated for distribution among the various basic and support functions for the time period being planned.

After solving this issue which is generally the responsibility of the top level authorities of the organization, specific programs or plans may be designed for each of the functions to be carried out.

- d) Achieve an optimum combination of tasks within each function.

After fulfilling the preceding requisite, it then becomes the responsibility of the area planning the examination to determine how available resources (human, computerized and material) will be distributed among the different tasks to be carried out during the operational plan, considering the peculiarities of the types of control to be applied therein.

The key aspect here is to arrive at an optimum “mix” for achieving maximum possible control with the existing resources, so as to induce voluntary compliance, increase the perception of risk, detect and sanction evading behaviors and thus fulfill the main objective of every Tax Administration, which is to improve tax compliance by the taxpayers.

The aforementioned “mix” is achieved when one may determine in advance the relative importance of each operational control task with respect to the rest, which is achieved to the extent there is a reasonable combination between the different specific functions and tasks, as discussed in the previous section and the present one.

- e) Allow the control of compliance carried out during and after the enforcement of the plan.

In order that the planning function will not become a theoretical exercise whose mere formulation may fulfill a formal requisite without any real operational impact, it is essential to complement it with an efficient management control task.

An alternative is to monitor it, following conclusion of the period subject to budgeting, to then determine the level of compliance achieved.

This option is not beneficial for the Administration, since it will only allow for knowing the “ex post” results and in the best of cases, each operational area that has not complied with the timely assumed commitments, will justify its noncompliance, to be taken into account for budgeting the next period.

In this respect, a good practice in planning is that during the period of enforcement of the plan, periodic information cuts be undertaken for making a partial evaluation of the level of compliance with the budgeted goals.

This mechanism not only facilitates timely detection and correction of over or under operational compliances, but also allows the early identification of errors in planning itself which may be corrected during the execution of the plan by making the pertinent adjustments.

In this same sense, in some circumstances, deviations in execution will arise from changes in the context or significant modifications of a legal nature after the formulation and enforcement of the plan, that call for adapting it, in order to consider therein the new activities to be carried out by the operational areas as a direct consequence of the changes made.

For example, if during the month of March of a specific year, the Legislative Body approves a new tax whose relative weight acquires importance in the tax structure, this new reality is sufficient so as to undertake an immediate adaptation of the examination plan for the current year, by incorporating examination guidelines and allocating sufficient resources to control compliance by the taxpayers with this new tax, since it will have an impact on a significant part

of the period of enforcement of the plan, if it is to be considered on an annual basis.

Continuing with the proposed assumption, it would not be advisable to modify the control budget if the new tax enters into force late during the year, since it would have a marginal incidence on the period about to be concluded, although it will be taken into account in formulating the plan for the next temporary cycle.

III) THE PLANNING FUNCTION IN THE EXAMINATION PROCESS

The main functions of every Tax Administration are collection and examination. However, there are at least three other functions related to compliance with the previously mentioned ones which are: planning, computerization and management control which should have a high level of interaction.

In fact, it is not very difficult to explain that, regardless of the level of the Tax Administration we are concerned with, either at the national, provincial or municipal level, in all those cases, one must administer from tens of thousands up to millions of taxpayers with hundreds or thousands of agents that comprise the respective tax entities.

Therefore, it is not very difficult to justify either, that in any of the aforementioned assumptions (levels of organizations whose mission is to administer taxes), the planning function is essential for budgeting levels of activity in the essential collection and examination functions, as well as to anticipate the computerized resources and developments that will be required.

In this same sense, although with respect to the computerized function, its importance is evidently explained in relation to the collection and examination functions, its application is also essential in the planning and management control stages, since it allows for promptly and efficiently managing volumes of data and information that constitute the essential raw material for budgeting and control purposes.

Finally, the management control function allows the periodical monitoring of the way in which the levels of timely budgeted activities are fulfilled, with respect to the rest of the Administration's functions.

Here it becomes implicitly evident that the management control function is the essential counterpart to be carried out in organizations using action planning or scheduling systems.

For a better understanding, there are two different ways of explaining how planning fits within the examination process in a Tax Administration: that is, either as an integral part of the vertical process of the examination function or as an integral part of the horizontal process thereof.

a) The vertical process of the examination function:

In many Administrations, the operational functions of those central or advisory offices are clearly separated within their respective organizational structures.

Taking into account this proposal, the main missions of central areas are to plan, schedule, issue standard operational rules, compile information from internal and external sources, set up data bases and design centralized systems for their subsequent use by the operational areas (collection and examination).

In keeping with the structure presented, operational areas are essentially responsible for execution, as regards the development of investigation techniques on sub-universes of potential taxpayers to be examined, their selection, verification of the veracity of what has been self-declared or performing the assessment or total or partially omitted obligations –auditing them-, carrying out the jeopardy assessment stage, etc.

Finally, the vertical process cycle closes with a new intervention of the central areas which involves the management control tasks for ensuring that the levels of activity budgeted during the planning stage have actually being carried out by the operational areas.

As a corollary to this point, it may be said that the vertical examination process favors the so-called “control by opposition”, whereby those who plan do not operate and those who operate, do not control.

b) The horizontal process of the examination function:

The horizontal process of the examination function includes all of the operational tasks that are normally carried out within a Tax Administration.

In this sense, the process begins in the stage known as taxpayer investigation and selection wherein all the tools available in the organization are applied, especially the computerized ones, which tend to objectively determine which taxpayers will be subjected to auditing.

The next step is examination or tax auditing as such. It includes every type of control oriented toward determining the taxable base in undeclared taxes and/or if what the taxpayer has self-declared is true, regardless of the manner in which the Administration performs such verification which, as will be seen further on in this paper, will be defined in each case, according to the type of taxpayer, reason for selecting him, scope and depth of the audit. and tax intended to be controlled.

If the taxpayers accept the adjustment promoted by the examination areas, the cycle will be considered fulfilled and the differences in tax detected will be recorded to control their receipt. Nevertheless, actually, in a significant number of examinations the taxpayer does not accept the projected assessment made by the tax agents and that is when another stage of the horizontal process begins, which is the jeopardy assessment of the taxable base.

In this stage, a review is made of the tasks carried out by the examining agents and parallel to this, the taxpayer is allowed to contribute the complementary elements and evidences to defend his rights vis-à-vis the tax claim.

This horizontal cycle concludes with the intervention of the legal or penal area, depending on the characteristics of the adjustment made and confirmed by the jeopardy assessment area, whereby the tax entity will be party to a trial before the Tax Court or Penal Court, as may correspond.

The importance of describing the different stages of this horizontal process of the examination function lies in that the Tax Administration, when designing its examination plan must tend to schedule the activities from the quantitative as well as qualitative standpoint of the greater part of these stages since, as has been observed, they are all part of the same mechanism.

In the majority of cases where the examination function is planned, undoubtedly the activities related to the “core” of the process, that is, the examination or tax auditing stage are scheduled, but it is also important and almost indispensable to consider in planning, the previous investigation and selection stage.

The reasons are obvious. If the plan endeavors to establish objective strategies and guidelines aimed at orienting the operational examination actions in a homogeneous manner throughout the organization, one cannot avoid likewise setting homogeneous strategies or lines of action intended for the areas that are in charge of investigating the subsets of taxpayers with a view to selecting specific individuals to be examined.

Even more ambitious is the incorporation of planning in the stages following examination, since their continuation does not purely and exclusively depend on the actions of the Tax Administrations, but rather will depend on alternatives for decision to be made by the taxpayers examined, as regards accepting or appealing against a tax assessment.

Regardless of the fact that it may be impossible to precisely predetermine the number of cases which the taxpayers may not accept and much less determine in advance, which cases may end in a penal denunciation as a result of the characteristics of the evasion or fraud maneuvers detected, experience indicates that, being able to reasonably estimate levels of average activity for these areas, will not only allow for better scheduling their work, but also facilitates determining the scarcity of human and/or material resources that may be detected and solved on evaluating the complete cycle of cases that may flow through the process being analyzed.

The conclusion with respect to this item is that the planning of examination actions should not only consider the examination stage as such, but also the previous and subsequent tasks, with a view to rationalizing the complete cycle of the process.

IV) THE ANNUAL EXAMINATION PLAN OF THE FEDERAL ADMINISTRATION OF PUBLIC REVENUES

4.1. Its evolution through time

AFIP has along history as regards the scheduling of examination activities which, in terms of operational actions to be carried out is described in the Annual Examination Plan (AEP).

Even though since the 70's the central areas for planning the examination function are carrying out tasks related to this issue, the way of developing the Annual Examination Plan has varied on several occasions, from the standpoint of the responsibility that has been attributed to each of the areas related to examination, as well as by the intrinsic characteristics of the AEP.

In its early stages, the AEP was prepared by the central area directly dependent on the top level authority of the General Directorate of Taxation and only budgeted levels of operational activity related to internal taxes, since at that time, the Argentine Tax Administration was not conceived under the current concept of Single Tax Agency, which status was obtained through the establishment of the Federal Administration of Public Revenues (AFIP) in 1997, as a result of the integration in a single tax entity of the General Directorates of Taxation and Customs. Currently, AFIP also includes the General Directorate of Social Security Resources.

At that time, budgeting was limited to estimating only the number of audits that should be carried out by the various operational areas, at that time, centralized at the level of the City of Buenos Aires and surroundings and geographically decentralized with respect to the country's inland and which were basically performed by the External and Internal Examination Divisions.

In this sense, on the one hand, the planning area, according to the human resources available in each of the different previously mentioned jurisdictions, estimated the number of actions for each of them and the latter had to comply with the committed number, and to decide at their discretion, the sectors, geographical zones, places and/or taxpayer segments toward which the examination action was oriented.

Accordingly, the planning cycle closed with manual statistics prepared by the inspectors at the end of each month, which were sent to the central

area for the latter to consolidate the data received and verify the AEP's quantitative level of compliance.

This budgeting methodology continued to be used until the mid-nineties, after which and as a result of a substantial improvement in the computerized systems applied to examination, scheduling was firmly decentralized and such responsibility jointly with the operational development of the examination activities was assigned to the various Regions, the latter being evaluated on the basis of compliance with the collection goals that were pre-established at the central level.

In this case, the role of the central programming area with respect to this function, was limited to establishing general policies or strategic guidelines, grouping at the centralized level the operational budgets determined for each regional unit and controlling their execution, basically against compliance with the collection goals which, as previously stated were determined by the top level authorities of the organization.

Regardless thereof, the central examination area assumed a much more relevant role as regards aspects of a computerized nature, based on progress achieved with respect to availability of information received at the Organization through electronic media, either from sworn returns filed by the taxpayers or from external sources.

During this period, the design and subsequent implementation of the system called "BAFIS" (examination data base) was begun. It allowed for the decentralized consolidation and use of AFIP's internal information, obtained from the electronic processing of all the sworn returns on taxes with the greatest collection weight and which falls on a larger number of taxpayers within the Argentine tax system (Profit Tax, Value Added Tax, Tax on Personal Properties and Social Security Resources), and the information originating from the real estate, automobile, ships and aircrafts Registries, from the financial system with respect to crediting in current accounts and savings funds, the CITI-Compras system, whereby the most important businesses in the country must report their purchases with the due identification of their suppliers, among other sources of information.

Based on the detailed information, the regionalized BAFIS facilitates the decentralized operational areas the use thereof, by means of a series of indicators predetermined at the central level, and likewise allows the regional investigation areas to perform other specific crosschecks in order to determine universes of potential interest for their subsequent examination.

In this sense, the main function of the central planning area with respect to examination was to compile and update the information periodically, develop computerized applications intended for investigation and selection of taxpayers to be examined, create new indicators and crosschecks in keeping with the type of new information included in the BAFIS and permanently monitor their use.

Starting in 2002, a new methodology was implemented for scheduling the examination activities in AFIP. In this sense, not only was there a return to preparation of an AEP with centralized characteristics, but also it ceased to include only quantitative aspects and became an integral planning tool in this area, by also incorporating for the first time, aspects dealing with customs control and examination.

As a result thereof, the role of the Deputy General Directorate of Examination was strengthened and it was assigned the responsibility of the tactical and centralized planning of the examination actions, in such a way that the AEP includes the general guidelines and objectives, framed within AFIP's Strategic Plan and agreed with the first level of direction of the General Directorates of Taxation, Customs and Social Security Resources, that are transmitted through that means, to the regional, decentralized level which participates in the elaboration of the operational program of its jurisdiction.

In this sense, and beyond the different chapters currently included in the AEP, which will be developed further on, it is important to stress the significance given to centralized planning in keeping with the conceptually mentioned aspects. The Deputy General Directorate of Examination determines the direction of the examination actions, agrees with the Deputy General Operational Directorates, the level of activity which each operational area commits itself to carry out, based on the human and material resources available at the regional level and considering also the quantity and quality of the information available in the data bases of the organization's mainframe, as well as in the BAFIS.

In addition, within the sphere of the aforementioned Deputy General Directorate, programs continue to be designed and the general working instructions are prepared. The latter set the rules and procedures to be applied by the examination agents thus fulfilling a guiding and support function for the homogeneous development of the examination activities by the operational areas.

As may be inferred, it continues to be responsible at the central level for the development and implementation of computerized systems and applications, whose implementation follows the criterion of operational decentralization, with a view to providing the end users the tools whereby they may make an efficient and objective selection of the cases to be examined through the use of the decentralized base (BAFIS) and providing, in addition, list of taxpayers pre-selected at the central level based on specific information crosschecks.

Likewise, within its functions there is the elaboration of study manuals and examination strategies by economic activity based on analyses and field examinations to test the evasion hypothesis and design specialized tax auditing prototypes aimed at different taxpayer universes, which are transmitted to the operational areas for their application.

Finally, it must be pointed out that in accordance with the concepts stated in this item, the aforementioned area also follows up compliance of the scheduled aspects through the so-called “management control”.

At this stage, the central area must strictly monitor the issues included in the AEP, from the strategic optics and from the quantitative standpoint, in order to promptly determine, that is, during the period of execution, the level of compliance by each and every one of the units responsible for the operational activities. This need is based not only on being able to know and report daily to the Federal Administration compliance with the goals determined, but also in verifying how such compliance is inserted in the institutional commitments assumed in AFIP’s Management Plan, whereby the upper level authorities of the National Executive Body through the Chief of the Cabinet of Ministers will evaluate their managerial action.

4.2. Central developments related to the elaboration of the AEP

Parallel to planning the operational examination actions, control mechanisms and measures of a structural nature that do not require the application of direct examination resources are analyzed, designed, developed and implemented.

They are part of AFIP’s Management Plan (general strategic planning of all areas of the Organization), thus constituting central projects whose definition and development are also under the responsibility of the Deputy General Directorate of Examination and are combined to the planning of operational actions (AEP) from a tactical level.

These developments are comprised in the planning of the examination process, since they are defined for the purpose of establishing favorable conditions for carrying out the control activities and achieving the strategic objectives set in the Management Plan.

They mainly consist of the issuance of regulatory rules and the implementation of automatic control mechanisms, tending to discourage or render difficult evasion maneuvers, by acting preventively as a way of extending and complementing the tax control processes. Additionally, they contribute to improve voluntary compliance and provide information that is used to guide the direct examination actions toward those who do not comply.

In this sense, sectorial tax registries were established to include therein individuals that meet specific tax compliance requirements and withholding and collection systems differentiated according to the tax behavior of the taxpayers, on which basis withholdings/collections are increased to individuals showing greater risk.

Likewise, information systems were established for controlling operations subject to the rules regarding transfer prices, those carried out by liquid fuel operators and the grain sector, among other significant activities of the Argentine economy.

Also implemented were automatic systems for controlling authorization for the printing of sales vouchers (invoices) and supporting the transfer of goods (shipping notices), for authorizing exclusion or reduction of withholding/collection systems, for reviewing the correct incorporation of individuals comprised in the sectorial tax registries, among other control mechanisms of similar characteristics.

4.3. Stages and requisites necessary for the operational formulation of the AEP

Although the experience acquired at AFIP as a result of several decades developing annual examination plans at the central level, allows for having an already defined conceptual structure, the need for continuously improving the scheduling function renders it necessary to explore new methodologies and macro and microeconomic information sources aimed at giving them greater strictness. It is also essential that the area responsible for scheduling be aware of the quantity and characteristics of the allowances, the changing material, financial and computerized resources in our Administration through the years, in order

to make some provisions prior to the formulation of the AEP for the following year.

The stage of preparation of the Annual Examination Plan for the immediately following year, begins early in the last quarter of the year, and mainly incorporates the operational contents of planning. In this sense, the requisites that should be defined and/or compiled are listed below:

a) definition of basic strategies and lines of action:

In this case, the main lines of action with respect to the different types of examinations to be applied in the period under budgeting are established in the AEP, by taking into account the information available. Regardless of the determination of the aforementioned strategies, in AFIP during the past years, actions have been partially determined at the centralized level, according to which 50% of the total operational actions must be applied to the sectors and groups identified at the central level, by quantifying the cases to be analyzed by type of examination for each sector, activity and group determined at the central level, leaving it to the operational Regional Directorates to investigate and select the specific cases to be audited within the aforementioned universes predetermined in the AEP.

The remaining 50% of issues to be examined may be determined at the jurisdictional level, although abiding by the general guidelines established therein. In practice, to determine “their” groups of interest, the regions use as instruments, to a great extent, the same sets determined at the central level.

b) analysis of regional geo-economic realities:

As part of the macroeconomic analysis prior to determining the groups of tax interest for the next year, one considers in addition, the relative importance of the sectors at the regional level. This is so, because otherwise, one could reach the absurd point of concentrating examination in two or three regions of the country which cover 80% of the country’s gross product and with a purely economist vision one could assign the same proportion of examination agents and other resources, leaving the rest of the country’s zones practically without coverage.

In this case, AFIP applies a federal policy in this respect and although there is no identical allocation of resources in all decentralized delegations devoted to examination operations, a reasonable amount of resources is assigned therein, so that there may be an appropriate level of presence in each jurisdiction. For these purposes, regional knowledge in this respect is essential when it comes to determining potential groups to be examined and they are considered thus at the AEP each year.

- c) analysis of the evolution of the sectors vis-à-vis changes in the economic policy:

Another aspect taken into account in this stage, is the increase or decrease of the relative weight of different sectors of the economy. In this sense, the way a greater relative weight is attributed to the control of sectors where there has been greater economic activity, while it is eliminated in others that have lost participation in macroeconomics. In all cases, the decisions as those posed, are made within a relative context; that is, one also takes into account other factors that have a strong influence therein (e.g., level of evasion or noncompliance of the different sectors).

- d) segmentation of taxpayers:

If the issue at stake, when planning is to set a coherent and reasonable framework for the examination actions at the country level and given the impossibility of indiscriminately assigning resources of any type, it is undeniable that one should not disregard the percentage composition of collection according to the importance or scope of the taxpayers. In this way, most certainly a greater proportion of agents and, accordingly of control actions will be assigned to the sectors concentrating greater collection than to the rest thereof.

In this sense, one may determine different types or forms of examination, according to the importance and number of taxpayers existing in each category thereof (large taxpayers, medium taxpayers or small taxpayers) by applying in-depth and specialized inspections to the first ones and faster, more precise ones to the others, as appropriate.

- e) be aware of the operational capability available:

This is an essential requisite for the operational areas since, on that basis, they will inform the estimated number of staff that will be assigned to the examination areas, in their different modalities, number of daily working hours and alleged workload pending at December 31 of the year, which should be considered when calculating the working hours available for the year being budgeted.

In addition, it is necessary to calculate the useful hours available, beginning with the theoretical free hours, from which there will be deducted the hours devoted to training, support of special operations, leaves of absences or sick leave, etc.

4.4. Main characteristics of the 2004 AEP

The Annual Examination Plan for the year 2004 is divided into Chapters referring to such aspects as Scope of application, Planning period, Context, Relationship with AFIP's strategic objectives, General guidelines, Guidelines for the actions of specific areas, Feedback and Management Control, among others.

As may have been observed, several of the chapters listed have been discussed in previous sections of this paper. Nevertheless, we shall proceed to discuss below the essential aspects of the 2004 AEP, as regards the planning of the tasks and strategies involving investigation and selection of cases for examination and likewise, the definition of the different types of examinations, bearing in mind AFIP's need to achieve the greatest coverage and perception of risk according to the human resources available, information existing in its data bases and the main characteristics of evasion in Argentina.

4.4.1. The investigation process in Examination

The investigation areas constitute the first link within the examination process and were especially created to analyze cases susceptible of examination. In these areas, after concluding the investigation tasks and based thereon, a suggestion is made with respect to the type of examination to be applied.

The investigation function supports, accordingly, the decisions generated by the examination activities in specific cases, with respect to the selection of taxpayers as well as to the type of control to be applied in each case, determining the convenience of extending or limiting the scope of examination based on the evidence gathered, as may be more appropriate for ensuring an effective tax action.

For the year 2004, and according to the strategies established, investigations which may support the generation of in-depth examinations are being planned.

For the rest of the examinations, the investigation tasks will be adapted according to the type of control to be performed, and limiting the analysis based on the pre-selection guideline, crosscheck, indicator or reasons that gave origin to the investigation.

4.4.2. Selection of taxpayers to be investigated. Aspects to be considered.

a) Identification of relevant economic activities

Based on macroeconomic data originating from censuses at the national and provincial level and other information elaborated by the various entities of the Ministry of Economy available to date, an estimate was made of the Gross Geographic Product (GGP) by jurisdiction, redistributing that corresponding to every political division of the country (Provinces) to assign it to each regional unit of AFIP's operational structure.

Then a selection was made of the most relevant economic Sections, by opening such Sections at the level of 3-digit Grouping of the CIIU code, and resorting to their additional sources of information, to complete the work with the greatest possible disaggregation.

Through the use of the BAFIS – Central application, information was obtained on income from sales, according to the Profit and Value Added Tax sworn returns and the difference between tax debits and credits declared with respect to VAT, corresponding to all activities groups at the 3-digit level of the CIIU Code.

The information obtained corresponding to each Region, regarding the distribution of the GGP and the data from the internal sources mentioned, was weighted through a value function to assign a percentage of relative importance to each activity group.

By means of this methodology, the 15 most relevant activities of each regional Directorate were determined, at the three-digit level of the C.I.I.U. code.

b) Identification of groups of tax interest

Also determined for every Regional Directorate are other taxpayer universes that count on similar characteristics called "Groups of Tax Interest". The identification of these groups allow the Tax Administration to guide its examination activity, as a consequence of the aforementioned peculiarities and the knowledge gathered with respect to their tax behavior, and to plan examination actions on risk sectors or groups of taxpayers whose control is of tax interest.

The following methodology was used for determining the groups of tax interest:

- Risk activities: disclosure was made of the information used for determining the most relevant activities, although at the six-digit level of the C.I.I.U. code, thus obtaining the total value stated in Pesos, number of cases included and the percentage expressed according to the totals at the regional level.
Thereafter, an analysis was made of the "debit/credit" relations and the "gross result on sales" corresponding to each activity, thus obtaining the average value of such indicators.
The average thus obtained is compared with the regional sample average of the country, determining thus the standard deviation for each activity, and establishing inferior and superior limits.
These data are useful for detecting those activities at the regional level that are below the regional sample average of the country with respect to those indicators, which allows for inferring a greater level of risk from the fiscal standpoint. In addition, each Regional Directorate, at the C.U.I.T. level may determine if the ratio of the indicators mentioned is within the respective range and select those taxpayers showing inferior indexes or close to the inferior limit.
- Identification of activities with evasion presumptions or showing a high level of noncompliance in accordance with the experience compiled by the operational areas and with the sectorial studies prepared by the central area.

- Identification of other groups of tax interest, by reason of the particular characteristics of their members in their capacity of taxpayers (withholding agents, businesses promoted and their investors, foreign trade operators, among others).

c) Result of examinations carried out in previous years.

It is convenient to consider the examination actions carried out in previous years to take advantage of the experience gathered and provide feedback to planning according to the results obtained.

To this end, based on the computerized examination registration and management control systems, historical data of cases examined throughout the operational areas which correspond to each economic activity sector are processed, to establish a classification by order of importance of the differences in tax determined, which is then related to the relative importance of each activity at the regional and national level.

As a result of the methodology described, with respect to the identification of relevant economic activities and groups of tax interest and the weighting of the results obtained in the examinations previously carried out by the operational area, the subsets of taxpayers who will be given priority in the control actions of the period being planned, will be determined.

d) Segmentation of Taxpayers

For the 2004 AEP, the universe of taxpayers potentially subject to examination and control actions, according to the attributes of their members as indicated in each case, will be divided into segments.

As a result of said process, differentiated “types” of taxpayers that comprise universes with similar characteristics have been identified. Through this process, it is possible to increase specific knowledge in relation to them.

In the formulation of the plan, the taxpayer universe was divided on the basis of different eventually related approaches:

- Separation by Taxes

Allows for understanding the composition of the taxpayer file, according to classifications existing in the Organization's control systems (Single Tax, Profit, VAT, Personal Properties, Social Security Resources) separated by AFIP geographical jurisdiction. Through the use of the data bases where the taxpayers are registered, the information may be divided into Individuals, Corporation, Large Taxpayers and other taxpayers.

- Active Profit Tax and VAT Taxpayers

Indicates the number of taxpayers paying Profit Tax and VAT (which are the taxes of greater collection importance within the Argentine tax system) corresponding to each regional directorate, for each of the economic sectors of the CIIU Code. This information may be obtained, broken down to three (3) digits according to economic activity groups that comprise the different Sectors.

- Separation by brackets of declared income

Listed in detail for each Regional Directorate is the number of taxpayers by brackets of income declared, related to each economic sector of the CIIU code, which information can also be broken down to 3 digits according to economic activity groups. In addition, from the data bases one may obtain the CUIT of the taxpayers comprising each class and their separation into Individuals, Corporations, Large Taxpayers and other taxpayers.

The information resulting from the separation of the taxpayers was taken into consideration in the identification of relevant economic sectors and activities corresponding to each Region and in the determination of the tax interest groups.

The purpose of this procedure is to determine the number of cases to be examined through the different types of control, considering the examination capability of each area, in order to apply those that may turn out to be more adequate in achieving greater effectiveness and reasonable coverage by the Organization, according to the number and characteristics of the taxpayers of each subgroup.

e) Other complementary information for the research areas.

In order to facilitate to the regional investigation areas, the analysis tasks prior to the selection of taxpayers that will be examined, the elaboration of the AEP includes varied information developed at the central level, which may be useful when determining potential groups of taxpayers to be investigated. This information is provided as a complement to that used to determine the most relevant activities and the groups of fiscal interest corresponding to each regional unit and that relative to the segmentation of taxpayers registered in the respective jurisdictions.

To this end, data corresponding to all jurisdictions are processed and they are assigned rankings and indicators referring, among other things, to economic activities organized according to the profit tax determined/revenues declared ratio; activities with high negative technical VAT balances; relationships between economic and fiscal data. Also comparative data are elaborated based on their interannual evolution.

In addition, the investigation areas are provided lists of the sectorial studies manuals and examination strategies developed by a specific area at the central level, with reference being made to the economic activities wherein they are applicable and the evasion hypotheses resulting from such works that correspond to economic activities and groups of fiscal interest whose priority examination is determined in the AEP.

4.4.3. *Examination procedures in relation to taxation.*

The objective determined for 2003 is maintained. It mainly involves undertaking more in-depth inspections of large taxpayers, modular and speedy inspections of those taxpayers which, on the basis of their magnitude and fiscal interest are in an intermediate range within the segmentation and preventive verifications and examinations made to the largest group of taxpayers, although with a lower taxpaying capacity, in order to achieve greater examination coverage, create risk and detect nonregistered taxpayers.

The AEP considers a smaller number of in-depth regular examinations representative of a larger percentage in terms of alleged fiscal interest, as compared to the speedy and modular regular examinations, given that the in-depth ones are addressed mainly to the more reduced segment of taxpayers with greater taxpaying capacity.

The selection of the type of examination should be in keeping with the objectives of the fiscal intervention, the characteristics of the taxpayer to be examined, the requirements determined for his selection and the scope of control to be performed, bearing in mind the following guidelines:

- In-depth Regular External Examination
These examinations are carried out in those cases where the magnitude and structure of the business or company and the alleged fiscal interest justify in-depth tax audits in all or almost all of the items of the balance or items of the sworn return, and thus, all the taxes and Social Security Resources under the responsibility of this Federal Administration are examined.

In-depth inspections require the participation of the best qualified staff in fiscal audits and eventually, they are carried out by inspections teams with the collaboration of systems experts.

- Regular modular/speedy External Examination
This is an inspection procedure with a modular structure for carrying out specific examinations, based on the analysis of the information available from a specific taxpayer, on whom there are indicators or hypothesis that seem to require adjustments in relation to specific items, but do not justify a more in-depth control. The subject modules have been entrusted to working groups that are devoted to those particular subjects, so as to facilitate the specialization of the inspectors.

These examinations do not only originate from systematic detection of inconsistencies, with limits set to the control of particular aspects, but also from other differences detected during the investigations of cases requiring a fast, speedy and effective inspection.

The two types of examination previously described –regular in-depth and regular modular/speedy are applied the guidelines established in the AEP which call for directing actions toward the relevant economic activities and priority tax interest groups and considering the segmentation of the taxpayer universe of each regional unit according to its fiscal importance.

- Preventive External Examination

The main objective of this type of examination is to exercise extensive control on taxpayer groups, by generating risk conditions that discourage the intention to evade and/or avoid taxes and social security resources. This control instrument is highways and roads, etc., to control compliance with regulatory standards that impose certain obligations to the taxpayers (invoicing and registration, use of fiscal controllers, early enrollment of employed staff, among others) inducing those responsible to declare taxes and social security resources in a correct and voluntary manner.

In order to ensure effective compliance with the guidelines determined for this type of examination, the corresponding areas should take into consideration the following objectives when carrying out preventive actions:

- ❖ Improve voluntary compliance;
- ❖ Induce compliance with the standards related to the assessment and declaration of their obligations;
- ❖ Undertake speedy, timely and effective controls;
- ❖ In regions of the country's inland, handling separately the so-called fixed cost tasks, aiming at carrying them out in a speedy and agile manner, in order to devote resources, to the extent possible, to carrying out the preventive actions that are planned.

Starting with the 2004 examination plan, preventive external examinations will be budgeted by types of activities or tasks to be carried out. In this way, there will be an adequate follow-up of the preventive external examination function when undertaking the subsequent control of operations in accordance with the tasks carried out.

- *Verifications*

The purpose of this type of examination is to undertake massive control of a specific segment of taxpayers, based on information crosschecks that determine universes of taxpayers showing inconsistencies that must be precisely analyzed. The procedure in question, considers a "desk examination" type of methodology to be applied to a specific segment of taxpayers. This involves a differentiation with respect to the external regular or

traditional, modular or speedy and preventive examinations.

The selection of taxpayers that will be subject to internal or desk verifications is made by processing the information declared by the taxpayer or provided by external agents, wherein inconsistencies or omissions have been detected, and which originate notices or requests for the review of documents and records which the taxpayer may contribute in relation to the aspects observed in his fiscal situation. As a result of this type of examinations and when the case justifies it, issues may be passed on to regular examinations.

4.4.4. Examination actions in relation to customs.

The budgeting of tasks related to investigation, examination and other customs control procedures to be carried out by the DGA areas that have been assigned such functions, are part of the 2004 AEP.

In order to improve the effectiveness of actions to be carried out, it is endeavored that control procedures be undertaken on the basis of the operations risk analysis and the profile of the operators, by adapting the detection of critical sectors according to economic changes that affect foreign trade.

In this sense, the introduction of variations in the selection rules to determine the customs verification channels, as well as the review and determination of referential values of goods in foreign trade operations, will contribute to guide the customs investigation and examination tasks.

Defined below are the different control actions:

- Cases analyzed: Any analysis and selection task, whether or not it may have derived into an examination, procedure, etc., and which may have its corresponding documentary support. The cases analyzed, which based on customs procedures do not justify an investigation and which are sent to the DGI for their examination, are not included here.
- Examination of operators: These are the inspections, audits, etc., generated by the area of investigation or other DGA areas, or by denunciations received from entities unrelated to AFIP, processed by the external examination / operators examination areas.

- DGA / DGI joint actions: These are actions carried out by the DGA and DGI areas to jointly examine customs and taxations aspects.
- Procedures: controls performed in shopping centers, route, primary zone (berths and borders) and every physical control aimed at verifying possession of goods of foreign origin for commercial, industrial or other purposes. Includes the cases with collaboration from/to other entities unrelated to AFIP (Superintendence, Police, Federal Police, etc).
- Judicial support tasks: Official procedures, performance of expert appraisals, search warrants, precautionary measures, non-interventions and any other proceeding undertaken at the request of the federal, criminal, economic courts or prosecutor's offices.
- Counter-verifications: Physical controls in areas that were already subjected to verification by another customs service agent. Included are areas that had been in the green or orange channel, but underwent a change of channel and were verified.
- Verification of destination: Are those inspections carried out to ensure compliance with the obligations imposed as condition for a benefit within the term established for such purpose. Comprises likewise the tasks carried out in collaboration with other areas customs offices or organizations. Does not include those carried out within the framework of inspections to operators.
- Documentary examination: Ex-post controls on documents regarding destination of imported/exported goods, carried out by the documentary verification areas.
- Valuation: Controls performed at the places of destination due to differences with respect to the value of imported/exported goods, performed by the valuation areas.
- Verification of goods in primary zone
An objective for the year 2004 will be the substantial improvement of management results of the areas of verification of goods, in order to speed up the first line of control and increase the transparency of the process.

This will be carried out through the implementation of several measures or action strategies, namely:

- Elaborate quantitative operational goals in relation to the percentage of observations detected by the verifiers. Their follow up will be performed through management reports agreed between the DGA and the Deputy General Directorate of Examination.
- Generate the necessary procedures to register in the María system all innovations detected by the verifiers.
- Implement specific follow-ups of conflicting tariff positions and/or having high tax charges.
- Improve training of the staff in charge of the verification function, as well as internal communications between the different areas of the General Customs Directorate.
- Increase specialized staff for facing current levels of red and orange selectivity.
- Improve intelligent selectivity according to the risk profile of the operator and/or the goods to be exported/imported.
- Support the logistics required for the extraction, transportation and analysis of samples for ensuring that the verification of products requiring special analyses be performed within the shortest possible time frame.
- Propose a better level of opening in value suffixes in order to afford greater accuracy to the customs declaration.
- Incorporate mobile scanners in order to improve the efficiency of the verification tasks.

4.4.5. *Examination of Large Taxpayers.*

At AFIP, there is differentiated treatment of the taxpayer segment of greatest tax significance which is in charge of specific areas of the organizational structure at the national as well as regional level, with a view to intensifying effective control of those few taxpayers limited in number, but which contribute a substantial part of tax, social security and customs collection. In particular, there is an area that has been assigned the examination of large taxpayers at the national level, a thousand of which generate approximately 50% of the tax revenues of the Nation.

Specific control and follow up schemes are planned for these taxpayers, which are adapted to their characteristics of large enterprises, by setting action strategies that are based on the following guidelines:

- a) Referred to the Investigation
- Segmentation of the subset of large taxpayers, considering different indicators for their stratification: Economic sector/activity; relative sectorial participation; level of revenues; assessed tax; net worth; sales/cost/expenses ratio; granting of promotional benefits, deferment of taxes and tax refunds, profile of importer/exporter, etc.
 - Setting up of Economic Groups through the identification of individuals and corporations comprising it, including the analysis of their participation in the economic sector wherein they act and the effect of operations between related co companies.
 - Systematic analyses which through predefined macroeconomic parameters may allow for detecting deviations that may serve as basis for generating investigations.
 - Detailed analysis of the procedures and methodologies which they use in their operational cycle.
- b) Referred to examination
- Essentially, regular, in-depth examinations regardless of the application of structured modular procedures to examine specific items or precisely observed aspects as a consequence of the investigation.
 - Integral auditing of all items of the positive balance, including the auditing of accounting and of systems in case it were convenient.
 - Integral analysis of the assessment of all taxes for which the taxpayer is responsible.
 - Examinations oriented at economic groups, including all the taxpayers that are part thereof, controlled and related businesses.
 - Examinations of the taxpayers from the most significant exporting sectors in the Argentine economy.

In the examination of businesses that are part of economic groups and businesses with a high level of foreign trade operations, the scope of auditing covers the treatment given to transfer pricing and aspects related to the financing of operations.

Likewise, tax and customs examinations are planned, with the joint and/or complementary participation of the competent areas of the General Taxes and Customs Directorates.

4.5. Feedback and Management Control

As previously stated, every form of planning should include feedback mechanisms. Therefore, the cycle of the examination process effective management control of the various stages.

Topic 1.1

The Deputy General Directorate of Examination periodically generates and updates management reports based on the data recorded in the computerized systems developed for such purpose. They are sent to the central and operational areas of AFIP so that they may have timely information for making decisions.

Likewise, it is important to undertake a continuous analysis of the results achieved through the execution of the scheduled tasks, jointly with the central areas and the General Directorate of Taxation, the General Customs Directorate and the General Directorate of Social Security Resources, in order to measure the level of progress and determine possible deviations.

Starting with the 2004 A.E.P., planning and follow up is undertaken based on the number of taxpayers examined and additionally, the number of audits according to tax examined.

With a view to improving management control, the information processing system is being tested and implemented for the integral follow-up of the examination process, which in its first stage will replace the systems existing for this purpose in the investigation and examination areas.

The objective is to control the complete cycle of the process, since the initial investigation of a case up to its conclusion with the collection of inspection adjustments, including the stages of jeopardy assessment and administrative or judicial discussion which may result from the taxpayer's nonconformity with the assessment made by the administration.

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Case study

TOPIC 1.2.

**POLICIES FOR THE ALLOCATION OF
FINANCIAL AND HUMAN RESOURCES FOR
THE EXAMINATION AREA**

François Guimont
Deputy Commissioner
Canada Revenue Agency

*CONTENTS: Executive Summary.- I. Introduction.- II. Canadian Tax System.-
Canada Revenue Agency Mandate.- Self-Assessment System.-
III. Compliance Strategy.- IV. Allocation of Resources.- 1. Strategic
Objectives and Priorities.- 2. Risk Management and Risk Assessment.-
3. Build and Maintain our Audit Capacity.- V. Workforce Development
Strategy.- VI. Trust and Integrity at the CRA.- VII. Conclusion.*

EXECUTIVE SUMMARY

The mission of the Canada Revenue Agency (CRA) is to promote compliance with Canada's tax legislation and regulations through education, quality service, and responsible enforcement, thereby contributing to the economic and social well being of Canadians.

The Canadian tax system is based on voluntary compliance and self-assessment. As such, it is fundamental that the CRA maintains public confidence in the fairness and integrity of the tax system. Limited resources are a challenge, which makes resource allocation a key issue. If we are not successful at maintaining public confidence, this may impact negatively on taxpayer's overall compliance, our voluntary assessment system and ultimately on the public's perception of the effectiveness of tax administration.

CRA's approach to compliance must, therefore, be dynamic. We continually identify current and emerging compliance issues; assess the risk of these issues on revenues and compliance behaviour; develop tailored strategies; and propose legislative approaches to improve compliance.

In this context, our allocation of financial and human resources for the examination area is based on three primary criteria: our strategic objectives and priorities; risk management and risk assessment; and the need to build and maintain an effective audit capacity.

In relation to CRA's strategic objectives, we have established five compliance priorities based on our analysis of the environment and our assessment of risk, namely: audit of large corporations; international transactions; aggressive tax planning; Goods and Services Tax (GST) fraud; and maintaining a credible audit presence. In addition to allocating resources to these five compliance priorities, the CRA recognizes the importance of maintaining an audit presence across all industry sectors and types of taxpayers. Maintaining adequate audit coverage upholds the integrity of tax administration, as it deters non-compliance by increasing the credibility and visibility of our compliance programs. We are committed to improving service and efficiencies, thereby reducing the compliance burden for taxpayers selected for audit. Credible enforcement not only deters tax evasion but also serves to remind taxpayers that the CRA is working to maintain the fairness of the tax system by ensuring that all pay their fair share.

CRA also allocates resources in relation to the results of its risk management and risk assessment activities. The successful achievement of the CRA's mission to promote compliance depends to a significant degree on effective processes for identifying, prioritizing, and addressing compliance risks. CRA's compliance programs are supported by world-class risk assessment systems that enable us to focus on areas of highest risk and direct our enforcement actions to them. All returns are reviewed, assessed for risk and high-risk files are audited.

The third broad criterion that drives the allocation of resources is the need to build and maintain our audit capacity. Our strategy in this area is predicated on fostering a learning environment based on enhanced communications, training, technical and analytical capabilities, and improved work tools, such as laptops and their associated systems and software.

The effective allocation of financial and human resources for the examination area is a key and critical success factor in enabling the CRA to achieve its mandate of ensuring compliance with Canada's tax laws.

I. INTRODUCTION

The examination strategies portion of the conference reviews the whole compliance continuum from facilitation to enforcement including the design of various enforcement programs and activities; the allocation of financial and human examination resources; and the legislative support in place for the examination functions. This paper will elaborate on the criteria and policies in place in the Canada Revenue Agency (CRA) relating to the allocation of financial and human resources for the examination area, which is defined as desk and field audit activities.

II. CANADIAN TAX SYSTEM

Canada Revenue Agency Mandate

The mission of the Canada Revenue Agency (CRA) is to promote compliance with Canada's tax legislation and regulations through education, quality service, and responsible enforcement, thereby contributing to the economic and social well being of Canadians.

Self-Assessment System

Canada collects taxes through a self-assessment system. This system is based mainly on voluntary compliance, and voluntary compliance is based on mutual responsibility. Individuals, corporations and trusts that are obliged to pay tax in Canada are expected to meet their responsibilities under the law.

Making it easier to self-assess and file voluntarily is a key objective of the CRA, as is encouraging individuals and businesses—who for whatever reason had not been filing—to enter the system and begin complying voluntarily. This means providing quality service and support to those who wish to comply with the law, while taking appropriate measures to identify and deal with cases of non-compliance. Achieving the right balance between these fundamental responsibilities is important for maintaining public confidence in the fairness and integrity of the tax system and ultimately, for effective revenue administration.

Limited resources are a challenge for all tax administrations, which makes resource allocation a key issue for everyone. If we are not successful at maintaining public confidence, this may impact negatively on taxpayer's overall compliance, our voluntary assessment system and ultimately on the public's perception of the effectiveness of tax administration.

III. COMPLIANCE STRATEGY

CRA's strategy to foster compliance has two major elements:

- Quality services and assistance for those who want to comply; and
- Responsible and effective enforcement actions against those who do not.

We are guided by a compliance continuum that is based on a full suite of education, service and enforcement activities. Based on the level of risk identified and the desired result, the CRA selects, from within this suite of instruments, the activity or combination of activities that is best suited to address the root causes of the identified non-compliance, i.e., enquiry services, partnerships with industries and associations, community visits, information matching, verification and audits, investigation, prosecution and publicity, to name a few.

As compliance activities are directed at achieving compliance through both facilitation and enforcement activities, they do not all result in the direct generation of revenue. However, we consider that all are necessary to support the overall objective of ensuring compliance as effectively as possible.

In this environment, our approach to compliance must be dynamic. We continually:

- Identify current and emerging compliance issues;
- Assess the risk of these issues on revenues and compliance behaviour;
- Develop tailored strategies, often in partnership with other governments, the public and private sector; and
- Propose legislative approaches to improve compliance.

Our compliance programs are supported by world-class risk assessment systems that enable us to focus on areas of highest risk and specifically direct our enforcement actions.

Every individual, corporate and GST/HST return is “scored” for potential non-compliance.

Last fiscal year, we undertook over 300,000 compliance actions (audits, verifications, investigations) and identified \$5.2 billion in additional revenues.

IV. ALLOCATION OF RESOURCES

Our allocation of financial and human resources for the examination area is based on three primary criteria. Resources are allocated in relation to our strategic objectives and priorities; risk management and risk assessment; and the need to build and maintain an effective audit capacity.

1. Strategic Objectives and Priorities

In Canada, the objective is to ensure compliance across a full spectrum of taxpayers and industry sectors with a limited amount of resources. To do so, we need to identify strategies and priorities to target limited resources to problem areas and ensure that the compliance burden for compliant taxpayers is minimized.

Our objective is to identify the most serious cases of non-compliance through the application of sound risk assessment principles and systems and take appropriate measures to correct and deter non-compliance with the aim of encouraging future compliant behaviour.

The CRA's strategic approach to compliance aims to ensure public confidence in the integrity of the tax system and to protect the tax base. Our approach ensures responsible enforcement in the detection, correction and deterrence of non-compliance by ensuring that appropriate resources are allocated to issue identification and analysis; risk assessment; compliance strategy development; and monitoring, evaluation and reporting.

Issue Identification and Analysis - Issues are identified through a variety of activities including compliance research, program monitoring, compliance verification projects, and intelligence gathering.

Risk Assessment – Once identified, issues are analyzed to determine any underlying causes, the scope and the potential risk to revenue.

Compliance Strategy Development and Implementation – Having a better understanding of the risk enables the CRA to develop and implement the strategy best suited to effectively address the issue. Activities to address non-compliance can include providing public education through client outreach programs; forming strategic partnerships with other tax administrations at the federal or provincial level, a particular industry or even an international organization such as the Organization for Economic Cooperation and Development (OECD) to find solutions to issues of mutual concern; proposing legislative amendments or an administrative policy or procedural change to address weaknesses; and targeting high-risk files through verification and/or enforcement activities.

Monitoring – Strategies are monitored during implementation to determine their progress against defined objectives. Monitoring activities may include field visits, quality assurance reviews, tracking of performance indicators and meetings with stakeholder groups to review progress.

Strategy Evaluation and Refinement – Once implementation is completed, strategies are periodically reviewed to assess whether objectives are being met or refinements to the strategy are in order.

Accountability and Reporting – Under the CRA objective of *Transparent Management for Results*, our strategic objectives are woven into management performance agreements the results of which are reported publicly through the CRA Annual Report to Parliament.

The Agency employs specialized strategies that target high priority compliance issues. Based on our analysis of the environment and our assessment of risk, the CRA has established five areas of priority.

Audit of large corporations - Given the complexity of corporate transactions, the impact of highly technical legislative provisions, and the magnitude of dollar amounts involved we continue to audit **all** returns of large corporations.

International transactions – The CRA also works in close collaboration with other tax jurisdictions, including the United States, Australia, Japan and the United Kingdom, as well as international organizations like the OECD, to attack abusive practices relating to international transactions in areas such as transfer pricing and the use of tax havens.

Aggressive tax planning and tax evasion - Tax avoidance transactions are often complex and are structured to avoid the application of provisions of the law. Most have no business purpose except to reduce tax. We are increasing our capability to deal with these challenging areas through legislative amendments and enhancements to our audit programs.

GST fraud - We have a multi-faceted approach to the early detection of potential abuses of the Goods and Services Tax (GST) system, in particular, mitigating the risks of fraudulent GST refund claims.

Maintaining a credible audit presence – The CRA also recognizes the importance of maintaining an audit presence across all industry sectors and types of taxpayers. Maintaining adequate coverage levels upholds the integrity of tax administration, as it deters non-compliance by increasing the credibility and visibility of our compliance programs.

2. Risk Management and Risk Assessment

The successful achievement of the CRA's mission to promote compliance depends to a significant degree on effective processes for identifying, prioritizing, and addressing compliance risks.

We believe the right mix of actions or instruments - both service and enforcement - will address the challenge of minimizing non-compliance. CRA's compliance programs are supported by world-class risk assessment systems that enable us to focus on areas of highest risk and specifically direct our enforcement actions to them. All returns are reviewed, assessed for risk and high-risk files are audited.

Risk management and risk assessment are essential for the efficient allocation of finite resources among competing audit programs and initiatives, and for placing the organization in a favourable position to respond to new opportunities.

Risk management is a process whereby an organization attempts to minimize losses and maximize its opportunities to achieve success in attaining its corporate goals. The cornerstone of the risk management process involves the identification, measurement, and analysis of risks. This process is known as risk assessment.

Risk assessment is used to guide audit programs by: providing estimates of the size, likelihood, and consequences of specific risks; identifying compliance patterns and trends within industry, geographic, or other demographic breakdowns; modeling and profiling identified non-compliance issues at the individual account level, or for specific non-compliance issues; and ultimately targeting high risk files. Risk assessment identifies specific issues for the auditor's attention and enables effective use of their time while not restricting their ability to identify other issues for audit.

We are constantly refining our already sophisticated risk assessment tools to monitor trends and identify emerging issues in terms of their impact on government revenues, taxpayer behaviour and the overall fairness of the system.

Using taxpayer compliance history, third party information, and criteria established on the basis of analysis of non-compliant behaviour, national risk assessment systems identify taxpayers whose returns require further review. For example:

- Risk profiling is used in processing individual T1 returns. Each return is handled according to its risk profile.
- In the Audit National Risk Assessment system every individual, corporate and GST return is "scored" for potential non-compliance using taxpayer information (cross-matched between income tax, payroll account and GST and provincial information) compared against more than 190 sets of criteria of non-compliance developed by experienced auditors based on those they most frequently encounter in their day-to day activity. Examples of the criteria include: i) low net income compared to neighbourhood, ii) no gross income reported by taxpayer, iii) significant continuous operating losses and iv) GST reported is low when compared to income tax gross revenues. The files that are scored high are subject to audit.

Size of taxpayer base

The Large Business Audit program is responsible for the audit of large, complex corporations and represents an area of great risk, due to the complexity of the issues and the necessity to review tax issues that cross functional lines. The population includes all corporations that satisfy the complexity criteria, as well as those with gross revenue over \$250 million. Approximately 900 corporations and their subsidiaries comprise this group.

600 of our most senior auditors work in teams to carry out audits in the least intrusive manner through various initiatives, such as Account Managers, protocol agreements with the taxpayer, detailed audit plans, real time and concurrent audits. Addressing the tax compliance issues presented by these types of clients requires a team audit approach, quite often with inter-office audit coordination, and may involve Customs, provincial and other tax jurisdictions.

The Small and Medium Enterprises (SME) population is comprised of 2.7 million unincorporated businesses and self-employed individuals, 1.3 million corporations and 2.4 million GST registrants.

There are a number of audit programs to address SMEs. These programs do not use a team audit approach. A single auditor, who relies on guidance from their team leader and technical advisor, performs these types of audits.

Resources devoted to large, medium or small enterprise files are committed on the basis of program standards relating to the number of files in a local field office, established coverage rates, grade of staff required to undertake the audit of the various categories of cases in each local field office and standard hours allowed to each case.

Large Files

In the last fiscal year our audits of large business accounted for \$2.4 billion in reassessed taxes. This represents about 46% of the \$5.2 billion from our compliance actions. Our risk assessment would lead us to continue our interest in large corporations. But our interest is not based on the simple assumption that these results mean all large corporations do not comply.

We fully appreciate the complexity of corporate transactions, as well as the impact of highly technical legislative provisions that affect large business. We know that we can have legitimate differences of opinion around the interpretation and application of the law. It is these factors, coupled with the sheer magnitude of the dollar amounts involved that lead us to continue to review all returns of large corporations.

Our approach to managing the compliance risks associated with this population centres around an integrated risk management framework where domestic tax, international tax, aggressive tax planning and protection of provincial tax bases are all elements. As many of the clients of this program represent the Canadian operations of vast, foreign-based corporate groups operating worldwide, there are often transfer pricing and other complex international tax issues involved. Allocation of resources is weighted according to the compliance risks, thus achieving a customized approach.

Small and Medium Enterprises

There are numerous studies that indicate an increased incidence of unreported income and unreported sales among the SME taxpayer population. Given the size of the population, effective risk assessment techniques are essential to identify those areas of highest risk. When allocating resources, this population is segmented along various lines (type of tax, structure of organization, or size of entity). The allocation of resources is based on the attributes related to any given segment and the inherent risk associated with it.

Small business clients are owner-operated with minimal or no internal controls, and a high proportion of cash transactions. Indirect methods of verification such as the net worth approach are often required since the books and records of these taxpayers are regularly found to be inadequate to determine tax compliance, thus reducing the ability to rely on the taxpayer's books and records. The audit emphasis for this taxpayer group is, therefore, on program visibility and deterrence as well as taxpayer education.

Audit concerns in the small business sector continue to include underground economic activity; the proper reporting of income from a business or property; the value of personal use benefits reported; the proper accounting of personal expenses; and the increase in fraudulent GST credit returns being filed by fictitious registrants.

The operations of the typical medium-sized business clients are generally much more diverse and complex than the small business clients, often involving subsidiary corporations and branch operations.

Common to the medium-sized clients are sophisticated and complex computerized accounting systems. The accounting and legal aspects of these companies are complex and are managed by professionally qualified staff, both internally and by public accountants and lawyers. The emphasis of the audit programs for this client group follows a traditional audit approach with high audit coverage. In this approach, the auditor places greater reliance on the books and records maintained by the taxpayer but still must be vigilant in finding errors that may be beyond the records. These audits require experienced auditors and may also include the assistance of industry specialists and technical experts in data retrieval.

International transactions

In the conduct of our audits, large, medium or small, we encounter a large number of diverse issues involving international transactions. We need to ensure that we allocate sufficient resources to address international issues such as treaty shopping, foreign reporting and advanced pricing arrangements. As always, we need to ensure we consider the full range of instruments available in the compliance continuum, as we know that sometimes just increasing resources alone may not be the most effective response. For example, the CRA works in close collaboration with other tax jurisdictions, including the United States, Australia, Japan and the United Kingdom, as well as international organizations like the OECD, to address issues such as transfer pricing or to attack abusive practices in the use of tax havens.

Aggressive tax planning

The CRA often encounters complex tax avoidance transactions that are structured specifically to avoid the application of the legislation. More and more aggressive tax planning and tax evasion is occurring with the purpose of reducing/avoiding the payment of tax. We need to allocate sufficient resources to effectively address such schemes, as they often involve arrangements that are promoted to thousands of investors. Here, as well, it is important to allocate the right resources to the right activities, choosing those instruments from the compliance

continuum that best address the root cause of the identified non-compliance. On tax avoidance issues, in general, we are increasing our capability to deal with these challenging areas through both legislative amendments and enhancements to our audit programs.

3. Build and Maintain our Audit Capacity

The third broad criterion that drives the allocation of resources is the need to build and maintain our audit capacity. Our strategy in this area is predicated on fostering a learning environment based on enhanced communications, training, technical and analytical capabilities, and improved work tools, such as laptops and their associated systems and software.

Ensuring that the staff has the necessary knowledge, skills, resources, technology and a positive work environment is critical to protect an increasingly complex tax system and to contribute to a competitive business environment.

Over 60% of our auditors have professional accounting designations or university degrees.

The remaining staff has completed some accounting courses and has received training in audit. The majority of them are working towards upgrading their accounting knowledge in order to allow them to move into higher positions.

Auditors also have the assistance of various support programs during the course of their audits. These include Industry Specialists Services, technical advisors, real estate appraisers/ business valuers and Computer Audit Specialists.

Audit Training

Training is very important to our organization and is considered essential in increasing the auditors' efficiency and effectiveness and creating an environment that allows professional development and opportunities for employees. Depending on the career path chosen, technical and technological training will be given to broaden knowledge and skill sets, specialization will be encouraged, or management skills enhanced. Training profiles, which are linked to employee competency profiles (CRA competencies include knowledge, skills, abilities, values, attitudes

and behaviours), have been developed for audit positions. The training profiles assist managers in identifying which courses or other learning events should be considered for employees in each position. On average, 10% of an auditor's time is spent on training.

Investing in training not only yields better auditors, it also yields more satisfied auditors. Auditors have many career opportunities within the government and also the private sector. Training is an investment in people and our staff regards it as a positive feature of the CRA - a feature that can help attract, retain and motivate staff.

In recognition of the Audit staff's key role, CRA is committed to creating an environment that allows professional development and opportunities for employees. It is important that staff receive appropriate training to enable them to provide quality work. In turn, quality work affords a reasonable degree of comfort as to the level of compliance with consideration having been given to relative risk, materiality and economy of approach.

Audit Tools

CRA auditors have, for several years now, been using laptop computers with specialized software to assist them in performing their audits. CRA resources are allocated to the development of valuable audit tools stored on the laptop computers, such as:

- Technical information or policies contained in court cases, interpretation bulletins, information circulars, operating manuals, and internal memoranda. This information enables the auditor to research an issue without having to leave the taxpayer's place of business or carry all of these documents in paper format.
- Templates for letters, working papers and standard forms often used by auditors. These templates reduce the number of hard copy forms the auditor has to carry, reduce the need for clerical assistance in typing letters, and in general, reduce time consuming and repetitive steps.
- Applications that compute calculations for the auditor (e.g. shareholder loan, capital cost allowance and the automobile benefit). Once the auditor enters certain key amounts, the computer computes calculations pursuant to the legislation, thus reducing errors and audit time.

- Upload/download functionality. A download is intended to accomplish three major tasks: first, reduce the necessity of an auditor having to return to the local office to obtain additional audit work; second, provide the auditor with a detailed picture of the Client's activity with the CRA in an electronic format, and third, provide a database of client data that can be automatically utilized to reduce repetitious audit work and minimize audit documentation errors. An upload is used primarily to update CRA mainframe systems with audit results. In addition, an upload reduces data transposition errors.

V. WORKFORCE DEVELOPMENT STRATEGY

The CRA also recognizes that our workforce is our most valuable asset. As a result, we are currently developing a comprehensive national strategy to ensure CRA is able to attract, develop, and retain, committed and capable employees to address future business needs in the examination area. In addition, we need to establish policies to maintain parity with the private sector in relation to wage, working environment, and ensure a balance of life in order to attract and retain employees.

The strategy provides a framework which enables the anticipation of future workforce needs; allows for the development of an action plan to address those needs; provides both managers and employees the necessary tools to assist in their career planning; and effectively manage human resources in a manner that reflects the CRA's values.

VI. TRUST AND INTEGRITY AT THE CRA

Our need to build and maintain an effective audit capacity is directly related to building and maintaining the public's trust and integrity in the tax system.

At the CRA, we've always worked hard to carry out our duties with integrity, striving to establish a bond of trust with our clients. We know that we can trust our employees to make choices that uphold the integrity of the CRA.

We must keep in mind that the public's trust has a major effect on our ability to carry out the mission of the CRA. Therefore, all employees are guided by CRA core values of integrity, professionalism, respect, and cooperation.

- **Integrity** is the cornerstone of our administration, ensuring that we treat people and apply the law fairly. Integrity requires that we act with honesty and openness.
- **Professionalism** is the key to success in achieving our mission, reflecting an ongoing commitment to the highest standards of achievement. Professionalism requires that we act with dedication and skill.
- **Respect** is the basis for our dealings with colleagues and clients, being sensitive and responsive to the rights of individuals. Respect requires that we act with courtesy and consideration at all times.
- **Co-operation** is the foundation for meeting the challenges of the future and building partnerships aimed at realizing common goals.

In addition, these values are linked to various CRA policies, including a code of ethics and conduct. The CRA has a tradition of integrity. We are committed to serving the public responsibly, and support an environment where people are respected. Our code of ethics and conduct guides our employees as they conduct their duties

Trust and integrity are the core of our business and the root of all activities, including those in the examination area.

VII. CONCLUSION

The CRA recognizes the importance of maintaining an audit presence across all industry sectors and types of taxpayers. Maintaining adequate audit coverage upholds the integrity of tax administration, as it deters non-compliance by increasing the credibility and visibility of our compliance programs. We are committed to improving service and efficiencies, thereby reducing the compliance burden for taxpayers selected for audit. Credible enforcement not only deters tax evasion but also serves to remind taxpayers that the CRA is working to maintain the fairness of the tax system by ensuring that all pay their fair share.

In summary, we accomplish these goals by allocating our financial and human resources for the examination area based on:

- The strategic objectives and priorities of the CRA;
- Effective risk management and risk assessment; and
- The need to build and maintain an audit capacity.

The effective allocation of financial and human resources for the examination area is a key and critical success factor in enabling the CRA to achieve its mandate of ensuring compliance with Canada's tax laws.

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Case study

TOPIC 1.2.

**POLICIES FOR THE ALLOCATION OF FINANCIAL
AND HUMAN RESOURCES FOR
THE EXAMINATION AREA**

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General Director

General Directorate of Contributions and Taxes
(Portugal)

CONTENTS: I. Objectives of Tax Examination.- II. Organization of the Tax Examination Services.- III. Annual Planning of Examination Actions.- IV. The Problem of Human Resources Assigned to Tax Examination.

I – OBJECTIVES OF TAX EXAMINATION

1 – The purpose of the TE activity is to verify whether tax obligations are being carried out adequately, by maintaining the evasion gap within a desirable minimum level. This action is of utmost importance in the series of activities that must be carried out by the Tax Administration, given that, within said sphere, there may arise problems of legal qualification as well as quantification of the collectible amount or tax to be paid, and also because from them, there may originate corrections to tax assessments or new assessments, and, -if needed- the application of the sanctions provided by the law for violations detected.

From there it follows that TE has a repressive role, although one must also point out the preventive nature of examination which, once carried out, acquires a pedagogical nature that must necessarily be part of the examination action.

Thus, the nature of the actions scheduled implies actions:

- Of a preventive nature, as regards the permanent follow-up of large taxpayers and those considered of great risk and the follow-up of small taxpayers located in risk activity sectors, in addition to the control of new taxpayers;
- Of a corrective nature, as regards effective control of the tax situation of the selected taxpayers, according to the risk criteria that may have been determined.

The TE action acquires even greater significance vis-à-vis the evolution of the tax systems based on taxation of actual and not presumptive amounts which better reflect the taxpaying capacity and wherein tax assessment is focused on spontaneous taxpayer declaration and voluntary compliance with tax obligations. Such evolution imposes new challenges on TE and calls for considering it from a new perspective, with new models resulting from the increase in the number of taxpayers and the generalized introduction of computerized means. The *a posteriori* control of taxpayer returns and the corresponding assessments acquire ever greater relevance, in order to verify whether all events of tax importance have been declared and if they agree with the applicable legal rules.

In this way, the effectiveness of the tax system essentially depends on a dynamic tax examination which is based, on the one hand, on data arriving at the Services or which may be inferred from actions undertaken for such purpose, and on the other, on the permanent observation of the economic reality, which may be capable of timely promoting tax assessments that may be necessary. That is, corrective assessments according to the respective factual and legal bases.

On the other hand, tax evasion and fraud methods are ever more sophisticated and acquire greater international dimension. For this reason, it is necessary to adopt new auditing techniques in the examination services as well as to resort in TE, to effective cooperation with the tax authorities of other States, in accordance with the international law instruments signed by Portugal (Directive 77/799/EEC of December 19; Council Regulation (EC) n.º 1798/2003 of October 7;

the VIES system which allows the Member States to receive information on intra-community operations carried out by VAT taxpayers; bilateral conventions intended to avoid double taxation as well as tax evasion). Likewise, it calls for having access to international data bases and specialized training of the respective staff.

The examination function may be and, in general, is a means for becoming aware of the defects of the system and proposing modifications to the standards and regulations for arriving at better management and effectiveness.

II. ORGANIZATION OF THE TAX EXAMINATION SERVICES

The functions of the Tax Examination Services (TE) are fundamentally distributed according to the organic structure model provided in Decree-Law n.º 366/99 of September 18, for all of the DGCI services, it being responsible for activities aimed at investigating tax irregularities as well as for preventing and fighting against tax fraud and evasion. Said model determines the basic options in sharing responsibilities between the central, regional and local services.

At the central level, examination is the responsibility of the Services and Tax Examination Directorate, which is in charge –based on visits and accounting examinations– of analyzing the tax situation of the larger companies, of the groups comprised within the special taxation system for groups of corporations and credit and financial institutions. It is likewise, within this group of businesses where problems dealing with transfer prices acquire greater importance. In addition, the Services may initiate any special examination action requiring centralized coordination, either for strategic reasons or other causes.

The Central Services are also responsible for coordinating and supporting the tax examination activities of the District Finance Directorates (DFD). Such function is entrusted at the national level, to a Directorate of Studies, Planning and Tax Examination and Prevention Services (DSPTEPS). This SD has responsibility in the following areas: planning, through the preparation of the action plan for national tax examination; coordination and control of the execution of the plans and elaboration of activities reports; analysis and preparation of the data available at the central and district levels, in order to provide adequate information for improving the efficiency and effectiveness of examination; compilation and treatment of the information; technical support to the

central and district services, mainly with respect to verification of computerized accounting systems; preparation of studies and information to be used in the TEs (at the central and regional levels); identification and analysis of the indicators to be used in the examination tasks and in the application of indexing methods; improvement of the examination methodologies; preparation of examination manuals; promotion of the re-verification of examinations made by the central and district services (regardless of the internal and external auditing functions of the General Finance Examination Office; collaboration with professional training actions for the examination staff.

At the regional level, the District Finance Directorates are in charge of examining all the taxes for which the taxpayers within their district are responsible, except for those that are examined at the central level.

At the local level, the Finance Services ceased to have examination functions as of the new organic structure provided for the DGCI in the aforementioned D.L. N° 366/99.

III. ANNUAL PLANNING OF EXAMINATION ACTIONS

- 3.1 – TE actions are being carried out on the basis of the National Tax Examination Activities Plan (NTEAP), in accordance with articles 23 to 27 of the Complementary System of the Tax Examination Procedure (Decree-Law N° 413/98 of December 31) elaborated annually by the DSPTEPS with the participation of the organic units of Tax Examination. The NTEAP is approved by the Minister of Finance, upon suggestion of the General Director of Taxes following consultation with the Specialized Council of General Directors for Tax Affairs.

The Plan defines the programs, criteria and actions to be implemented and which will be the basis for the selection of taxpayers and others responsible for tax obligations which will be examined. It also sets the objectives to be achieved by the organic unit of the central, regional and local services, objectives dealing with the human resources that will be assigned the examination tasks, and, if execution strategies are determined for each of those actions, it should also consider the allocation of part of the tax examination resources to examination actions not expressly anticipated.

The NTEAP may subject to review during its execution, upon justified request of the DSPTEPS.

Based on the NTEAP, the regional services elaborate regional activities plans that specify the actions scheduled and serve as basis of the work to be performed by the examination officials and teams in their respective territorial areas.

- 3.2 – This plan is an essential instrument in conducting the tax examination activities and its relevance increases, to the extent the universe of taxpayers whose tax compliance must be controlled also widens. The different organic units participate in its elaboration thus sharing responsibility with respect to the objectives determined. Said objectives are aimed at the specific actions which each of them must obligatorily fulfill. The plan also includes the criteria for taxpayer selection in order that the organic unit will not be totally free to select the taxpayers who will be in the list of anticipated or scheduled actions.

The annual plan determines the priority actions to be selected which, for efficiency's sake, naturally lead to those that are expected to produce the greater dissuading effects, direct and indirect, in relation to tax fraud and evasion. That is, priorities should be determined by comparing the values of the results expected and the anticipated examination costs. Nevertheless, the difficulties for measuring the results and –what is even more serious- the practical inability to evaluate the indirect dissuading effects, results in the lack of continuous improvement of the process for determining priorities. A useful indicator of productivity could be the analysis of results of past experiences with the various types of examination.

However, it is true that the execution of the annual plans is affected by the assignment to the examination services of unplanned tasks –extraordinary actions–, or else by the performance of functions –as providing information to other services or supporting legal actions and that, at times, results in a heavy workload.

- 3.3 – It is known that plans are only effective, if their execution is automatically controlled and evaluated through an adequate computerized data base and an analysis as to the why of the divergences between what is projected and what is actually done

and if, subsequently, the necessary lessons are extracted to then adopt the measures considered essential for minimizing the differences. Control in the execution of the annual plan calls for elaborating reliable statistics which will not generate significant delays in its implementation and in obtaining results. Such statistics should also allow for a separate analysis, according to the type of examination and the taxes comprised in the analysis.

The control of results of the NTEAP is operationally based on the management indicators system (SIG).

Although it is considered that incentives are a positive means for improving the execution of plans, the law does not provide for granting incentives when objectives are exceeded, or the application of penalties when the plans show high margins of noncompliance with the objectives due to reasons attributed to the services in charge.

Compliance with the NTEAP is evaluated through the annual report on the Tax Examination activity, which mentions the means used and the results obtained, as well as the difficulties and limitations imposed on the TE activity. As previously mentioned, the execution of the national plan is frequently affected by unforeseen requests originating from the Central Services.

In the current productivity measurement system, use is made of indexes that relate the amounts of the corrections introduced in each examination action to the number of man/days directly applied to such action, leaving aside, of course, the results of actions of an essentially preventive nature. Nevertheless, the validity of such results is debatable, since only part of the corrections resulting from the examination action entails effective collection that same year, given that the taxpayers will use the means of defense within their reach, or will initiate tax enforcement processes for nonpayment. Thus, the indicators elaborated at the DGCI on productivity of the examinations, although providing information of interest, are still rather deficient,

for which reason it is important to improve the indicators of the results obtained, while also improving the statistical record of the results of the examination actions and their cost in terms of man/days.

According to the Law (V, article 27 of DL N° 413/98, of December 31), the selection of taxpayers to be examined, in keeping with the examination procedure is based on: a) the application of objective criteria determined in the NTEAP; b) the application of criteria which, even though not contemplated in the NTEAP, are defined by the General Director of Taxes according to the critical need for prevention and effectiveness of the TE, or else, the justified application of random methods; c) communication or denunciation provided they are presented within the legal terms; d) the verification of significant deviations in the tax behavior of taxpayers subject to examination or others having tax obligations, given the parameters of normality that characterize the activity or net worth situation, or any act or omission that may be an indication of a tax violation.

In sum:

The measurement of productivity of the different examination actions is essential for: 1) determining the types of examination which, on being more productive, should be given priority in the allocation of resources scheduled in the annual plans; 2) disseminating the selection criteria of taxpayers to be examined and the examination methods to be applied, which afford better perspectives of high cost/benefit indexes; 3) evaluating the performance of the teams and examination technicians and establishing incentives schemes according to the results achieved, as well as a system for assuming due responsibility for the deficiencies indicated.

IV. THE PROBLEM OF HUMAN RESOURCES ASSIGNED TO TAX EXAMINATION

Human resources problems in the TE services are of a quantitative as well as qualitative nature. On becoming ever more technical and specialized, the services impose greater requirements with respect to personal qualification and experience.

The TE's staff will have to change progressively in such a way as to keep pace with the needs and methods of execution of the services, which calls for improving competencies, redefining careers and categories and determining new profiles and qualification requirements for the staff to be hired, in addition to aiming at a more profound and frequent professional training, by prioritizing specific programs on topics of special interest for the staff, such as for example, audit techniques, methods for detecting tax frauds, legal tax actions, financial markets and products, costs of transfer and auditing of computerized accounting systems.

Likewise, at the Central Services, it is necessary to improve specialization in planning techniques, sampling statistics and auditing of businesses with branches abroad; financial system operations, including financial innovations and the preparation of statistical studies and data to support examinations, for example, indexes, comparisons between companies, sectorial studies, etc.

In general terms, there are endogenous and exogenous factors that condition the policies for assigning human resources to the Examination area.

Identification of endogenous factors:

The endogenous factors conditioning the policies for assigning human resources to the examination area are: i) technical qualification of the staff, ii) the resources allocated to the examination function, iii) the legal and ethical strictness with which functions are performed, iv) the internal auditing systems, v) the fighting spirit and level of internal control exercised by the directorate, vi) the example given by superiors, vii) the social and functional aspect of the examination function, viii) the level of remuneration of the functions, ix) the relationship between merit in performance and progress in the professional career.

We will briefly analyze each of these conditions:

- i) The technical qualification of the staff.

The specific technical qualification of the staff assigned to examination can and should not be related to obtaining academic degrees. The function of the universities is to provide generic and basic training which, in the case of the examination activity

should be complemented with specific training in the action area and which implies: a) exhaustive knowledge of the tax system, particularly in the area of action and related areas. Such knowledge should include knowledge of the legislation, the corresponding accounting rules, the administrative doctrine on the subject matter, the jurisprudence of the courts; b) knowledge of evasion practices and techniques by area of action and by sector of activity, as well as the ways of detecting and combating them; c) practice and experience in the elaboration of reports and conclusions, as well as knowledge and promotion of activities complementing data detection and their use for other taxes and/or other activity sectors.

ii) The resources allocated to the examination function.

An examination function implies the existence of an adequate, effective material and human structure for carrying out the planned tasks.

With respect to material resources, in general, the financial policy determined for TE is based on the following vectors:

- training;
- equipment;
- expirations;
- costs;
- transportation expenses.

The technician's equipment (hardware and software) should be at least as effective as that used by the taxpayer. In addition, the technician should have computerized programs that may allow for the analysis and detection of modifications in the data provided or accounted for; that is, he should count on all modern management instruments preferably adapted to the reality that is to be examined, which requires the development of one's own examination technology adapted to the needs of the specific tax system and the economic-accounting reality one wishes to clarify.

The basic working conditions are also essential, namely: installations, computers, conditioning, access to basic services, etc.

- iii) The legal and ethical strictness with which functions are performed.

The relationship between the taxpayer and the Tax Administration represented by the examiner, is regulated by law. For all purposes, it is a juridical relationship where the powers and duties of the parties are regulated. This means that the activity is carried out with strictness and impartiality, based on the exercise of the powers and framed within the law and within a spirit of discovery and explanation of the material truth. The discovery of the material truth cannot justify illegal attitudes of abuse of power or lack of civic or social education. The examiner should, to the extent possible, establish a courteous and strictly educated relationship with the taxpayer's representative, making it clear in each of his attitudes that he is exercising a superior function that demands compliance with the law. Provided that it is verified that errors detected are due to negligence or ignorance or that they are not relevant in the determination of the tax *quantum*, nor do they imply loss of income or distortion of the system, the examiner must fulfill a pedagogical function inviting to its correction and subsequent modification of the mistaken data, contributing thus to a better relationship between the economic agents and the Treasury and a better application of the tax system and its practices.

In no case may the pedagogical role be confused with the fact of deceitfully ignoring the fraudulent or erroneous practice. The examiner must observe an irreproachable behavior from the technical, ethical and moral standpoint.

- iv) The internal auditing systems.

The internal auditing system should be structured and controlled by small technical units carefully selected and with proven experience in the area or related areas. The criteria to be used in internal auditing must be restricted and, preferably, unknown to those who are to be audited. The determination of monitoring indexes and indicators should be updated according to the needs detected, the evolution of the system and the cases detected. Most of the practices tend to be institutionalized and may be

detected through said means. In principle, there are risk zones whenever an evaluation or disbursement depends on human intervention and there is a margin of discretionality.

The close relationships between examiners and accounting firms and/or management businesses may equally cause concern and require internal follow-up and monitoring.

- v) The fighting spirit and level of internal control exercised by the directorate.

An effective Examination implies the existence of a spirit and awareness of the importance, ethics and experience of the activity and the body of officials carrying it out. The existence of an internal practice and code of conduct allow for easy learning and selection of the candidates that will be come officials in this area.

Such learning and knowledge and control of the officials by the directorate allow a better follow up and the establishment of a technical behavior pattern and a high level staff.

- vi) The example given by superiors.

As stated above, the position, attitude and example of the superiors is an essential factor for managing and conducting the body of examiners. To carry out his tasks, the official will take the example, knowledge and explanation from his superiors. Of course, the normative framework governing the activity and determining the limits and scope of its powers is very important, as it promotes the standard behaviors to be observed.

- vii) The social and functional aspect of the examination function.

Closely linked to the function are social recognition and the functional *status* of the task to be carried out. Examiners should have a high and fair remuneration system that may allow them to face the day to day situation without difficulty. Their decisions can in no way be influenced by the economic needs of the examination agent and the exercise of the examination

function should be linked to social and professional prestige. A factor that could motivate the examination technicians could be a technical subsidy for those functions requiring significant specialization and awards for the examination teams according to results achieved, that is, according to increased revenues actually collected.

- viii) The relationship between merit in performance and progress in the professional career.

The access to a career and the possibility of progressing imply a close relationship between the official's attitude, his practice and progress in his career. To this end, the directorate should set the criteria and rules for determining the merit and its consequences in terms of the career or, that is, access and promotion.

An adequate examination also implies that the existing resources should be allocated to the activities and sectors where they may have a greater multiplying effect and value added. For this purpose, the weak points of the system should be identified and diagnosed, as well as the way of combating its fragility and analyzing the way of correctly and effectively allocating these resources.

This involves a careful diagnosis, a study and adequate response to the examination needs of the system.

Through the NTEAP human/temporary resources are allocated to each of the functional areas defined, according to order of priority: (i) studies, planning and technical support; (ii) examination control; (iii) coordination; (iv) support to justice and legal tax action; (v) general, given that in the plan and activities for 2004, 70% of the human resources were allocated to examination control and 10% to support justice and legal tax action.

Annually, at the examination control level and according to the strategies determined for the TE – internal or external intervention, partial or general intervention -, more or less human resources and the necessary financial resources are allocated to one or other type of intervention.

Example:

If the strategies determined were of great scope and visibility, a larger number of partial external examination actions will be scheduled, then more human resources will be allocated to this type of actions, as well as more financial resources for facing the costs and transportation expenses of the TE technicians.

If the strategies determined would only have to do with the scope, more internal actions will be scheduled and, accordingly, human resources will be allocated to internal examination programs, while reducing financial resources for facing costs and transportation expenses.

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Case study

TOPIC 1.3.

THE NECESSARY NORMATIVE SUPPORT FOR THE EXAMINATION ACTIONS

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CONTENTS: Powers of the Tax Administration Service.- Legal framework.- Examination powers of the authority.- Case studies: 1. Presumptive assessment by means of information and documents contributed by third parties related to the taxpayer.- 2. Assessment of revenues based on bank deposits not linked to the accounting records.- Conclusions.

POWERS OF THE TAX ADMINISTRATION SERVICE

The Tax Administration Service (SAT in Spanish) is the entity in charge of collecting taxes in Mexico, as well as of their examination. SAT was established through a Law published on December 15, 1995, amended through Decree published on June 12, 2003.

The aforementioned law provides that SAT is a decentralized entity dependent on the Secretariat of Finance and Public Credit (Ministry of Finance), and has the capacity of fiscal authority.

The Law which provides for the establishment of SAT grants it such powers as, verification of compliance with the laws and rules that regulate internal taxes and foreign trade operations, as well as handling of the issues entrusted by the aforementioned Law and different laws applicable with respect to taxation.

To achieve its objective and carry out its functions, SAT has Administrative Units that are provided for in its Internal Regulations, which include the General Administration of Federal Fiscal Auditing (AGAFF in Spanish).

AGAFF is in charge, among other things, of verifying compliance with tax and customs obligations by the citizens, those jointly responsible and others obliged in relation to taxation, including duties originating from the entry or departure from the national territory of goods and means of transportation. They can also request taxpayers, those jointly responsible or third parties related to them, to show and, if appropriate, provide accounting records, returns, notices, other documents and reports related to compliance with the tax laws. AGAFF also gathers from public employees and attesters, reports and data related to the payment of taxes, obtained while carrying out their functions.

Legal framework.

In order to carry out its verification functions, the tax authority must abide by the legal framework that regulates them, which consists of the following:

Political Constitution of the United Mexican States; Supreme law which regulates the Mexican system of laws and provides individual guarantees in favor of those governed, which must be respected by the fiscal authority when carrying out its examination functions.

The Constitution stipulates that the administrative authority will visit the taxpayer at his domicile and request him to show the books and documents proving that he has complied with the fiscal provisions, by means of a written order indicating the legal bases and the reasons why the order is issued, and also specifying therein, the place of the aforementioned visit, as well as the name of the taxpayer and the object or purpose of the order.

Fiscal Code of the Federation (F.C.F.); legal instrument regulating the procedures which should be applied by the fiscal authority when carrying out its examination powers.

Tax Laws and their Regulations, which control, among others, Income Tax, Value Added Tax, Special Tax on Production and Services and Asset, and likewise cover the obligations which must be fulfilled by the taxpayers according to the activity they carry out.

In order to strengthen the examination function, the reviewing staff has been given technical instruments or elements for carrying out their function in a systematized, homogenous and coordinated manner, through the Single Auditor's Manual. The latter includes the legal framework they must observe, as well as the guidelines and procedures they must apply in the examination acts.

Said document allows the staff to act with integrity, honesty and abidance by the law, thus avoiding discretionality in when making decisions and the generation of irregular behaviors that may affect the interests of the taxpayers and the Nation.

Examination powers of the authority

Numeral 42 of the Fiscal Code of the Federation grants the authority, among others, the following powers to verify that the individual has duly complied with the tax laws.

- Request, by means of an official letter, for documents and information from taxpayers, those jointly responsible or third parties related thereto. (Office Examination)
- Visit the taxpayers, those jointly responsible or third parties related thereto, at their domiciles.
- Compile from officials and public employees and attestors, the reports and data they may have as a result of their functions.

One of the most complete methods due to its very nature, is that of visits at the domicile. By means of such visit, the authority issues an order which must respond to the guarantee of legality that is provided in article 16 of the Political Constitution.

Topic 1.3

The aforementioned order for visits at the domicile must necessarily include the name of the authority issuing it, the resolution, its object or purpose, the signature of the pertinent official, the name or names of the individuals to whom it is addressed, the place or places where the visit will be made, the name of the individual or individuals who will make the visit.

During the visit at the domicile the fiscal authority issues a series of documents called records with facts or omissions detected when exercising the examination powers and which may conclude with the issuance of a resolution that determines a credit in favor of the federal treasury.

Fiscal authorities are also empowered to determine the taxable revenues, as well as the amount of the acts or activities by means of presumptions, which are defined as the inference made of an unknown fact, based on a known fact; that is, there is presumption when an event is considered as proven, by virtue of having proven or accredited a different one.

The most important legal presumptions are provided in articles 55, 56, 57, 59, 60 and 62 of the Fiscal Code of the Federation.

In order that the fiscal authority may presumptively determine the taxpayers' fiscal situation, the latter must respond to any of the hypotheses included in the aforementioned law, which are generated when:

- The taxpayer does not contribute his accounting books and records.
- Does not show documents proving over 3% of any of the items in the returns.
- Does not provide reports on compliance with the fiscal provisions.
- Omits the recording of transactions, revenues or purchases, alters the cost by over 3% of the amounts declared in the fiscal period.
- Omits filing the return for the fiscal period with respect to any tax, up to the time when the powers begin to be exercised and provided that more than a month has elapsed as of the date of expiration of the term for filing the return, among others.
- Omission of withholding and payment of taxes, by over 3% of withholdings made and paid.

Article 56 of the Fiscal Code of the Federation provides for the procedures which the authority may apply for calculating the taxpayers' gross revenues, the cost of acts, activities or assets, which involve:

- Using the taxpayer's accounting data.
- Taking as basis the data included in the returns of the fiscal period which correspond to any tax, either from the same period or any other one.
- Using as basis the information provided by third parties at the request of the fiscal authorities, when they have business relationships with the taxpayer.
- Other information obtained by the fiscal authorities on exercising their examination powers.

Additionally, the legal provision indicates the elements which the authority may use as basis for the presumptive assessment of revenues and cost of the acts or activities, as such.

- Deposits in the taxpayer's bank account which do not correspond to entries of the accounting records they are obliged to keep, represent income and cost of acts or activities for which taxes must be paid.
- The information included in the accounting records, verifying documents and correspondence maintained by the taxpayer, corresponds to transactions carried out by him, even though they may appear without his name or under another person's name, provided it is proven that at least one of the transactions or activities included in such elements was carried out by the taxpayer.
- The information included in the accounting systems, under the taxpayer's name, or under individuals at his service, or stockholders or owners of the company, are considered to be the taxpayer's transactions.

Likewise, one of the procedures used in the examination acts, is to obtain the bank statements of account of financial entities to find out whether the taxpayers record and declare all of the revenues they receive in a specific fiscal period.

SAT cannot obtain information directly from the banks, but must rather do so by means of the National Banking and Securities Commission (NB&SC), which is the federal government's entity in charge of regulating those who comprise the financial system. In order to obtain financial information on individuals, SAT requests the financial entities, through the NB&SC to provide it copies of the bank statements of account, indicating the account number, name of the holder of the account, name of the bank and branch where the account has been opened, as well as the corresponding period.

Case studies

1. Presumptive assessment by means of information and documents contributed by third parties related to the taxpayer.

On exercising the examination powers for ensuring correct compliance with tax obligations, the authority is faced with a situation whereby some taxpayers do not provide either accounting records or documents proving the transactions carried out during the period or periods subject to examination. It has also detected that sometimes, taxpayers fail to record transactions which exceed 3% of the amounts declared during the fiscal period, as well as deposits made to their bank accounts.

This prevents the authority from knowing whether the taxpayers fully declared the income obtained and, accordingly, if they correctly paid their taxes. Therefore, in order to compile the accounting elements that may allow it to determine the taxpayers' fiscal situation, the fiscal authority uses, among others, the following procedures:

In our example, we will be considering a company whose commercial activity involves the sale of natural seeds, grains, sugar and milk and pays income and value added taxes under the general legal regime for the 2000 fiscal period and is issued an order for a visit at its domicile.

After the designated staff for making the visit has been organized, the taxpayer is requested to show the accounting records and documents proving transactions carried out in the 2000 fiscal period.

The staff must likewise tour the taxpayer's facilities in order to locate departments, warehouses, offices where the documents, correspondence and other information dealing with the revenues, purchase and expense transactions generated by the activity or activities carried out by the taxpayer are concentrated and which are outside the accounting and filing areas.

The documentation sought consists of books and records, documents proving revenues, acquisitions, expenditures, bank statements of account, control registers, and reports dealing with goods or raw materials, etc, entering or leaving, with partial records being drawn up to show, as appropriate, the facts determined during the tour through the company.

It is possible that there are no results from the tour of the facilities of the company examined, given that the taxpayer does not maintain the accounting records in his fiscal domicile, even though article 30 of the Fiscal Code of the Federation provides, as an obligation, that he must keep his accounting records in the fiscal domicile and make them available to the fiscal authorities, unless he may have requested the pertinent fiscal authorities for authorization to keep them elsewhere. However, this is not the situation in our case, for which only copies are found of 7 paid invoices made out in the name of 3 different businesses.

Under these conditions, the visiting officials, on the basis of paragraph a) of number 53 of the Fiscal Code of the Federation, request the taxpayer for the accounting books and records, which must be submitted immediately, in addition to the diagrams and design of the electronic recording system.

If the taxpayer fails to respond to the oral request made by the visiting officials, a written request is issued asking for the documents and information dealing with the transactions carried out during the period being examined, for which a six working day term is allowed, as of the date following that on which the respective notice is given, in accordance with the provisions of paragraph b) of the aforementioned article 53 of the F.C.F.

If the taxpayer fails to respond to the aforementioned request, the fiscal authority will not have the accounting records for determining the taxpayer's fiscal situation, even though the latter is obliged in accordance with number 45 of the F.C.F. to make available to the fiscal authority, the accounting and other records that prove compliance with the legal provisions. Likewise, if the accounting records are maintained in electronic, microfilm, or optical disc systems, or in any other authorized means, it must make available to the authority the computer equipment and its operators, so that the latter may have access to the information contained therein.

In view of this situation, the fiscal authority has the power to apply compulsory measures which consist of the application of formal fines, request support from the public force, as well request the pertinent authority to proceed due to disobedience to a legitimate mandate from the competent authority, all of which are provided in article 40 of the aforementioned Code.

In the case of the taxpayers' refusal to provide the accounting records, in general, only a fine is imposed for not providing the requested information and documentation.

In some cases, the taxpayers' properties or business are attached to guarantee the possible fiscal credit determined, if they prevent the authority from exercising the examination powers by refusing to show the requested documents and information, based on section III of numeral 145 of the F.C.F. However, in this case, banking accounts in the name of the taxpayer were not detected, nor were we aware of personal or real estate properties belonging to the latter, for which reason the attachment procedure could not be applied.

1.1 Comparison of third-party information.

One of the strategies applied by the fiscal authority for obtaining the necessary elements to determine the taxes to be paid by the taxpayer is the comparison of third-party information.

The fiscal authority has the power to request data, reports and documents to third parties related to the taxpayer who, in the period or periods being examined, may have carried out transactions with them, and with these elements it may be able to determine the fiscal situation of the taxpayer being examined.

This request for data from third parties which in practice has been called "comparisons", is one of the most effective audit techniques to determine omissions incurred by the taxpayer, thus constituting a speedy, appropriate and necessary tool whereby the fiscal authority may learn about, prove or discard omissions incurred by the taxpayers.

This audit technique is used when there are essential reasons to apply them or when planning or the results of procedures carried out indicate that it is necessary to apply them. In this case, the following situations are considered:

- To confirm or discard presumptions or incongruities detected during the examination.
- When there are absolutely no accounting records in an examination.
- When the accounting records are blank and the taxpayer only shows part of the documents proving his transactions.
- To confirm or discard the deduction on acquisitions or disbursements based on fictitious invoices.
- To prove the veracity of purchases supported by documents that are unaccounted for.
- To support or confirm omitted income.
- To confirm which acquisitions, disbursement and/or services that are not deemed essential for purposes of the taxpayer's activity and since it is a company, benefit the partners or stockholders thereof.

In our case study, comparisons were made, since the taxpayer did not provide accounting records or documents to support the transactions carried out in the fiscal period subject to examination.

To issue the requests for comparison to third parties related to the taxpayer, the following elements and circumstances were considered:

- The information provided with respect to its customers, as well as the 50 main suppliers.
- Customers and suppliers which do not appear in the sales or purchase journal or in any other record of the taxpayer visited, whose names and addresses appeared in photocopies of paid invoices found at the beginning of the visit.
- Customers and/or suppliers with large amounts of transactions and taking into account that:
 - a) They are companies to whom the audited taxpayer supplies and/or receives goods.
 - b) They are customers with respect to which several paid invoices were found, although without the originals.
 - c) When at the beginning of the audit, the accounting elements (records, policies, documents) are not found or provided, even though they have been requested, or they are not updated and, in addition, have not filed returns.

For convenience purposes, “comparisons” always take place through visits at the domicile and therefore, the fiscal authority applies the rules provided in the Fiscal Code of the Federation with respect to such visits, since a personal comparison, is in itself a visit at the domicile.

Accordingly, the requisites of the order issued to the third party related to the taxpayer are the same with respect to reasons and motivation as those issued for visits to the taxpayers’ domicile.

Based on the foregoing, orders for provision of third party data were issued to 6 customers of the taxpayer being audited, which were detected through photocopies of paid invoices and information found in the returns of customers and suppliers. The “comparisons” were carried out through visit at the domicile, for which reasons the results were entered in records showing the data on transactions carried out by the third parties with the taxpayer, as well as documents proving the irregularities that originated them as well as the form of payment.

Likewise, the staff performing the comparisons, must certify at the third party domiciles, photocopies of the documents shown to them, such as invoices, remittances, credit notes, check vouchers, letters of agreement, contracts, settlement of commissions, store requisitions (entering or leaving), recovery, deposit slips, customer or supplier ledgers, etc., according to the first paragraph of article 45, of the F.C.F.

As for the examination to be carried out in the comparisons, this should be exclusively limited to reviewing the transactions carried out between the taxpayer being audited and the requested third parties during the fiscal period in question. That is, it does not comprise the procedures considered in an audit, but rather only covers:

- The transaction(s) between the taxpayer being audited and the third party,
- Initial and final records are not always prepared; at times, only one is prepared, due to the speediness of such visits.
- It is not obligatory to tour the premises, warehouses, facilities, etc.

In the records drawn up, transactions proven to have been carried out between the third party and the audited taxpayer are entered one by one, even though they are not registered. Also the type of record from

which the information is obtained should also be indicated; that is, type of economic registry, number and date of policy, amount and VAT transferred and total, ledger (customer or supplier card), documents such as invoice, receipt, remittance, contract, assessment, check, credit note or charge, stores entry or departure requisition, customs declaration, correspondence between third party and taxpayer being examined, etc., so that the taxpayer may truly be aware of the elements used for determining the revenues in the period being examined.

The audited taxpayer was given copies of the data requests issued to third parties so that he would be aware of the results of the comparisons and in due time will be prepared to provide the documents and information aimed at counteracting the facts or omissions stated in the aforementioned records.

1.2 *Presumptive assessment.*

If the authority fails to obtain the verifying documents during its visit to the taxpayer premises and the latter, during the course of the examination does not provide accounting records, it will be subject to presumptive assessment as provided in section II of numeral 55 of the Fiscal Code of the Federation, in force during the period of the examination, which provides that:

“The fiscal authorities may presumptively determine the taxpayers’ fiscal earnings, the fiscal result under the simplified system or the remainder which the taxpayers paying taxes according to Title III of the Income Tax Law may distribute, their revenues, receipts and the amount of the events, activities or assets on which they must pay taxes when:

...

“II. They fail to submit accounting books and records, documents proving over 3% of some of the items in the returns, or if they do not provide the reports relative to compliance with the fiscal provisions.”

Accordingly, the fiscal authority presumptively determines the taxpayer’s fiscal situation, taking into account for that purpose the result of the comparisons made with third parties related to the taxpayer, from which it was known that the latter obtained \$25’600,000.00 during the fiscal period examined.

The foregoing is based on the provisions of numeral 56 of the F.C.F., which states that in order to presumptively determine the fiscal situation of the taxpayers, gross income as well as the value of events, activities or assets subject to the payment of taxes, any of the procedures indicated therein may be applied, such as that which considers the information provided by third parties at the request of the fiscal authority, when they maintain business relationships with the taxpayers.

Once the income has been determined, as well as the value of events or activities and, considering that the taxpayer did not contribute the documents related to his expenditures, in keeping with the provisions of numeral 62 of the Income Tax Law in force in the year 2000, his fiscal earnings are presumptively determined.

Said numeral provides that the fiscal earnings will be presumptively determined by applying to the gross income presumptively determined, the 20% coefficient or that which corresponds to any of the activities included therein.

Given that in the period under examination the taxpayers carried out commercial activities which involved the sale of natural seeds, grains, sugar and milk, the 12% coefficient provided in section II of the aforementioned article was applied.

On that basis, the 12% coefficient is applied to the amount of \$25'600,000.00, which results in fiscal earnings of \$3'072,000.00. In turn, the 35% rate is applied to that latter amount, as provided in article 10 of the Income Tax Law in force, in the period subject to examination.

Taking into account that the aforementioned taxpayer does not seem to have fiscal losses from previous periods, the fiscal earnings are not reduced and the aforementioned amount continues to be the same.

Accordingly, the omitted income determined amounts to \$1'075,200.00, which amount must be updated. Likewise, surcharges are calculated and the corresponding fines are applied.

The foregoing is based on the provision of the Fiscal Code of the Federation which states that when taxpayers fail to pay taxes within the legal terms, these will be updated in accordance with the time elapsed and the change of prices taking place in the country. Such updating covers the month in which payment should have been made, up to the time, it is actually made.

Likewise, the aforementioned Code provides that surcharges will be paid to the federal treasury by way of indemnity for untimely payment. Such surcharges are estimated on the basis of the updated taxes.

In addition, a fine is applied to the taxpayer for having failed to pay the taxes within the terms provided by the Law and likewise because the violation was detected by the authority when carrying out its examination functions.

In the case of value added tax, one takes into consideration the provisions of numeral 39 of the Value Added Tax Law in force in the year 2000, which states that the amount resulting from the presumptive assessment of acts or activities for which tax must be paid, will be subject to the corresponding tax rate, and the resulting amount in this case, will be reduced by the appropriate credits determined.

Given that in the year 2000, period under examination, the taxpayer obtained 25'600,000.00 which is subject to a general 15% rate, the total amount of value added tax determined was \$3'840,000.00, which amount was not subject to any credit reduction since, during the visit to the taxpayer's domicile, the latter did not provide any document proving amounts which could be credited, that is, documents showing that value added tax had been transferred to him.

On the other hand, it is indicated that, since the fiscal authority draws up records of the facts or omissions determined during the course of the visit, which constitute public documents issued by public officials in compliance with their functions, the latter enjoy full value as evidence, unless there is proof to the contrary.

In accordance with the provisions of article 129 of the Federal Code of Civil Procedures, public documents are those whose preparation is entrusted by Law, within the limits of his responsibility to a public official who has been conferred the authority to attest documents and those issued by public officials in compliance with their functions.

2. Assessment of revenues based on bank deposits not linked to the accounting records.

In carrying out its examination functions, the fiscal authority has found out that a frequent method mainly used to determine the taxpayers' fiscal situation is that included in section III of article 59 of the Fiscal

Code of the Federation, since during the visits to the taxpayer domicile, bank deposits not linked to the taxpayers' accounting records have been found.

In our case, to prove how information can be obtained through bank deposits, we will use an individual who pays taxes under the general business activities regime, whose commercial activity involves the sale of wines and liquors, sausages, pastries, and chocolate, in order to verify compliance with income and value added tax obligations for the 1996 and 1997 fiscal periods.

During the course of the visit, it is found that the taxpayer did not show in his accounting record transactions that exceed 3% of the amount declared in the fiscal period, for which reason this omission responded to the cause for presumptive assessment included in paragraph a) of section III of numeral 55 of the Fiscal Code of the Federation.

2.1 Request for information.

Since a bank account was detected, in accordance with the provisions of section VII of numeral 42 of the Fiscal Code of the Federation, which empowers the fiscal authority to request from public officials and employees, reports and data which they may hold as a result of their function, the bank where the account was opened was requested, through the National Banking and Securities Commission to provide the statements of accounts issued in the name of the taxpayer for the 1996 and 1997 fiscal periods. The entity provided what was requested and it was found that the aforementioned banking account was not linked to the accounting records and as a result, bank deposits in the amounts of \$2'862,244.76 and \$2'036,369.00, respectively, were not registered and so, this situation was considered within the assumptions provided in article 59, Section III of the aforementioned code.

In view of the foregoing, each of the unaccounted for deposits is considered income and the value of events or activities of the individual, unless the latter submits proof to the contrary, for which reason, by means of an official letter, he is asked to clarify the source of the bank deposits and is allowed a term of 6 working days, according to the provisions of paragraph b) of numeral 53 of the Fiscal Code of the Federation.

In accordance with the guidelines provided in the Single Auditor's Manual, the reviewing staff has been instructed that the following documents will not be accepted to justify unaccounted for bank deposits:

- Those issued or formulated by the taxpayer himself.
- Letters or evidences, even notarial ones, wherein third parties related to the taxpayer only state that they have made loans to the latter or payments on debts or contributions for future capital increases.
- Simple contracts or promissory notes to try to prove that the deposits in the taxpayer checking accounts that have not been accounted for, are actually loans received from third parties.

In addition to the aforementioned documents, the taxpayer must show bank slips on transfers from third party accounts to that of the taxpayer being examined, or banking statements of account in the name of third parties proving the amount which they allegedly have given to the taxpayer.

2.2 Presumptive assessment.

Since the taxpayer did not clarify the source of the bank deposits and did not show any document, a formal record is drawn up indicating such situation and accordingly, the fiscal authority presumptively determines his fiscal situation, by virtue of the fact that section III of article 59 of the Fiscal Code of the Federation provides as follows:

“For the verification of income, or the value of acts, activities or assets on which taxes must be paid, the fiscal authorities shall presumptively determine, unless there is proof to the contrary:

...

“III.- That the deposits in the taxpayer's banking account which do not correspond to the accounting records he should maintain, represent income and the value of acts or activities for which taxes should be paid.”

Therefore, in order to apply the aforementioned cause of presumption it is only required that the taxpayer **will have failed to register bank account deposits in his accounting records.**

Bearing in mind that during the examination the taxpayer argued that he is entitled to be recognized a cost with respect to the income determined on the basis of his bank deposits not registered in his accounting records and by virtue of the aforementioned legal presumption provided in section III of article 59 of such Code, the result can be modified only on the basis of what the individual authentically proves, by contributing the supporting documents that fulfill the fiscal requirements and the fiscal authority only recognizes the cost which the taxpayer proves with the respective documentation.

In this case, the taxpayer did not provide any document, thus the fiscal authority lacks the elements to determine his fiscal earnings and therefore, the latter is determined presumptively in accordance with the provisions of article 62 of the Income Tax Law in force in the periods being examined.

The aforementioned article states that the Tax Administration Service will presumptively determine the taxpayers' fiscal earnings by applying to the gross income declared by the taxpayer or presumptively determined by the tax authority, the general 20% coefficient or the one that may correspond, if the taxpayer's activity is found within any of those mentioned in said law.

Since the taxpayer's commercial activity involves the sale of national wines and liquors, sausages, pastries, and chocolates, he is subject to a 15% coefficient, according to section III of the aforementioned article.

Accordingly, the bank deposits amounting to \$2'862,244.76 and \$2'036,369.00 were applied the 15% coefficient, with a fiscal result in the amounts of \$429,336.71 and \$305,455.35, for the 1996 and 1997 fiscal periods, respectively, and which amounts served as basis for determining the income tax to be paid by the taxpayer.

As far as value added tax is concerned, the deposits are considered as the value of acts or activities, to which the general VAT rate of 15% is applied in accordance with the provisions of numeral 39 of the Value Added Tax Act in force during the periods being examined.

The taxpayer may request the deduction of value added tax corresponding to income originating from bank deposits not included in his accounting records; nevertheless, he must provide the documents proving that he carried out acts or activities for which value added tax

was transferred, given that numeral 39 states that: “The amount resulting from the presumptive assessment of the value of acts or activities for which tax must be paid in accordance with the terms of this Law, will be subject to the corresponding rate of tax and the results will be reduced by the proven amounts which may be credited.”

After the taxes have been determined, they will be updated, surcharges will be estimated and the corresponding sanctions will be applied.

On the other hand, it is mentioned that whatever is stated in the records drawn up during the visit to the domicile is fully valid, since these are public documents prepared by an official exercising his functions.

Likewise, based on the information which the authority obtained when carrying out its examination functions, such as the banking statements of account provided by the bank, one should endeavor to determine the taxpayer’s fiscal credit as provided by article 63 of the Fiscal Code of the Federation.

CONCLUSIONS

The fiscal authority is obliged to abide by the legal framework that regulates its powers to verify that taxpayers duly comply with their fiscal obligations, in order to ensure that its examination acts will not affect their legal guarantees and juridical security.

The most complete method of examination to determine the taxpayers’ fiscal situation are the visits to the domicile, since they allow the fiscal authority to become aware of the magnitude of the company, concentrate the accounting documents found in the warehouses, stores, etc.

In Mexico, the fiscal authority is empowered to presumptively determine the taxpayers’ fiscal situation, through various procedures such as:

- Data, reports and documents contributed by third parties related to the taxpayer, on transactions that may have been carried out with the latter during the period being examined.
- Information and documents provided by public officials and employees.

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The fiscal authority only applies these procedures in those cases in which the taxpayers do not provide the elements of their accounting systems or fail to register in their accounting records the transactions carried out, as well as the deposits made to their bank accounts, as a result of which the fiscal authority will not know whether the taxpayers duly complied with their fiscal obligations.

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Case study

TOPIC 1.3.

THE NECESSARY NORMATIVE SUPPORT FOR EXAMINATION ACTIONS

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CONTENTS: I. Introduction.- II. Legal Framework.- 1. Political Constitution.- a) Principles ruling the tax regime.- b) Fundamental Rights of the Individual.- 2. The Tax Code.- a) The Examination Power.- b) Discretion in Examination Powers.- c) Powers in the Examination Function.- d) The application of the assessment of the tax obligation through a presumed base.-3. Resolutions of the Superintendence.- a) Information provided by withholding agents and taxable income.-b) Information sent by the bank regarding operations subject to the Tax Obligations Payment System with the Central Government (SPOT).-c) Information on operations performed with third parties.- d) Information provided by notaries.- 4. New Legal Provisions .-III. Conclusions.

I. INTRODUCTION

The purpose of this presentation is to explain the norms that support examination actions of the Superintendence National de Administration Tax (SUNAT)¹, as well as comment on the relevant experiences that have been generated in Peru regarding the development and compliance with this function.

¹ The entity that administrates Internal Taxes and Customs in the Republic of Peru.

Topic 1.3

Therefore, we begin this work by assuming as a premise that a modern tax administration has as one of its central challenges the precise determination of the amount and amount of the tax obligations of the taxpayer's, task that in its first approach seems simple and routine. However, in a globalized world where economic actions (thanks to fast and sudden advance of technologies in production, commercialization, management and information systems²) have fully surpassed national borders and the classic concepts of territoriality and nationality, tax administrations see the imperious need to constantly adapt their examination and control strategies, so that they may satisfactorily respond to this new reality.

SUNAT is the organ that Administrates Internal Taxes and Customs of the Republic of Peru, and it is a decentralized institution from the Economy and Finances Sector, with its own assets and economic, administrative, functional, technical and financial autonomy.

SUNAT's mission consists of achieving an increase in tax and customs' collections, by fighting evasion and contraband honestly and fairly, through the effective generation of risk and quality services to taxpayers and foreign trade users, as well as promoting taxpayer compliance with tax obligations to contribute with the social and economic welfare of Peruvians, framing their actions within the laws in force, so that their actions are legitimate.

In this manner SUNAT exercises the control of internal and external taxes which constitute income for the Central Government, such as Income Tax, General Sales Tax³, Selective Consumption Tax, Tax on Financial Transactions, Extraordinary Solidarity Tax, the Solidarity Tax in favor of Unprotected Children, the Extraordinary Tax for the National Promotion and Development of Tourism, and Customs' Rights, tax which collection represented 99.8% of the State's total revenue for the year 2003, this powers SUNAT's database, by having the information on practically all tax and customs revenues of Peru⁴.

² Accounting information is included, which, unlike what happened some years ago, currently work is performed with the support of computerized systems.

³ Name of the Value Added Tax in Peru.

⁴ SUNAT also collects Social Security and the National Pension System the same does not constitute revenue for the Central Government.

These control powers are exercised on a universe of 2,661,000 registered taxpayers⁵, of which 420,100 are located in the General Income Tax Regime, 144,000 in the Special Regime of the mentioned tax, 360,800 in the Unique Simplified Regime⁶ and 1,761,000 are classified as Independent Workers.

II. LEGAL FRAMEWORK

SUNAT's actions must be developed within the powers and limits that are imposed by the legal provisions, so that their action, by balancing the examination powers that the Tax Administration has with the taxpayers' rights, is able to facilitate the examination procedures that are carried out.

In this regard, the Peruvian juridical system presents the following standards:

1. Political Constitution

The Political Constitution of Peru of 1993 contains different articles that provide a general normative framework to the State's Tax Powers, by ruling the following topics:

a. Principles ruling the tax regime

The Constitution states that upon the enactment of norms of tax nature the following principles must be respected:

a.1. Legal Reserve. By virtue of this principle, the essential aspects of taxes must be approved by a Law or a Legislative Decree (case in which the Congress of the Republic delegates in the Executive Power the authority to legislate tax matters).

The Tax Code, by developing this principle establishes that only the Law can set forth the action that generates the tax obligation, its calculation base and the aliquot, the tax creditor, the tax debtor, it may grant exemptions

⁵ Data at November 30, 2003, published in the Tax Note, which appears at the Virtual SUNAT, which address is: <http://www.sunat.gob.pe>.

⁶ This regime substitutes Income Tax and the General Sales Tax, for small and medium size taxpayers, under determinate conditions and restrictions. As 01.01.2004 the new Unique Simplified Regime, we will have the final data of the taxpayer comprised in said regime as from February 2004.

and other tax benefits, rule jurisdictional as well as administrative procedures regarding the guarantee or the tax debtor's rights, define violations and establish the sanctions, privileges, preferences and guarantees for the tax debt and rule special extinction forms for tax debts.

- a.2. *Equality.* By virtue of this principle, taxes are applied to all persons having equal standing before the Law and before a specific tax, providing for the possibility that a difference may be made in tax matters depending on the person (differences may only be made when it is required by the nature of the circumstance).
- a.3. *No Confiscations.* This principle pertains to the fact that there should be a proportion between the value of the asset on which tax is paid and the value of the tax itself, that the tax should not absorb a substantial part of the asset.
- a.4. *Respect of the Fundamental Rights of the Individual.* By virtue of this mandate upon exercising Tax Powers the fundamental rights of individuals must be observed, mainly those directly linked to taxations and that have been previously commented.

b. Fundamental Rights of the Individual.

b.1 Bank Secrecy

In Peru bank secrecy is set forth in the Constitution as a limit to the right to information of citizens, protecting in this manner the right to the individual's privacy. This provision establishes that bank secrecy may only be lifted at the request of the Judge, of the Attorney General of the Nation or an inquiring commission appointed by Congress, according to the provisions of the law and provided that it pertains to the case investigated.

In this regard, the reach of the Bank Secrecy is developing at the level of the Law that rules the Peruvian Financial System⁷, a norm that imposes on the companies of the Financial System the obligation to not disclose any information pertaining to the passive operations⁸ of their customers, unless there is a written authorization from these, or is requested by officials empowered by the Political Constitution.

As a consequence thereof, SUNAT officials must resort to the Judicial Power whenever they deem convenient to request the lifting of the bank secrecy regarding a taxpayer subject to examination.

In the event of a constitutional reform, SUNAT has proposed the modification of the Political Constitution of the State in the sense of empowering the Tax and Customs Administration to directly and immediately access the information held by the entities of the Financial System regarding the bank operations performed by taxpayers. SUNAT's position is based on the circumstance that said information is indispensable to execute the correct control of compliance with tax obligations and in this manner, determine the taxpayer's contribution capacity.

The proposed constitutional reform of SUNAT results logic, when considering that it has the obligations (as well as its officials) to keep information and declarations that it has obtained through confidential means and may only use the same to carry out the principles that are inherent thereto.

SUNAT's free access to bank secrecy is supported, since it cannot serve as an instrument to protect from committing actions directed towards tax avoidance or evasion or in the worst of cases, to commit illegal penal actions, which is the case of tax and customs offenses.

⁷ Law N° 26702- The General Law of the Financial Systems, Insurance and Organic Law of the National Superintendence of Banks and Insurance.

⁸ It should be indicated that the Law N° 26702, does not establish what should be understood as "passive operation", for which according to the doctrine, is considered like such to the current deposits, savings, on fixed term, judicial and official deposits, transfers.

In Peru, experience tells us that there is an important universe of financial operations which have a tax incidence, but do not generate any income for the State, since they are protected by bank secrecy, which prevents them from being revised by SUNAT or that causes examination to be cumbersome and complicated.

Of the information currently being protected by bank secrecy, it is of vital importance for the adequate control of compliance with tax obligations by taxpayers, those that refer to the following operations:

- Capital contributions coming from abroad performed by investors or related companies that do not have their domicile in Peru.
- Capital or dividend remittances to related companies or persons residing abroad.
- Transfers to subjects not domiciled for services rendered abroad to be employed in Peru.
- Payment for commercial operations of regarding purchases or sales performed in the country, which declared amount differs from that effectively delivered.
- Money deposits that are delivered to employees from tax debtors as generosity, when in reality they correspond to remunerations that do not appear on payrolls.
- Professional income that is declared before SUNAT and that are deposited in banks or are transferred to their accounts abroad.

In this order of ideas, the Tax Code in force in Peru established that to have access to information protected by bank secrecy, SUNAT must request a Judge to lift the bank secrecy in regards to a determinate taxpayer, which shall necessarily be found subject to examination.

Furthermore, said norm establishes that SUNAT's request to lift the bank secrecy must be reasoned and specify and individualized the information required.

Even when the judicial procedure seems simple and the terms are summary processes (the Judge must make a pronouncement within a 72 hour term), in transacting the request to lift bank secrecy the following difficulties are observed:

- Judges usually do not observe the terms of the summary process provided for to pass pronouncement and generally decree the resolution that orders or denies the delivery of information protected by bank secrecy outside the term of the law.
- Often and in spite of not being allowed prior to passing pronouncement transfer the request for the lifting of the bank secrecy to the taxpayer subject to examination.
- The order that lifts the bank secrecy is very strict and formal, therefore in the case that the information provided by SUNAT to the Judge does not coincide exactly to the bank transaction to which access is requested, the entities of the Financial System refuse to provide the information (there is a policy to protect customers).
- Banking and financial entities prior to providing the information requested by the Judge and as a maneuver to delay, request SUNAT to credit that the tax debtor is subject to examination.
- To obtain information pertaining to each new bank transaction that has been detected as from the lifting of the bank secrecy as from the first transaction, requires beginning new proceedings before the Judge.

- If the a taxpayer has performed operations in which regard information is required and that is in different institutions of the Financial System, the petitioner has to file as many requests as there are institutions involved.
- Regarding the delay of the banks in granting the information, it is necessary to request the Judge to withdraw his order to the party obliged to provide the information.
- The information sent by the bank is not delivered directly to SUNAT, it is sent to the Count that sends the order, and then it is finally sent to SUNAT.

In brief, the judicial process to have access to the lifting of the bank secrecy in Peru is slow and cumbersome, therefore, often, it constitutes an obstacle in making examination processes agile and successful.

b.2 Tax Reserve

The Constitution of Peru guarantees the tax reserve, understood as an obligation of the Tax Administration to use in a reserved manner and only for its own purposes, the amount and the source of income, expenses, taxable base or any other data pertaining thereto, when they are contained in returns and information that it obtains by any other means from taxpayers, responsible parties or third parties.

In this manner, our Constitution expressly establishes the subjects that may request the lifting of the tax reserve:

- In judicial processes, the judge when ordering the delivery of information for the case that it has to investigate or judge.
- The Attorney General of the Nation, during investigations performed by the Office of the Attorney General.

- The Commissions appointed by the Congress of the Republic, during investigations performed by them.

It is a condition that in order to lift the tax reserve, the information being requested must be directly related to the case that is being investigated.

The Tax Code develops the contents of the institution of the tax reserve, establishing that it contains all the information that is obtained through any means regarding the amount, source of income, expenses, taxable base as well as any data that refers to these concepts, except information – under determinate conditions – referred to statistical data.

Currently, having modified the Income Tax Law regarding the regulation that refers to norms on transfer pricing, it is imperative that modifications be introduced into the Tax Code regarding the tax reserve to the effect that:

- It does not form part of the tax reserve, the information from independent third parties used as a comparison by the Tax Administration in administrative acts that are the result of the application of the transfer pricing norms⁹.
- That the information provided by third parties used as comparison can only be disclosed before the taxpayer or its representatives within the framework of the examination process, before the administrative authorities and the Judicial Power, when the acts of the Administration are the purpose of an objection.

In the case of assessments for transfer pricing, this would include information corresponding to third parties that have been used as comparison, therefore it is necessary to make more precise in the reserve norm that the Fiscal Tribunal cannot send the information to the taxpayer or its representatives.

⁹ Mexico, Argentina and Venezuela have similar provisions.

- That the tax debtor keep absolute reserve of the information to which it has access, regarding independent third parties.
- The Tax Administration cannot reveal the identity of the third party to which the information that is presented before the taxpayer corresponds.

b.3 Non-violation of Domicile

The Peruvian Constitution guarantees the non-violation of domicile, providing that entry into the domicile shall only be permitted if a judicial order has been obtained in advance.

In agreement with the constitutional provision, the Tax Code establishes that to perform inspections to closed establishments or in the case of private residences, it will be necessary to obtain the respective judicial authorization.

In the same manner, the Tax Code establishes that for the case of enforced collection, the official in charge of the collection is empowered to perform the opening of the closed establishment if it has obtained a judicial authorization.

The procedure to obtain the entry and opening authorization is ruled by the Tax Code, which establishes that SUNAT officials must file a request before the Judge that Specializes in Civil Cases, who must pass judgment within a maximum of 24 hours.

Similarly, the Tax Code establishes the Judge's obligation of not communicating the request ordered by SUNAT to the tax debtor, under responsibility.

b.4 Confiscation of Documents

The Peruvian Constitution protects the secrecy and inviolability of communications and private documents of an individual. However, grants the possibility that books, vouchers, accounting and administrative documents may be subject to inspection or examination by the competent authority, pursuant to the law, being necessary that there be a judicial order to proceed with the seizure or confiscation thereof.

In agreement with the constitutional provision, the Tax Code in the part that refers to the examination powers granted to SUNAT establishes that when the existence of tax evasion is presumed, the confiscation of books, files, documents, registries in general and assets of any nature, that have a relation with the taxable facts, for a term no greater than 15 business days to be extended for a similar term.

Similarly, the mentioned Code sets forth that to carry out said confiscation, prior judicial authorization must be obtained, for which effect the Tax Administration must present a request before the Specialized Penal Judge, who must pass judgment in a 24 hour term (the Judge is prevented from advising the taxpayer on the existence of the request).

Finally, within the guidelines established by the Political Constitution of the State and considering the staggering technological advances in data processing developed during past years, the Tax Code empowers the Tax Administration to require taxpayers to provide information or documents related to the computer equipment that they have (including information pertaining to source programs), to be able to perform systems audits, as it is usual in external audit processes performed today.

b.5 Professional Secrecy

The Constitution indicates that individuals have the right and duty to keep professional secrecy¹⁰. In that sense, though the Tax Administration can request information, the subject required can be opposed to the demand of information that violates this right. It is important to mention that is also applicable what it is indicated by the Law ruling administrative procedures¹¹ that considers legitimate the refusal to attend the demand when the latter supposes a violation of professional secrecy, a disclosure forbidden by law or which affects constitutional rights, and this shall not mean the protection of the misrepresentation of the facts or the reality.

2. THE TAX CODE

a. The Examination Power

The Peruvian Tax Code, establishes the general principles, procedures and norms of tax nature, which guide the development of the examinations performed by SUNAT. This legal body rules the rights and obligations that must be present for the adequate relation tax administration - taxpayer.

The Code in mention expressively states the powers invested in the Tax Administration, among which there is the examination power which includes the inspection, investigation, and the control of the tax obligations and it is exercised on subjects that enjoy immunities, exemptions, or tax benefits.

It is important to mention that when Peruvian legislation uses the term “examination”, it does so in its most ample and generic meaning, that is, as the power of the Tax

¹⁰ **BERNALES Enrique, LA CONSTITUCIÓN DE 1993.** Lima, Editora RAO. 1999, page 154. *...“Professional secret is the group of ideas and knowledge of facts that the professional receives from who request their services...protecting who consults a professional, in order to tell him/her all the truth or all his/her opinions without feeling threatened because the professional is then obliged say all he/she knows”.*

¹¹ Law N° 27444 – Law on the General Administrative Procedure.

Administration to review returns, books and other documents owned by the taxpayer, without making reference to the different actions that take place within an examination process and this shall not imply the performance of the typical examination procedure (tax audit) therefore the powers foreseen in the Tax Code are applicable to all SUNAT actions.

Notwithstanding, the Basic Examination Manual¹² is distinguishes among the different types of examination actions that are executed, the following:

- a.1. Audit:* It may be integral or partial. Involves the review of books and registries, tax returns and their verification with the purpose of establishing the correct determination of the taxable base and the amount of tax. It generally comprises more than a taxable year.
- a.2. Verification:* These are cases selected based on what was declared by the taxpayer and was registered in its accounting, includes inspections performed with the purpose of evaluating internal control of taxpayers. It comprises among others, massive examination programs in regards to the General Sales Tax (with a reach no higher than 12 months); verification of the accounting documents with the purpose of granting tax refunds, verification of corrected returns, which determine less tax to be paid.
- a.3. Operations:* These are examination actions that are quick, unexpected and massive in nature, directed towards the detection of informality situations, to the “generation of risk”, for the creation of “tax awareness”. There is active participation on behalf of the officials of the Administration.

¹² Internal Document of the Tax Administration, which comprises the administrative and legal procedures required for the adequate compliance of the functions of the officials of the Tax Administration which work in the areas of Examination and furthermore, provides a general view of the examination procedure, from the selection of cases until the termination of the examination task and includes the duties and powers of the officials. Said document was prepared as a result of the examination reforms introduced in the Peruvian Tax Administration with the support of IADB-CIAT and the Spanish Tax Agency.

a.4. Inductive: Massive actions, which seek to generate voluntary compliance of tax obligations at a lesser cost, through the delivery of communication to taxpayers of little fiscal interest. The source of information to detect inconsistencies in taxpayer returns is done through the use of computerized cross-referencing. These actions include preventive communications, inductive letters, and summons. In Peru it is done through Examination Control Centers.

b. Discretion in Examination Powers

In the beginning it must be mentioned that the Tax Code indicates that examination powers are exercised “discretionally” by the Tax Administration, it is convenient to express that that Code establishes that in these cases the Administration must opt for the administrative decision which it considers more convenient for the public’s interest, within the regulatory frame conferred by the Law.

In this regard the Tax administration is subject to the juridical framework, therefore upon exercising its examination power it has to act by respecting constitutional rights and principles, the legal provisions and in the sense that no standard shall set forth or imply a decision, and must be adopted by considering the interest of society.

In attention to the above, the Tax Code empowers in general the Tax Administration to adopt determinate administrative actions within an examination procedure, since to rule it in detail would imply to foresee the totality of the same with the risk of not comprising any assumption within the power indicated.

However, the manner to exercise the examination power must be found submitted to the juridical framework and in any event abide to criteria of technical nature (timeliness and randomness), which does not imply that “discretion” refers to the will of the official of the Tax Administration, but to the criterion that are to be exercised correspond to the Tax Administration as an institution and are set forth in the Resolutions of the Superintendent or in internal documents (Circulars, Handbooks) for their general application to taxpayers.

c. Powers in the Examination Function

The Tax Code establishes a series of duties to taxpayers, responsible parties, and third parties with the purpose of executing their examination function. Hereinafter a comment on the main functions:

- c.1.* Require from tax debtors to display and present their books and accounting registries and supporting documents.

It is important to mention that pursuant to resolutions of the Tax Tribunal “display” must be understood as the action to manifest or show in public and by “presentation” the actions to deliver, transmit or send.

For the effect of such distinction, the officials of the Administration must be very careful upon issuing information requirements, because in the event of not stating the place where the display shall be performed, the same must be performed at the taxpayer’s fiscal domicile, and the presentation, when the place where it must be complied is not specified, it will be done at the offices of the Tax Administration.

The term that the Tax Administration must request for the display shall be no less than two (2) business days and for the presentation no less than three (3) business days, in both cases as from the day following the notice.

Tax debtors, are obliged to conserve books, registries and other supporting documents for the duration of the prescription term, that is, a minimum of four years.

c.2. To require information on the electronic data processing system or microfilm system.

Information may be requested from taxpayers, responsible parties as well as third parties, and the Administration shall be empowered to require:

- The copy of the totality or part of the microforms supports levied or the magnetic supports, as well as the instruments to carry out said operation, with the obligation of returning the same at the end of their actions.
- Information or documents pertaining to computer equipment, whether the processing is performed with rented or owned equipment or when a third party provides the service.
- The use of technical equipment of visual microforms recovery and computer equipment to perform audit tasks.

It is important to mention that, in Peru, pursuant to global trends through a special provision¹³ authorization has been passed so that micro files and documents contained therein are valid for any accounting and tax review, indicating as well that tax inspectors shall review the information that appears micro-recorded as well as through the use of visual recovery equipment, screens, viewers and similar devices that must be provided by the companies and entities subject to review.

However, due to security concerns in the event of tax offenses, with the purpose of having the relevant evidence in a physical form, the Tax Administration has set forth a modification to the decree in mention so that the taxpayer cannot destroy the original documentation during the prescription term of the tax obligation.

It is important to mention that the provisions require taxpayers to maintain in operational conditions, magnetic supports used in their application for a two-

¹³ Legislative Decree N° 681 dated 10.14.1991.

year term. The modification of this provision is foreseen so that the term is extended until the prescription of the taxes, to uniform treatment in regards to the physical documentation (accounting books and other documents).

c.3. Require information and documents from third parties

The Tax Administration is empowered to require from natural persons, bodies corporate, public or private entities information and the display of books, registries, documents, the issue and use of credit cards, commercial correspondence related to the fact that the same determine taxation, and the same must be granted in a term no lesser than three (3) business days. In this case, the constitutional rights protecting professional secrecy must be observed.

Similarly, it may require from public or private entities to inform or verify compliance with tax obligation from subjects under responsibility with which they perform operation. In this regard, Supreme Decree N° 027-2001-PCM¹⁴ established that the Entities of the National Public Sector are obliged to provide information to SUNAT regarding all their acquisitions of goods and/or services, which involve the use of State resources.

In this regard, the Tax Code expressly contains the obligation that the Judicial Power, the Office of the Attorney General and public officials are obliged to communicate information which they have knowledge of, pertaining to actions that generate tax obligations.

Based on this power, the Administration through Superintendent Resolutions, has generated the obligation for Notaries as well, to the effect that they must present, through computerized means the Annual Notaries' Declaration, which is a valuable information

¹⁴ Published on 03.22.2001, it approved the Consolidated Text of the Norms duly updated, which rules the obligation of certain entities of the Public Sector of providing information on its acquisitions.

tool coming from an outside source that is used as an input in the selection of taxpayers to be examined. Through this declaration over 500 authorized notaries, annually inform assets operations where they have participated as well as all accounting books and registries authorizations that they have performed. Said declaration must be filed through the Internet.

c.4. Request the appearance of tax debtors or third parties.

For the application of this power the Tax Administration may require the person to come to the offices of the Tax Administration to clarify situations linked to taxation. This procedure is generally used by official when they require the release of taxpayer or third parties' declarations in processes where the existence of tax fraud is presumed and its purpose is to complete the indications that prove the existence of negligent behavior.

c.5. Perform inventory taking and practice cash audits.

In this case, the Administration is not obliged to previous inform the taking of inventories or practice cash audits, the same are executed immediately as a result of the intervention.

c.6. Immobilize books, files registry documents and assets.

In this case the mere presumption of tax evasion is enough, not requiring for an authorization to such effect. The immobilization may be performed up to a ten (10) business day term, which may be extended up to sixty (60) business days.

c.7. Establish that the minutes' books, registries and accounting books pertaining to tax issues that must be carried by the taxpayer be duly authorized by Notaries.

d. The application of the assessment of the tax obligation through a presumed base

The Peruvian tax system is a declaration system, where the initial responsibility in the assessment of the tax obligation

pertains to tax debtors. They are responsible of filing tax returns, and the Administration is empowered to proceed to modify the same, and therefore it is supported on a certain or presumed base.

The Administration in principle must establish the assessment on a certain base and shall apply the presumed base in a supplementary manner.

To the effects of assessing the presumed base, the law has established a series of suppositions which qualify the Tax Administration to apply presumed base procedures as provided for in the Tax Code, the Income Tax Law and the General Sales Tax Law and the Selective Consumption Tax Law. These suppositions are related to the taxpayer's behavior when it shows the intention of not complying with its tax obligations, it conceals the elements that are necessary for an examination on a certain base or does not collaborate with the Administration in controlling compliance with its obligations, being necessary to resort to the presumptions to estimate the approximate amount of the taxpayer's debt. The presumptions foreseen in the Code are subject to evidence to the contrary.

In this regard, the Peruvian Tax Code establishes assessment procedures based on presumptions to be applied by examination officials, and it has recently incorporated the following presumptions:

- d.1.** The possibility of determining the tax debt based on returns filed by the taxpayer, caused by the impossibility of having the taxpayer's books and/or registries. Therefore, the Tax Administration has detected taxpayers that omitted the declaration of sales or purchases which performance has been verified by means of cross referencing information and which does not appear in their books and/or registries in order to prevent the application of presumptions as a result of omissions in the sales Registries or as a result of omissions in the purchase Registry which necessarily require the verification of both accounting registries.

- d.2.** The presumption of sales or income in the case of tax evaders, directed to tax debtors who do not present accounting registries but are total evaders in the presentation of assessment declarations or declare zero in the taxable base or do not consign any figure, evidencing evasive behavior in complying with the tax obligation.
- d.3.** The presumption of sales or income omitted as a result of the existence of negative balances in the flow of revenue and expenses in cash and/or bank accounts. Because experience has proven, in tracking the cash flows (or bank accounts) of a Company or a person, the existence of tax debtors that maintain as a constant practice that their expenses surpass their income, presuming the existence of expenses outside accounting, product of omitted sales.
- d.4.** The presumption of Net Income and/or omitted sales through the application of economic tax coefficients, to the effect of closing non-compliance gaps that appear in monthly tax returns regarding the General Sales Tax and the Annual Income Tax.

3. RESOLUTIONS OF THE SUPERINTENDENCE

The Tax Administration, based on the aforementioned powers by means of Superintendence Resolutions, has established obligations for taxpayers, responsible third parties and third parties regarding actions that generate tax obligations, among which we have the following:

a. Information provided by withholding agents and taxable income

In Peru, the implementation of Withholding Regimes and Taxable Income from the IGV has had as a main purpose the assurance of the payment of the tax through its withholding or assessment at the source; but at the same time, it has constituted an important tool in the struggle against evasion, as it has provided information that allows the identification of taxpayers which present high indexes of tax non-

compliance and remained concealed to the control of SUNAT.

During 2003, said withholding and taxable income regimes have generated a total of 592 million dollars in collection, as shown in the following table:

MEASURES TO INCREASE THE TAX BASE

Millions

REGIMEN	COLLECTIONS
- Withholding	409
- Withdrawals	143
- Taxable Income	30
- Collection through the Integrated Financial Administration System	10
TOTAL COLLECTED	592.5

SOURCE: SUNAT System

Different collection levels are explained in the reach of each regime, by the amounts of withholding or assessment agents appointed, as well as by the products affected.

On the other hand it is important to mention that withholding or taxable income IGV agents appointed by SUNAT are obliged to declare and pay monthly the withholding or taxable income that they are obliged to pay.

b. Information sent by the bank regarding operations subject to the Tax Obligations Payment System with the Central Government (SPOT)

In general terms, through SPOT individuals or companies that purchase goods or service users must subtract from the sales price of the goods and or services a percentage from the sales price of the goods or services provided that are levied with the IGV and deposit the same in the bank accounts in the name of each service provider of said operations. The main objective of this system is to assure

the payment of the tax on behalf of subtracted subjects, who may use the amounts deposited for the payment of their obligation through the use checks.

The bank, for its part, is obliged to provide to the Tax Administration monthly information pertaining to deposits performed and those subjects that intervene in operations comprised in SPOT, information that results to be vital for compliance with the purposes of SUNAT, if you take into consideration that goods and services subject to the payment system mentioned are those that present high tax non-compliance indexes, such as the marketing of products as sugar, ethylic alcoholic, rice, cotton and wood among others.

b. Information on operations performed with third parties

The Tax Administration has established the obligation for determinate taxpayers of informing, through computerized means, purchase operations that they have performed as from a determinate amount. Said information is presented through the Annual Declaration of Operations with Third Parties (DAOT).

By virtue of the principle of counter-position of interests, declarations from the seller and the buyer, to the effect of verifying the consistency of information. In this regard, while for the seller the value of the operation constitutes a tax debit, for the buyer it will be a tax credit.

c. Information provided by notaries

As previously indicated, the Tax Administration has established the obligation of notaries of presenting, by computerized means, the Annual Notaries' Declaration, through which they periodically inform the assets operations in which they have participated, as well as the accounting books and registries performed.

Therefore, the Tax Administration has in a complementary manner the information obtained as a product of tax returns from taxpayers, data obtained from other sources, which

are input into a National Database and are processed for their use.

Therefore, in function of the information obtained and through information cross-referencing – performed based on technical criteria – taxpayers that present inconsistencies are selected in order to be examined by the operational areas of the Tax Administration. It is important to mention that as from SUNAT's merger with the National Customs Superintendent, nationally our database is the largest and most complete database in the nation.

The aforementioned measures do not substitute SUNAT's examination actions, but allow the obtainment of valuable input, which permit to assure that the same are truly effective.

1. NEW LEGAL PROVISIONS

In September 2003, the Congress of the Republic of Peru, under the protection of the Constitution has delegated to the Executive Branch the power to legislate tax issues until February 2004, establishing some limits for such effect.

The mentioned delegation is supported on, among other arguments, the need to develop a standardized framework which allows the Tax Administration to make perfect the assessment and examination systems regard the tax debt, to have information that is held in the public sector, issue provisions which formalize economic operations with the participation of companies from the financial system to improve examination systems and systems used in the detection of tax fraud, as well as modify the General Customs Law.

Based on this, the Executive Power has issued different Legislative Decrees which purpose is to have the legal support that permits the Tax Administration to have access to as much information as possible in regards to operations performed by tax debtors, information that will serve as support for further examination actions.

Among these standards, we can mention the following:

- a) Legislative Decree N° 931, published on October 10th, 2003, which rules the obligation of the Peruvian State to inform SUNAT whenever an expense is earned in favor of its suppliers. Through this system, the Tax Administration can have information pertaining to the acquisitions performed by the State and those who are its suppliers, to then cross reference the information or verify whether if these operations are being declared.

It is important to mention that the State is one of the main economic agents, since 20 of its main companies perform purchases for approximately S/. 5,700 million Nuevos Soles annually. However, these have over 10,600 suppliers, most qualified as Micro and Small companies, these sectors present high non-compliance indexes regarding their payment obligations.

- b) Legislative Decree N° 937, published on November 14th, 2003, which rules the new Unique Simplified Regime which purpose is to facilitate compliance with tax obligations and increase the number of tax debtors registered, by making the formalization of the small taxpayers of our economy more attractive and implement control mechanisms of immediate verification.
- c) Legislative Decree N° 939, published on December 5th, 2003, which establishes measures for the struggle against evasion and informality. This provision is of vital importance as a normative support for examination actions of SUNAT, as it rules two institutions which greatest value is in the information that will be obtained regarding the operations of tax debtors.

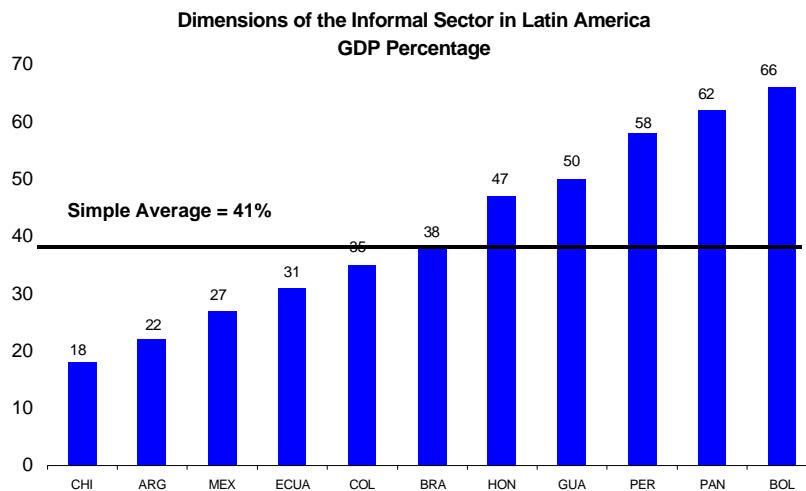
As well as in first term, said norm rules the so called “bancarización” of commercial operations, upon establishing that all commercial operations which quantity surpasses certain amount of money, will have tax effects only if paid through institutions of the Peruvian financial system.

At the same time it establishes that financial institutions that are obliged to inform SUNAT on the total operations performed during the calendar month.

The second provision is the called Tax on Financial Transactions which purpose is to fight against evasion and to increase the base of registered taxpayers.

The purpose of these provisions is to evidence financial operations performed by taxpayers to determine whether if the movements performed by a taxpayer correspond to the income level that it declares.

It is important to mention that the “Bancarización” as well as the Tax on Financial Transactions are useful tools to increase the tax base, furthermore in an economy such as the Peruvian that presents an informal sector that represents around 58% of the country’s GDP, one of the highest of Latin America.



Source: World Bank Policy Research Working paper (1997)

- a) Legislative Decree N° 940, published on December 20, 2003, which rules the Payment System of Tax Obligations with the Central Government, provision that – in addition to achieving the generation of funds for the payment of tax debts, legal costs and expenses – has as an immediate effect that taxpayers register, declare and pay the taxes corresponding to operations that previously remained concealed and were not declared before the Tax Administration, which will allow to close registration, declaration and veracity gaps.

- b) Legislative Decree N° 941, published on December 20, 2003, incorporated into the Tax Code new assumptions to apply to the assessment of the presumptive base. This is, in fact the most important provision among the new provisions leading to improve the examination system, since it closes legal gaps and creates new assumptions for SUNAT's actions, empowering it act in situations where it previously could not and comprising within the examination range activities and actions performed by tax debtors, which were previously left without control.
- c) Legislative Decree N° 943, published on December 20, 2003, which enacts the new "Master Taxpayer File Act" (RUC, in Spanish). This provision stipulates that all Entities of Peru's Public Administration are obliged to incorporate as a requirement into its procedures, acts or operations the requirement for the RUC number of the interested parties. An increase in the number of taxpayers registered in the RUC is expected with this measure. Furthermore, this norm rules the obligation that these entities have to make available information in the form, terms and conditions stipulated by SUNAT.
- d) Lastly, Legislative Decree N° 945, published on December 23, 2003. This norm modified the Income Tax Law, comprised within the scope of said tax, activities and actions performed by taxpayers that were in tax avoidance or evasion, facilitating examination actions and clarifying provisions which generated doubts regarding its sense and range.

III. CONCLUSIONS

1. The Peruvian experience has determined that the provisions that support examination actions must be dynamic and flexible to the effects of gathering and if possible, anticipate technological changes, which promote commercial transactions.

Likewise, regarding the globalization of the world's economy, the Tax Administration is facing the new challenges in taxpayer examination. Hence, we have seen the need to rule new forms of fair market value assessments in the case of commercial operations performed between related third parties, through the application of transfer pricing. On the other hand, during the past years Peru has

subscribed different international agreements, not only to avoid internationally double taxation, but to exchange information with other countries as well, which permits to surpass territorial barriers on information matters.

2. The success of examination actions depends largely on information obtained from the tax debtor or third parties. Said information must be true and timely so that its use contributes to the correct assessment of the tax debt.
3. The assessment on the presumed base constitutes an efficient tool in the struggle against evasion, avoidance and tax offenses, inasmuch the application of presumptions allows inclusion within this scope the examination of subjects that usually escape from the control of the Tax Administration.
4. The Tax Administration, within the legal framework in force, has decreed provisions, which in addition to assuring the payment of tax obligations, allows access to more information which will serve as support for future examinations practiced by it (withholding regimes and taxable income from the General Sales Tax, the Payment System of Tax Obligations with the Central Government, the Annual Declaration of Operations with Third Parties and the Annual Notaries' Declaration) helping to close registry, declaration and veracity gaps.
5. Recently through delegated powers, the Peruvian Government has decreed a series of measures directed to increase the taxpayer base registered in the RUC and power assessment, examination and control actions regarding compliance with tax obligations.
6. Finally, we believe that the existence of norms that allow the ample action of the Tax Administration are important, it is equally important that the actions of the officials in charge of examination procedures be framed within the respect of constitutional rights so that their actions are legitimate.

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TOPIC 2

**VERIFICATION AND AUDITING
OF LARGE TAXPAYERS**

Lecture

TOPIC 2.

VERIFICATION AND AUDITING OF LARGE TAXPAYERS

Deborah Nolan

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

CONTENTS: Introduction.- Background.- Demographics.- Organizational Structure.- Measures of Performance.- Compliance.- Examination Process.- Catalyst for Change.- Appendix 1: Part 801—Balanced System for Measuring Organizational and Employee Performance within the Internal Revenue Service.

INTRODUCTION

During the last year, there has been much attention on corporate governance, both from the standpoint of the financial statements of public companies and the compliance with tax laws. While there were and continue to be large corporations who have maintained integrity in their financial and tax reporting, there have clearly been others which have not. The risks to the tax system presented by those corporations and individuals who choose to engage in abusive tax avoidance transactions or tax shelters have resulted in significant actions being taken through legislation, the creation of oversight bodies and controls, and changes in the taxpayers' approach to risk analysis to strengthen the overall corporate governance.

These provide challenges and opportunities for the tax administrator of large corporations to evaluate our effectiveness and improve our processes and interactions as appropriate.

This paper will outline the current structure and processes to address compliance of large corporate taxpayers. It also will outline some of the changing dynamics and external drivers of corporate governance that influence our current thinking in reengineering our processes. Since the new processes will serve to supplement current ones, not totally replace them, it is important to build the framework to set the context for the significant change.

A brief outline of the paper is below:

- Background.
- Demographics.
- Organizational Structure.
- Measures of Performance.
- Compliance
 - Issue Management Strategy.
 - Service and Enforcement.
 - Examination Process.
- Catalyst for Change.
- Future Steps.

BACKGROUND

The Internal Revenue Service was established in 1952, the objective of which was to create an agency that would collect federal taxes according to the law without political or corrupt influence. The IRS mission statement written in the 1960's and in effect until 1998, reflected the way the agency saw itself and was seen by the public. Its operative words were "collect the proper amount of tax." In 1998 after some very public hearings, the IRS Restructuring and Reform Act of 1998 (RRA'98) was passed. The direction given to the IRS was clear: it 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.

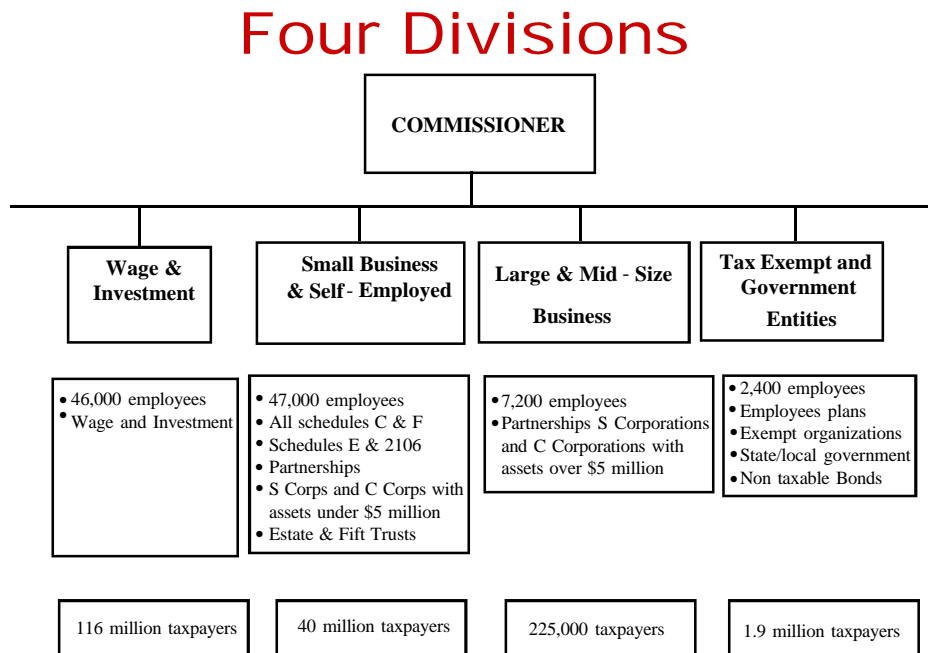
This mission statement accurately describes the role of the IRS, as well as the public's expectations as to how the IRS should perform it. In the United States, the Congress passes tax laws and requires taxpayers to comply with them. It is the role of taxpayers to understand and meet their tax obligations, 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 minority who are not willing to comply are not allowed to burden their fellow taxpayers.

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.

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. The key operational units are four operating divisions, each charged with full end to end responsibility for serving a set of taxpayers with similar needs.

Below was the concept and design at its inception:



This paper will describe the approach used by the United States Internal Revenue Service to administer the tax law for the large corporate taxpayer since June 2000. It will also share some of our current and future challenges.

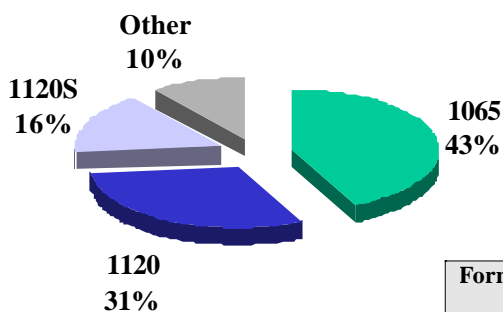
DEMOGRAPHICS

The large corporate taxpayer base is one that demands a tax administration that is responsive to its service and enforcement needs, in the global environment in which they operate. Additionally, the tax administration must be proactive and innovative in being able to predict emerging issues of compliance risk and deal with them appropriately. Tax laws must be applied with fairness and integrity, with consistent and uniform application of the law for similarly situated taxpayers. The complexity of the tax laws coupled with the sophistication of the taxpayers and their representatives require a highly competent workforce, equipped technologically and intellectually to administer those laws.

Within the Large and Mid-Size Business Division, there are approximately 162,000 corporations and partnerships with assets in excess of \$10 million. Of these, there are approximately 11,000 publicly held corporations, many of which are in the "Coordinated Industry Case" program.

LMSB Return Filings

LMSB Serves the 161,946 Largest Corporations & Partnerships



Form	PY-02 Total Returns
1065 (Partnerships)	69232
1120 (Corporations)	49766
1120S (Sub. S-Corp)	26393
Other	16556
Totals	161,946

These corporations are the largest businesses in the United States with global operations. They are well-represented by external and internal accountants and attorneys and have relationships with other regulatory agencies. They are very influential in shaping legislation and policy. They are strongly motivated to present steady profitability to shareholders and the public and use tax planning extensively.

Adding to this complexity is the enterprise relationships, the form of doing business, and the extent and implications of global operations. Tax treaties, tax information exchange agreements and international cooperation among taxing authorities will only increase in its importance.

ORGANIZATIONAL STRUCTURE

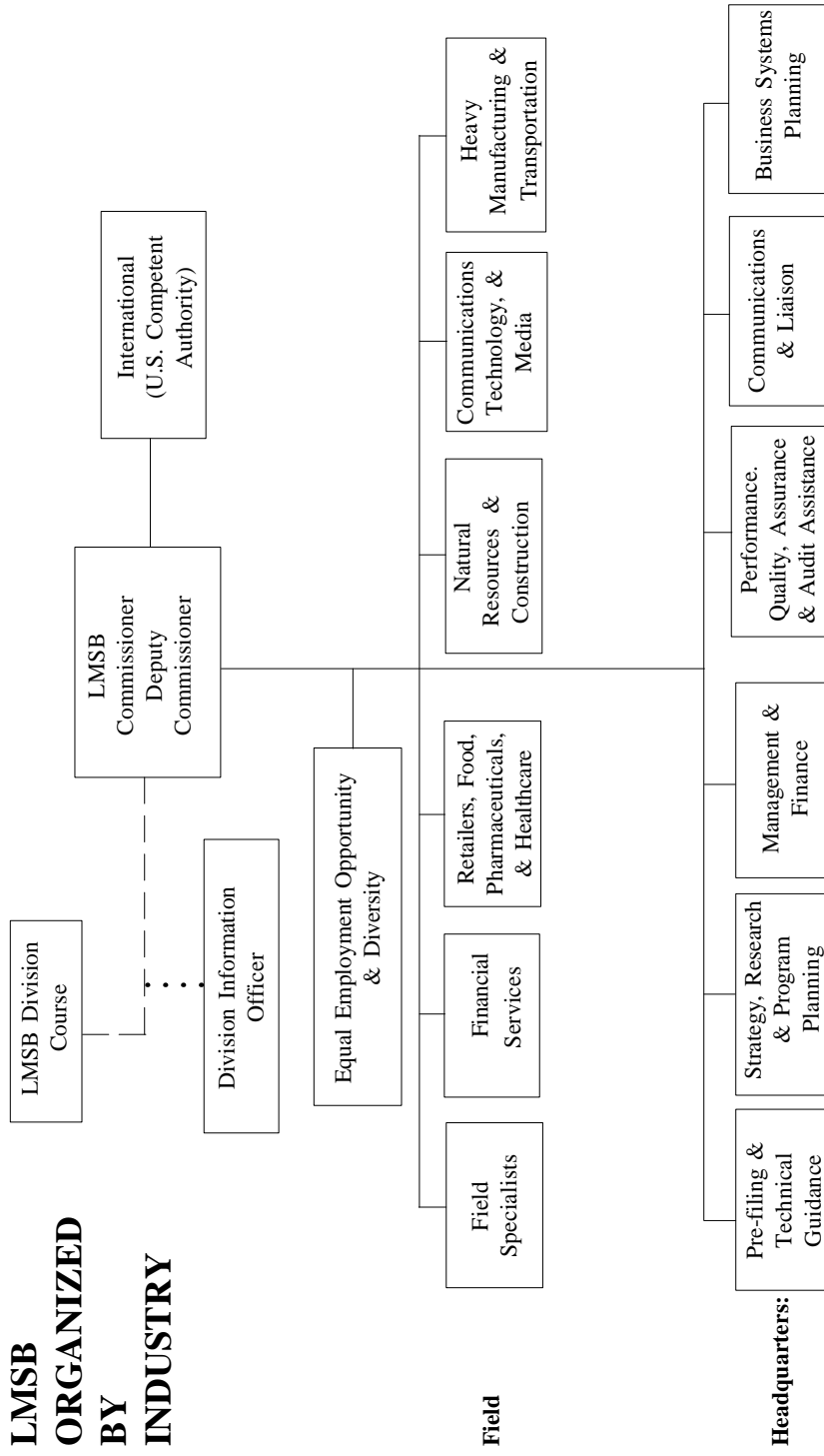
The Internal Revenue Service was organized to provide a tax administration focused around taxpayer segments:

- *Wage and Investment*
- *Small Business and Self Employed*
- *Large and Mid Size Businesses*
- *Tax Exempt and Government Entities*

The Large and Mid Size Business (LMSB) Division is a nationwide organization with a flat structure to ensure uniform tax administration, quick decision making, and coordination with Treasury on issues of tax policy and Counsel. With 6,000 employees geographically dispersed, the organization has an industry focus.

The role of the headquarters is to support the field operations and to ensure consistency and Service policy relative to issues of tax administration. The industry structure facilitates the “customer focus” by dealing with compliance issues that are industry specific. I will provide additional detail regarding the role of the International office and the essential role of Research in dealing with tax administration for the large corporate taxpayer.

**LMSB
ORGANIZED
BY
INDUSTRY**



MEASURES OF PERFORMANCE

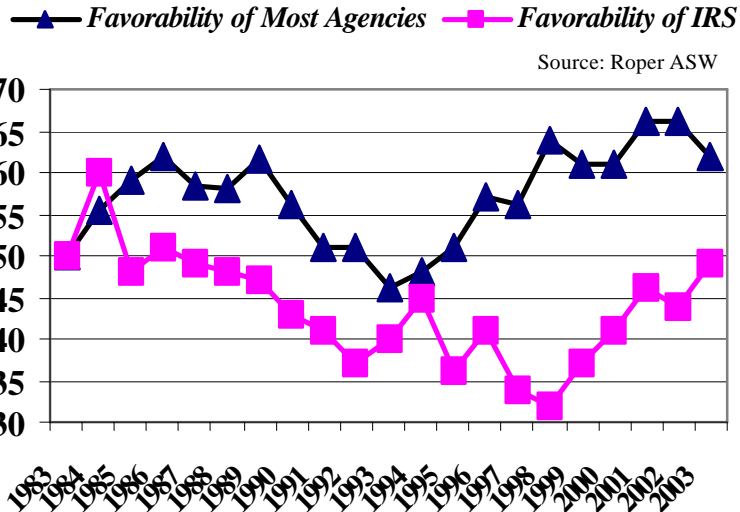
Organizational metrics of performance are designed around a balanced set of measures:

- **Business Results: Quality:** Examination cases are reviewed to measure the level of compliance with auditing standards and provided with a score for each of the standards and overall case quality. Reviews are performed on cases in process and well as on closed cases.
- **Business Results: Quantity:** Organizational metrics include cases closed as compared to planned closures by category. Direct time spent on cases as compared to other activities is measured as well as time applied to organizational priorities. Cycle time and currency are also diagnostic metrics of business results.
- **Customer Satisfaction:** Two surveys are conducted; one as a random sample of taxpayers who have been examined. Metrics of professional behavior and technical competence of our examiners as well as the responsiveness of our actions and clarity of our requests for information are among areas addressed. Additionally, another survey is conducted regarding the full range of services provided to all taxpayers, including filing the return, telephone sites for taxpayer inquiries, resolutions of account questions, and the examination process.
- **Employee Satisfaction:** Annually, the opportunity to respond to an employee satisfaction survey is provided to all employees. Questions related to guidance and feedback provided by the manager, the sufficiency of training and tools needed to do their jobs, and environment issues of fair treatment and quality of work life are among the questions asked in the survey.

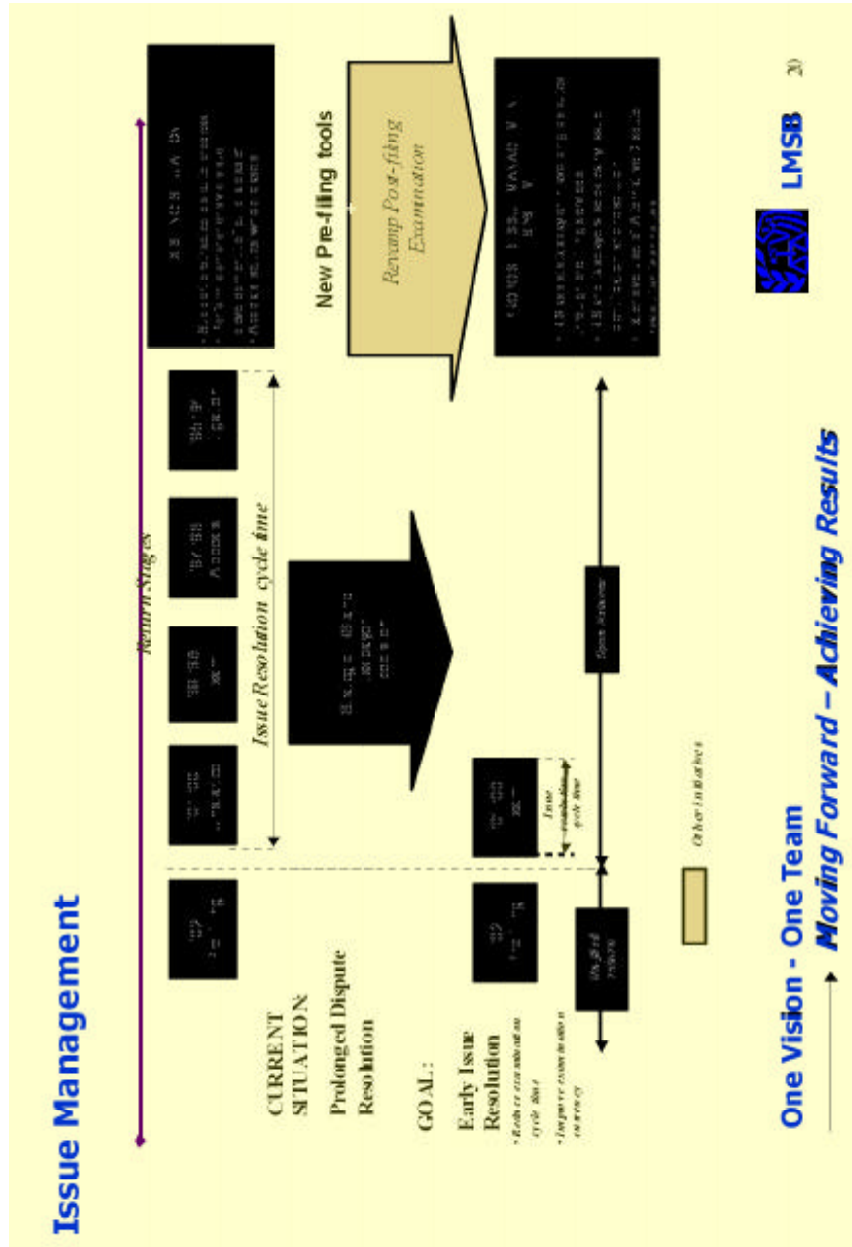
Measures of voluntary compliance and outcome measures (as opposed to output measures) are being developed as a part of the current strategic assessment and planning process.

Everyone in the IRS shares responsibility for fulfilling the mission and making progress toward the IRS' strategic goals. Every employee is also evaluated against some standard of performance, which in turn is the basis for awards and promotions. It is vital that the standards used to measure and evaluate performance at all levels be aligned so as to encourage and reward performance that advances the IRS' strategic goals. It is equally as important to avoid measures or standards that reward inappropriate actions or are subject to manipulation. (Appendix 1: Balanced System of Measuring Organizational and Employee Performance with the Internal Revenue Service)

IRS Favorability vs. Most Agencies



The concept of: “Service + Enforcement = Compliance” is demonstrated for the large corporate taxpayer through an issue management strategy. The more traditional approach to compliance was weighted primarily towards the examination process. Enforcement resources must be used efficiently and effectively, focused on those taxpayers and issues that truly warrant the enforcement approach. One of the guiding principles of fair tax administration is that of transparency. Published guidance in the form of regulations, revenue rulings and procedures, and administrative guidance is one way to increase taxpayer reliance and confidence in our interpretation of the law. It also provides us with a “brighter line” for determining our enforcement focus, and the use of administrative enforcement tools such as penalties, litigation, and examinations. The diagram below illustrates the two work streams for the large taxpayer to prevent or resolve tax controversy:



Topic 2.

The goal is earlier issue identification and resolution. Over the past few years, different tools and processes have been developed to accelerate the processes, and eliminate controversy or determine the appropriate enforcement tool and approach to resolve it. Examples include:

- Pre-filing Agreements
- Industry Issue Resolution
- Fast Track Mediation
- Limited Issue Focused Examinations (LIFE)

Examination Process

A broad overview of the examination process from return filing is illustrated below:

Taxpayer Files

Return Processed, Classified, Shipped to Group
Assignment to team, Risk Analysis, Preliminary Review
Examination
Quality Review, Closing

This next section will specifically address the examination of a tax return following the determination of compliance risk and appropriate allocation of resources. Generally, the large corporate taxpayers are examined through the use of a team. The following factors are considered in “pointing” the case to determine whether the team approach is warranted:

- Gross Assets
- Gross Receipts
- Operating Entities
- Multiple Industry Status
- Team Members
- Specialists
- Support agents
- Total Direct Examination Staff Days planned

The Coordinated Industry Case (CIC) identification standards have been established with the objective of bringing all segments of a business together for concurrent examination. This facilitates an overview of the taxpayer’s structure and overall operations for level of compliance and accuracy of reported tax liability as well as aiding in management of the case.

The CIC case package included the primary taxpayer and all effectively controlled entities plus those that are unrelated but associated with the taxpayer in activities having significant tax consequences. Several factors, including stock ownership are considered to determine “effective control”. Corporate officers’ returns are also reviews to determine whether an examination is warranted, and to ensure filing of tax returns.

The examination itself begins with a joint planning process that includes the taxpayer and counsel. It includes everything from space and the use of taxpayer’s facilities, to the scope of the examination, the identification of issues, agreements as to the “rules of engagement”, requests for information and agreed upon response times. Dates for progress meetings and participants are agreed upon. The use and the role of specialists are planned with a time line for the entire process with an expected date of completion.

Phase two can best be described as preliminary audit work involving the review of certain taxpayer records and analysis of accounts. Discussions with the taxpayer are ongoing. Activities expected to be performed by the team should include a review of basic records of the taxpayer which at a minimum should include:

- Reconciliation of book income to tax income (Schedule M)
- Corporate Minutes
- Internal Controls
- Internal Management Reports
- Accounting Manuals and Systems Analysis
- Any Other Pertinent Data

Various comparative analyses are performed and in most cases, should be accomplished by analysis of computer generated data.

The third step is to develop audit procedures. This includes:

- Specific accounts on the taxpayer’s books to be examined
- Preliminary audit procedures to be used
- Justification for examination of the account
- Time estimate

The result is an examination plan, which is a written document containing agreements with the taxpayer, information for Service personnel, work assignments, audit procedures, time estimates, and special instructions. The plan has three basic parts:

Part I – Taxpayer Information Section (Examination Arrangements)

Part II – Service Management Information Section

Part III- Examination Procedures Section

As the examination proceeds, the team will identify those issues of controversy which are attempted to be resolved at their level through discussions with the taxpayer and documentation and analysis of the law. The process for issue resolution beyond the examination team, include a conference with the management officials, an administrative appeal with an “independent” appeals officer and litigation. The process can be time consuming and resource intensive, therefore, to the extent that the examination team can resolve the issue but still remain within the context of the law; they are encouraged to do that.

CATALYST FOR CHANGE

During the past few years, there have been a number of factors that serve as a catalyst for having us reevaluate our compliance processes. The use of abusive tax avoidance transactions, the corrosion of the professional and ethical standards for some accountants and attorneys, and the heightened corporate governance and legislation has created the need have a fundamental change in our approach to ensuring compliance. Taxpayers have told us that they need a higher degree of certainty on a timely basis regarding issues of tax controversy and means to resolve it. We need a higher degree of assurance that the tax return filed is substantially compliant. We also need to be able to identify emerging issues of non compliance sooner, and with fewer resources. There have been a number of factors including legislation, corporate governance, accountability of corporate officers, the role of the board of directors and the audit committees and the impact of recent publicity that create a responsibility and an opportunity for us to reengineer our processes.

We are currently engaged in an initiative to reengineer our process, working with external stakeholder groups to seek input, as well as with other federal and state agencies. The objective of the effort is to design and implement a process that provides service to taxpayers while improving compliance with the tax laws. The process will give us a higher degree of confidence regarding the compliance level of the return or enable us to identify issues of controversy sooner. We will also be able to identify broad areas of risk sooner, and get guidance out to the public or use enforcement to work with taxpayers to resolve the issues more contemporaneously.

This paper provides a broad overview of the infrastructure and the process for the examination of the large corporate taxpayer. It also outlines in more detail, the examination process. As tax administrators, we are all challenged with the need to continuously improve our processes in an environment that is rapidly changing. I hope to be able to share an exciting new process with you at a future conference, along with our successes and perhaps even more important for a forum of this type, lessons that we have learned through the past few years.

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**Appendix 1:
Department of the Treasury
Internal Revenue Service**

PART 801—BALANCED SYSTEM FOR MEASURING
ORGANIZATIONAL AND EMPLOYEE PERFORMANCE WITHIN THE
INTERNAL REVENUE SERVICE

Sec.

- 801.1 Balanced performance measurement system; in general.
- 801.2 Measuring organizational performance.
- 801.3 Measuring employee performance.
- 801.4 Customer satisfaction measures.
- 801.5 Employee satisfaction measures.
- 801.6 Business results measures.

Authority: 5 U.S.C 9501 et seq. ; secs. 1201, 1204, Pub. L.
105-206, 112 Stat. 685, 715-716, 722 (26 U.S. C. 7804 note).

801.1 Balanced performance measurement system; In general

- (a) In general— (1) The regulations in this part 801 implement the provisions of sections 1201 and 1204 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105 - 106, 112 Stat. 685, 715-716, 722) and provide rules relating to the establishment by the Internal Revenue Service of a balanced performance measurement system.
- (2) Modern management practice and various statutory and regulatory provisions require the IRS to set performance goals for organizational units and to measure the results achieved by those organizations with respect to those goals. To fulfill these requirements, the IRS has established a balanced performance measurement system, composed of three elements: Customer Satisfaction Measures; Employee Satisfaction Measures; and Business Results Measures. The IRS is likewise required to establish a performance evaluation system for individual employees.
- (b) Effective date. This part 801 is effective September 7, 1999.

801.2 Measuring organizational performance

- (a) In general. The performance measures that comprise the balanced measurement system will, to the maximum extent possible, be stated in objective, quantifiable and measurable terms and, subject to the limitation set forth in paragraph (b) of this section, will be used to measure the overall performance of various operational units within the IRS. In addition to implementing the requirements of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105 -206, 112 Stat. 685), the measures described here will, where appropriate, be used in performance goals and performance evaluations established, inter alia, under Division E, National Defense Authorization Act for Fiscal Year 1996 (the Clinger-Cohen Act of 1996) (Public Law 104 -106, 110 Stat. 186, 679); the Government Performance and Results Act of 1993 (Public Law 103 -62, 107 Stat. 285); and the Chief Financial Officers Act of 1990 (Public Law 101-576, 108 Stat. 2838).
- (b) Limitation—quantity measures (as described in '801.6) will not be used to evaluate the performance of or to impose or suggest production goals for any organizational unit with employees who are responsible for exercising judgment with respect to tax enforcement results (as defined in '801.6) except in conjunction with an evaluation or goals based also upon Customer Satisfaction Measures, Employee Satisfaction Measures, and Quality Measures.

801.3 Measuring employee performance

- (a) In general. All employees of the IRS will be evaluated according to the critical elements and standards or such other performance criteria as may be established for their positions. In accordance with the requirements of 5 U.S.C. 4312, 4313 and 9508 and section 1201 of the Internal Revenue Service Restructuring and Reform Act of 1998 (Public Law 105 -206, 112 Stat. 685) (as is appropriate to the employee's position), the performance criteria for each position will be composed of elements that support the organizational measures of Customer Satisfaction, Employee Satisfaction and Business Results; however, such organizational measures will not directly determine the evaluation of individual employees.
- (b) Fair and equitable treatment of taxpayers. In addition to all other criteria required to be used in the evaluation of employee performance, all employees of the IRS will be evaluated on whether they provided fair and equitable treatment to taxpayers.
- (c) Senior Executive Service and special positions. Employees in the Senior Executive Service will be rated in accordance with the

requirements of 5 U.S.C. 4312 and 4313 and employees selected to fill positions under 5 U.S.C. 9503 will be evaluated pursuant to workplans, employment agreements, performance agreements or similar documents entered into between the Internal Revenue Service and the employee.

- (d) General workforce. The performance evaluation system for all other employees will:
 - (1) Establish one or more retention standards for each employee related to the work of the employee and expressed in terms of individual performance —
 - (i) Require periodic determinations of whether each employee meets or does not meet the employee's established retention standards; and
 - (ii) Require that action be taken, in accordance with applicable laws and regulations, with respect to employees whose performance does not meet the established retention standards.
 - (2) Establish goals or objectives for individual performance consistent with the IRS' performance planning procedures —
 - (i) Use such goals and objectives to make performance distinctions among employees or groups of employees; and
 - (ii) Use performance assessments as a basis for granting employee awards, adjusting an employee's rate of basic pay, and other appropriate personnel actions, in accordance with applicable laws and regulations.
- (e) Limitations—(1) No employee of the Internal Revenue Service may use records of tax enforcement results (as defined in '801.6) to evaluate any other employee or to impose or suggest production quotas or goals for any employee.
 - (i) For purposes of the limitation contained in this paragraph (e), employee has the meaning as defined in 5 U.S.C. 2105(a).
 - (ii) For purposes of the limitation contained in this paragraph (e), evaluate includes any process used to appraise or measure an employee's performance for purposes of providing the following:
 - (A) Any required or requested performance rating.
 - (B) A recommendation for an award covered by Chapter 45 of Title 5; 5 U.S.C. 5384; or section 1201(a) of the Internal Revenue Service Restructuring and Reform Act of 1998, (Public Law 105 -206, 112 Stat. 685, 713-716).
 - (C) An assessment of an employee's qualifications for promotion, reassignment or other change in duties.
 - (D) An assessment of an employee's eligibility for incentives, allowances or bonuses.
 - (E) Ranking of employees for release/recall and reductions in force.
- (2) Employees who are responsible for exercising judgment with respect to tax enforcement results (as defined in '801.6) in cases

concerning one or more taxpayers may be evaluated with respect to work done on such cases only on the basis of information derived from a review of the work done on the taxpayer cases handled by such employee.

- (3) Performance measures based in whole or in part on Quantity Measures (as described in '801.6) will not be used to evaluate the performance of or to impose or suggest goals for any non-supervisory employee who is responsible for exercising judgment with respect to tax enforcement results (as defined in '801.6).

801.4 Customer satisfaction measures

The customer satisfaction goals and accomplishments of operating units within the Internal Revenue Service will be determined on the basis of information gathered via various methods. For example, questionnaires, surveys and other types of information gathering mechanisms may be employed to gather data regarding customer satisfaction.

Information to measure customer satisfaction for the particular work unit will be gathered from a statistically valid sample of the customers served by that operating unit and will be used to measure, among other things, whether those customers believe that they received courteous, timely and professional treatment by the Internal Revenue Service personnel with whom they dealt. Customers will be permitted to provide information requested for these purposes under conditions that guarantee them anonymity. For purposes of this section, customers may include individual taxpayers, organizational units or employees within the Internal Revenue Service and external groups affected by the services performed by the Internal Revenue Service operating unit.

801.5 Employee satisfaction measures

The employee satisfaction numerical ratings to be given operating units within the Internal Revenue Service will be determined on the basis of information gathered via various methods. For example, questionnaires, surveys and other information gathering mechanisms may be employed to gather data regarding employee satisfaction. The information gathered will be used to measure, among other factors bearing upon employee satisfaction, the quality of supervision and the adequacy of training and support services. All employees of an operating unit will have an opportunity to provide information regarding employee satisfaction within the operating unit under conditions that guarantee them anonymity.

801.6 Business results measures

- (a) In general. The business results measures will consist of numerical scores determined under the Quality Measures and the Quantity Measures described elsewhere in this section.
- (b) Quality measures. The quality measure will be determined on the basis of a review by an especially dedicated staff within the Internal Revenue Service of a statistically valid sample of work items handled by certain functions or organizational units determined by the Commissioner or his delegate such as the following:
 - (1) Examination and Collection units and Automated Collection System units (ACS). The quality review of the handling of cases involving particular taxpayers will focus on such factors as whether Internal Revenue Service personnel devoted an appropriate amount of time to a matter, properly analyzed the issues presented, developed the facts regarding those issues, correctly applied the law to the facts, and complied with statutory, regulatory and Internal Revenue Service procedures, including timeliness, adequacy of notifications and required contacts with taxpayers.
 - (2) Toll-free telephone sites. The quality review of telephone services will focus on such factors as whether Internal Revenue Service personnel provided accurate tax law and account information.
 - (3) Other workunits. The quality review of other workunits will be determined according to criteria prescribed by the Commissioner or his delegate.
- (c) Quantity measures. The quantity measures will consist of outcome-neutral production and resource data, such as the number of cases closed, work items completed, customer education, assistance and outreach efforts undertaken, hours expended and similar inventory, workload and staffing information, that does not contain information regarding the tax enforcement result reached in any case involving particular taxpayers.
- (d) Definitions — (1) Tax enforcement result. A tax enforcement result is the outcome produced by an Internal Revenue Service employee's exercise of judgment recommending or determining whether or how the Internal Revenue Service should pursue enforcement of the tax laws.
 - (i) Examples of tax enforcement results. The following are examples of a tax enforcement result:
a lien filed; a levy served; a seizure executed; the amount assessed; the amount collected; and a fraud referral.
 - (ii) Examples of data that are not tax enforcement results. The following are examples of data that are not tax enforcement results: case closures; time per case; direct examination time/out of office time; cycle time; number or percentage of overage cases; inventory

information; toll-free level of access; talk time; number and type of customer education, assistance and outreach efforts completed; and data derived from a quality review or from a review of an employee's or a work unit's work on a case, such as the number or percentage of cases in which correct examination adjustments were proposed or appropriate lien determinations were made.

- (2) Records of tax enforcement results. Records of tax enforcement results are data, statistics, compilations of information or other numerical or quantitative recordations of the tax enforcement results reached in one or more cases, but do not include tax enforcement results of individual cases when used to determine whether an employee exercised appropriate judgment in pursuing enforcement of the tax laws based upon a review of the employee's work on that individual case.
- (e) Permitted uses of records of tax enforcement results. Records of tax enforcement results may be used for purposes such as forecasting, financial planning, resource management and the formulation of case selection criteria.
- (f) Examples. The following examples illustrate the rules of this section:

Example 1. In conducting a performance evaluation, a supervisor may take into consideration information showing that the employee had failed to propose an appropriate adjustment to tax liability in one of the cases the employee examined, provided that information is derived from a review of the work done on the case. All information derived from such a review of individual cases handled by an employee, including time expended, issues raised and enforcement outcomes reached may be considered in evaluating the employee.

Example 2. When assigning a case, a supervisor may discuss with the employee the merits, issues and development of techniques of the case based upon a review of the case file.

Example 3. A supervisor may not establish a goal for proposed adjustments in a future examination, based upon the tax enforcement results achieved in other cases. Example 4. A headquarters unit may use records of tax enforcement results to develop methodologies and algorithms for use in selecting tax returns to audit.

Commissioner of Internal Revenue
Approved:

Case study

TOPIC 2.1

**VERIFICATION AND AUDIT OF LARGE TAXPAYERS. THE
SECTORIAL SPECIALIZATION IN THE SECRETARIAT OF
FEDERAL REVENUES**

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CONTENTS: 1. Context: The Administrative Structure of the Secretariat of Federal Revenues.- 2. The Creation of Specialized Units of the SFR.- 3. Sectorial Specialization by Economic Activity: the Special Financial Institutions Delegations (DEINF).- 3.1. Administrative structure.- 4. Sectorial Specialization by Type of Business: Special International Affairs Delegation (DEAIN).- 4.1. Transfer pricing.- 4.2. Worldwide taxation.- 4.3. Customs valuation.- 4.4. Overlapping of jurisdictions.- 4.5. Administrative structure.- 5. Specialization: Instruments and Benefits.- 5.1. Admission of officials in the Specialized Units.- 5.2. Training of officials.- 5.3. Systematization of activities.- 5.4. Coordination at the national level.- 5.5. Benefits for the other SRF units.

SUMMARY

In 1998, the Secretariat of Federal Revenues (SFR) implemented administrative units specialized in specific economic and activities sectors, through the creation of two Special Financial Institutions Delegations (Deinf) and the Special International Affairs Delegation.

In geographical terms, the Special Financial Institutions Delegations have their headquarters in the cities of Sao Paulo and Rio de Janeiro, with responsibility, respectively, over the taxpayers of the 8th Fiscal region – which corresponds to the State of Sao Paulo – and the 7th Fiscal Region – which corresponds to the States of Rio de Janeiro and Espiritu Santo. Currently, the Special International Affairs Delegation is responsible only for taxpayers located in the 8th Fiscal Region.

Special Financial Institutions Delegations (Deinf)

They have jurisdiction over the financial institutions as such and over the other taxpayers that are part of the Financial System, covering banks and other credit institutions, brokerage and securities and valuables distribution agencies and exchange agencies, insurance companies, funds and investment clubs and other institutions that are part of the National Financial System.

Exception: businesses that carry out similar or analogous activities to those performed by the institutions of the Financial System and which do not fall within the jurisdiction of the specialized delegations, on having similar characteristics to the transactions carried out by other corporations, for which reason they are not subject to examination by specialized units in the financial sector.

Special International Affairs Delegation (Deain)

An ever larger and diversified series of commercial activities or relationships in all sectors of the economy have justified the creation of a specific unit by the Secretariat of Federal Revenues – the Special International Affairs Delegation (Deain).

Specifically, and for purposes of administrative organization within the sphere of the SFR, the following aspects of the modern tax systems, or in simpler terms, the following matters are considered International Affairs:

- transfer pricing operations between related persons;
- international taxation; and
- customs valuation.

Overlapping of jurisdictions

The Deain shares jurisdiction with the other Federal Revenue Delegations of the 8th Fiscal Region.

Specialization: Instruments and Benefits

a) Admission of officials in the Specialized Units

- initial process of internal selection;
- criteria:
 - academic training;
 - professional experience prior to SFR
 - experience in carrying out similar fiscal procedures to that of the action area of the specialized unit;
 - perspectives of professional growth in the area.
- admission of new auditors through routine internal selection processes, based on the candidates' background

b) Training of the officials

- specific training, promoted by the SFR itself, which may resort to the support of the School of Finance Administration (Esaf);
- external training, performed by public or private institutions;
- post-graduate courses – university extension, master's and Phd degrees – taken in institutions with headquarters in the country or abroad.

c) Systematization of the activities

Basic concept: the actions of the tax administration should not differ by virtue of the administrative unit or official.

Main instruments for the systematization of the activities:

- orientation manuals for the examination
- computerized systems to support the fiscal activities:
 - selection of taxpayers to be examined
 - generation of files on digital media
 - auditing on digital media
 - preparation of record of violation
 - control of fiscal activities
- internal training, especially with the use of Intranet/SFR.

d) Coordination at the national level

General Examination Coordination (Cofis) => Financial Market and International Affairs Division (Dimej) => Financial System and transfer prices and international taxation.

General Customs Administration Coordination (Coana) => Division of Customs Valuation and Customs Inspection of Textiles (Divam) => customs valuation.

Benefits for other SRF units

Given that the geographical delimitation of action of the two units specialized in financial institutions and the specialized unit in international affairs covers only two of the ten fiscal regions existing in Brazil, there are many taxpayers and operations that also require supervision from the tax administration and are outside the jurisdiction of the Deinf and the Deain.

As it occurred prior to the creation of the specialized units, in the other fiscal regions the Federal Revenue Delegations themselves are in charge of the examination of the financial institutions and international affairs. Various instruments are used which systematize the fiscal activities for their consolidation and dissemination among the other administrative units of the SFR which take advantage of them to carryout fiscal activities relative to matters that are constantly treated by the Deinf and Deain.

1. CONTEXT: THE ADMINISTRATIVE STRUCTURE OF THE SECRETARIAT OF FEDERAL REVENUES

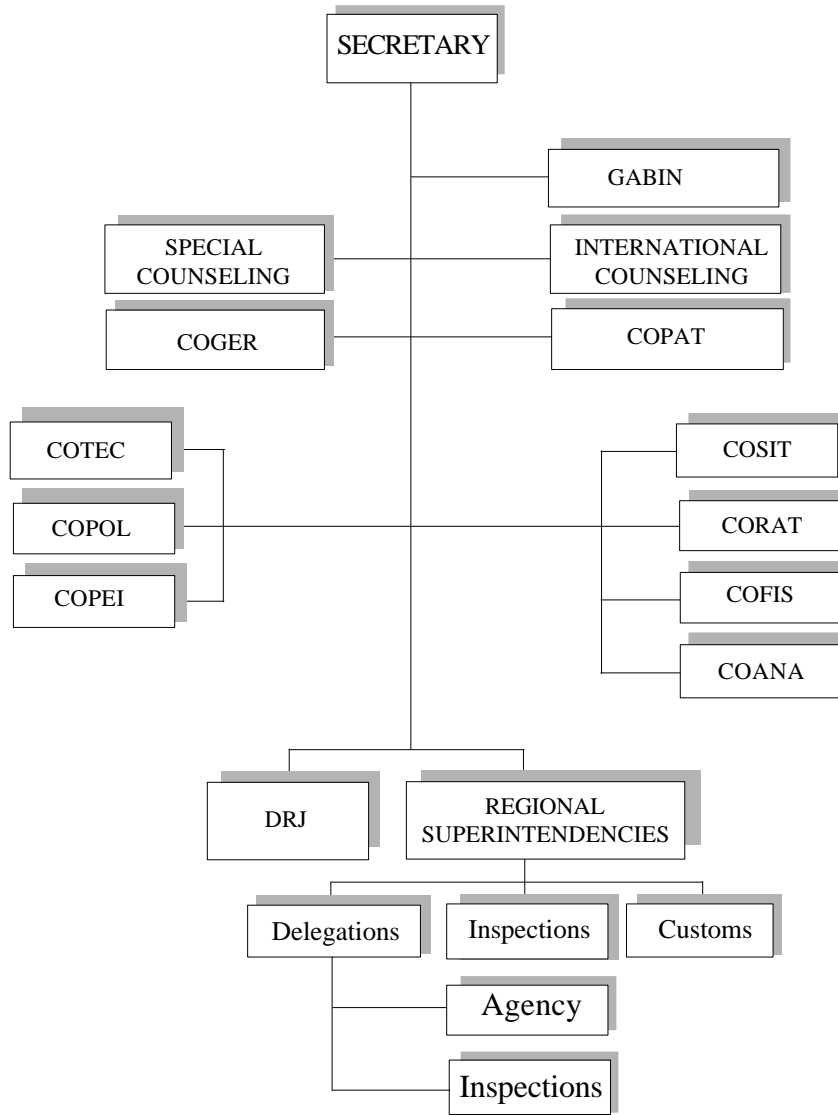
The Secretariat of Federal Revenues was established in 1968. This entity depends directly on the Ministry of Finance and is in charge of the administration, examination and collection of federal taxes.

The SFR is headed by the Secretary of Federal Revenues, assisted by four Deputy Secretaries. Directly subordinate to the Secretary of the SFR are the central units, formed by the direct counseling units and the specific activities units, the 10 Regional Superintendencies of Federal Revenues (RSFR) and the 18 Trial Delegations (RTD).

Direct counseling includes four units which, in general terms, carry out the following functions:

- Cabinet (Gabin): assists the Secretary in representing the institution, in the preparation and delivery of the file and in the relationships with the press, submits issues of interest of the SFR to the National Congress;
- Special Counseling (Asesp): assists the Secretary and his Deputies in juridical issues, examines and prepares proposals for agreements to be entered into between the Public Finances of the States and coordinates, programs activities and special works;
- International Counseling (Asain): coordinates the necessary actions for negotiating, entering into and applying international agreements of mutual administrative assistance, exchange of information of a tax and customs nature, as well as to avoid double taxation and prevent tax evasion; conducts and participates in the negotiations that deal with international taxation, and coordinates the activities of the tax and customs officials that are assigned to the Brazilian Diplomatic Missions or Consular Offices abroad;
- General Corrective Office (Coger): plans and coordinates, guides, executes, controls and evaluates the corrective internal auditing activities and other correction activities, promoting preventive and repressive actions relative to the ethics and discipline of the officials;
- Coordination of Tax Policies (Copat): carries out economic studies in relation to tax and customs issues; contributes to the formulation and evaluation of tax policies; coordinates technical cooperation between the SFR and national or foreign entities and with international organizations, in matters under its jurisdiction; elaborates and diffuses economic-tax/customs studies and statistics; elaborates and supervises the forecast and analysis of the taxes administered by the SFR; and represents the SFR before the Permanent Technical Commission of the ICMS (Cotepe).

Secretariat of Federal Revenues - SRF



The specific activities units comprise seven General Coordinations, namely:

- General Information Technology and Security Coordination (Cotec): formulates and coordinates the proposals of computerization policies and the activities that result therefrom; manages the information systems and contracts signed with the suppliers of computerization services;
- General Programming and Logistics Coordination (Copol): plans and coordinates the activities related to the organization, administrative modernization, budget, programming and financial execution, accounting, human, material and net worth resources;
- General Inquiry and Investigation Coordination (Copei): carries out inquiries and studies in relation to offenses against the tax order and exchange frauds, evaluates and controls reports related to tax unlawful actions and offenses against the tax order; and elaborates information to respond to requests from the countries with which Brazil maintains international agreements in matters under its responsibility;
- General Taxation Coordination (Cosit): plans and coordinates the taxation activities, interprets the tax and concordant legislation and provides normative orientation;
- General Tax Administration Coordination (Corat): plans, coordinates, orients, supervises, controls and evaluates the activities related to collection, classification of revenues, management of tax credit, taxpayer assistance and management of records, in addition to coordinating the activities dealing with institutional planning and evaluation;
- General Examination Coordination (Cofis): plans, coordinates, orients, supervises, controls and evaluates the activities involving the examination of taxes and contributions administered by the SFR, except that relative to foreign trade taxes;
- General Customs Administration Coordination (Coana): plans, coordinates, orients, supervises, controls and evaluates the activities relative to foreign trade, in addition to issuing normative orientation intended to standardize the customs procedures.

The SFR is divided into ten Fiscal Regions, represented by the Regional Superintendencies of Federal Revenues (RSFR), which are directly dependent on the SFR and within the limits of their jurisdictions, they plan, schedule, supervise, follow up, control and evaluate the activities involving taxation, collection and recovery, taxpayer assistance, examination, customs control, technology and security of information, programming and logistics.

The SFR has 18 Federal Revenue Trial Delegations (RTD), which within the limits of their jurisdictions try, in first instance, after the lawsuit has been established, the fiscal administrative processes, including those resulting from customs inspection.

Lastly, the SFR has:

- 98 Federal Revenue Delegations (DRF);
- 2 Federal Revenue Examination Delegations (Defic);
- 2 Tax Administration Federal Revenue Delegations (Derat);
- 2 Special Financial Institutions Delegations (Deinf);
- 1 Special International Affairs Delegation (Deain);
- 46 Inspections;
- 24 Customs Offices; and
- 357 Federal Revenue Agencies.

2. THE CREATION OF SPECIALIZED UNITS OF THE SFR

In 1998, the Secretariat of Federal Revenues (SFR) implemented specialized administrative units in economic sectors and in specific activities, through the creation of two Special Financial Institutions Delegations (Deinf) and the Special International Affairs Delegation established through Resolution N° 27 of the Ministry of Finance, dated February 16 of that same year.

On delimiting the geographical area of action of those specialized units, it should be noted that, of the ten fiscal regions previously mentioned, those with greater economic relevance are the 8th Fiscal Region – which corresponds to the State of Sao Paulo – and the 7th – which covers the States of Rio de Janeiro and Espiritu Santo. The Special Financial Institutions Delegations have their headquarters in the cities of Sao Paulo and Rio de Janeiro, with jurisdiction over the taxpayers of the 8th Fiscal Region and the 7th Fiscal Region, respectively. Currently, the Special International Affairs Delegation only has jurisdiction over the taxpayers located in the 8th Fiscal Region.

3. SECTORIAL SPECIALIZATION BY ECONOMIC ACTIVITY: THE SPECIAL FINANCIAL INSTITUTIONS DELEGATIONS (DEINF)

With the creation of the specialized Financial Institutions units, the Financial Institutions as such were comprised therein, as well as the other taxpayers that are part of the Financial System, such as:

- Commercial Banks;
- Multiple Banks;
- Investment Banks;
- Development Banks;
- Cooperative Banks;
- Federal Economic Funds [Savings Funds];
- Credit, Financing and Investment Corporations;
- Mortgage Credit Corporations;
- Savings and Loan Associations;
- Credit Cooperatives;
- Commercial Leasing Corporations;
- Mortgage Companies;
- Securities and Valuables Brokers;
- Securities and Valuables Distributors;
- Exchange Brokers;
- Goods Brokers;
- Investment Corporations;
- Representations of Foreign Banks;
- Securities, Goods, Futures and Related Exchanges;
- Administrators of Secondary Market;
- Settlement and Compensation Entities;
- Private Insurance Companies;
- Reinsurance Companies;
- Capitalization Companies;
- Private social security entities;
- Investment funds whose managing institutions have their headquarters in the Fiscal Region where the Special Financial Institutions Delegation has jurisdiction;
- Investment Clubs registered in institutions with headquarters in the Fiscal Region where the Special Financial Institutions delegation has jurisdiction;
- All other Financial Institutions that are part of the National Financial System;
- The Credit Recovery Companies (Factoring).

Nevertheless, there are companies that carry out similar or analogous activities to those carried out by the institutions of the Financial System that are not included within the jurisdiction of the specialized delegations. Even though directly related to the Financial System, the business carried out by these companies have characteristics that are similar to the operations carried out by other corporations devoted to trade and the rendering of services and therefore, their activities should not be examined by specialized units of the financial sector. They are:

- Financial intermediation:
 - Credit granting activities:
 - Consortiums management;
 - Credit cards management;
 - Corporate financing funds;
 - Other credit granting activities;
 - Financial intermediation activities:
 - Investment trusts;
 - Financial institution holdings;
 - Granting of licenses, purchase and sales, leasing of nonfinancial intangible assets, excluding copyrights;
 - Funds management for varied purposes, excluding investments;
 - Other financial intermediation activities.
- Health plans;
- Auxiliary activities of financial intermediation:
 - Management of valuables and securities portfolios for third parties;
 - Issuance of vouchers for food, transportation and the like;
 - Other auxiliary activities of financial intermediation.
- Auxiliary activities of private insurance and social security;
 - Insurance brokers and agents, private social security plans and health plans;
 - Insurance experts and appraisers;
 - Auditing and actuarial consulting;
 - Insurance club;
 - Other auxiliary activities of private insurance and social security.

3.1. Administrative structure

With the administrative jurisdiction related to those units, those taxpayers came to relate themselves to the federal tax administration exclusively through them. Its structure is, accordingly, similar to that of a conventional administrative unit, being formed by:

- Tax Orientation and Analysis Division (Diort)
- Tax Control and Supervision Division (Dicat)
 - Collection Network Control Section or Sector (Saarf or Soarf)
- Taxpayer Assistance Center (CAC)
- Examination Division (Difis)
- Fiscal Activity Programming, Evaluation and Control Section (Sapac)
- Information Technology and Security Service (Setec)
- Programming and Logistics Service (Sepol)

4. SECTORIAL SPECIALIZATION BY TYPE OF BUSINESS: SPECIAL INTERNATIONAL AFFAIRS DELEGATION (DEAIN)

Contrary to what occurs with the financial institutions, whose clearly delimited and relatively small universe allows for carrying out all the tax administration supervision activities in an administrative unit exclusively devoted to them, there is a series of activities or business relations that appear in ever greater number and increasing diversification in all sectors of the economy and which deserve the creation of a specific unit of the Secretariat of Federal Revenues - the Special International Affairs Delegation (Deain).

Specifically, and for purposes of administrative organization within the sphere of the SFR, considered as International Affairs are the following figures of the modern tax systems, or said in simpler terms, the following matters:

- transfer pricing operations between related individuals;
- international taxation; and
- customs valuation.

4.1. Transfer Pricing

For purposes of the legislation on income tax and also Social Contribution on Net Profits (CSGL), the deductibility of the costs of goods, services and import duties, and the recognition of revenues and benefits derived from export in operations carried out by an individual and/or corporation, with real or legal domicile in Brazil, with an individual or corporation with real or legal domicile abroad and considered related, an intermediary or even a resident in countries with favored taxation, would be subject to the transfer pricing rules.

In operations related to exports subject to transfer pricing adjustment, according to the terms of art. 19 of Law N^o 9.430 of 1996, income from exports would be determined according to one of the following methods:

- Selling Price on Exports Method (PVEx);
- Wholesale Selling Price in the Country of Destination, less Profit Method (PVMa);
- Retail Selling Price in the Country of Destination, less Profit Method (PVMe);
- Cost of Acquisition or Production Method, less Taxes and Profit (CAP).

The costs, expenses, charges relative to goods, services and duties, the evidence of import or acquisition documents, in operations carried out with a related person, intermediary or a person with real or legal domicile in countries with favored taxation, would only be deductible in the assessment of the real profit and the base for calculating the CSGL, up to an amount that does not exceed the price determined by means of one of these methods:

- Comparative Independent Prices Method (PIC);
- Reselling Price less Profit Method (PRL);
- Cost of Production plus Profit Method (CPL).

The legislation even anticipates the adjustment of transfer prices in relation to interest paid or credited to a related person, intermediary or a person with real or legal domicile in countries with favored taxation.

A country considered as having favored taxation is:

- that where no tax is paid on income or which is paid at a lower than twenty percent rate, or else,
- that whose internal legislation takes exception of anonymity with respect to the composition of corporations and their ownership.

4.2. Worldwide taxation

The benefits, earnings and capital gains obtained abroad will be calculated in assessing the real profit of corporations in the balance through December 31 of each year, as provided in the specific legislation.

Starting on October 1st, 1999, profits earned abroad will become the base for calculating the CSGL.

Starting on January 1st, 2002 - the modifications introduced through Complementary Law N° 104 of 2001, which added § 2^o to art. 43 of Law N° 5.172 of 1966 (CTN), authorize the law to set the conditions and the occasion on which revenues and benefits originating abroad will be available. Also, in accordance with the provisions of articles 21 and 74 of the Provisional Measure N° 2.158-35/01 – the profits obtained by the controlled or affiliated company abroad, will be considered available in Brazil, on the date of the balance in which they would have been earned abroad, regardless of its effective distribution.

4.3. Customs valuation

Considering that customs administration is included within the functions provided in the Internal Regulations of the SFR and that the application of taxes on foreign trade is directly dependent on the value attributed to the goods negotiated in those operations, with the adjustments anticipated in the Customs Valuation Agreement of the World Customs Organization (WCO), included among the purposes of the Decree were fiscal procedures in the area of customs valuation, in order to verify their application in international agreements on the subject.

4.4. Overlapping of jurisdictions

Given the previously mentioned definitions of International Affairs and for purposes of clearly assigning the activities that correspond to each unit, the Deain is in charge of examination activities regarding transfer pricing operations between related persons, international taxation and customs valuation, examination of technology and security of information and programming and logistics, as well as activities dealing with planning, organization, modernization and human resources, within the limits of its jurisdiction.

On the other hand, it would seem clear that specialization by type of business presupposes carrying out the tax administration's supervisory activities in traditional administrative units, with the specialized unit being in charge only of matters to which it is closely linked.

Since practically all taxpayers may carry out businesses requiring consideration at the level of International Affairs and, on the other hand, the great majority of operations and businesses of said taxpayers fulfill the characteristics usually comprised in the supervision by the traditional administrative units, it is neither interesting or feasible to transfer the jurisdiction of all the taxpayers located within a certain geographical region to assign them to a specific unit.

In geographical terms, the Deain's jurisdiction corresponds to the country's most economically important region – the 8th, which comprises the State of Sao Paulo – and complements the supervisory activity of the 22 Delegations of the Secretariat of Federal Revenues existing in the State, which act jointly with the taxpayers of said Fiscal Region, by handling other tax issues.

4.5. Administrative structure

In view of the limited scope of its functions, the Deain is administratively structured according to the following modality:

- Tax Administration Division (Divat)
- Examination Division – Transfer Pricing (Difis/PT)
- Examination Division – International Taxation (Difis/TBM)
- Examination Division – Customs Valuation (Difis/VA)
- Fiscal Activity Programming, Evaluation and Control Service (Sepac)
- Technology, Security of Information and Logistics Service (Setel)

5. SPECIALIZATION: INSTRUMENTS AND BENEFITS

5.1. Admission of officials in the Specialized Units

In the case of the Brazilian federal tax administration, the establishment and consolidation of the specialized units took place by means of a process that covered several stages. Initially, following the creation of the new administrative structures and the appointment of the respective managers, an internal selection process within the decentralized units of the SFR, to identify the officials whose profile corresponded to the activities to be carried out in the new units.

Such officials were selected on the basis of their academic training, professional experience prior to joining the SFR, experience in carrying out fiscal procedures in their respective unit, in relation to matters of interest of the specialized units and prospects for professional growth in that area.

New auditors in the specialized units are selected through internal routine processes, by analyzing the curriculum vitae of the candidates registered for such process. This ensures – at the national level – the motivation of those selected and affords equal opportunities to those interested.

5.2. Training of officials

After placing the auditors in the respective organizational areas, according to the previously described administrative structure, it is possible to specifically train them for the activities to be assigned to them. At the SFR, this is achieved through internal training, promoted by the institution itself, which may resort to the support of the School of Finance Administration (Esaf), an entity that is also part of the Ministry of Finance's structure.

In addition to internal training, external training is also promoted for specific purposes and is carried out by public or private institutions, in order to provide adequate working conditions to the auditors, in a highly technical and complex environment.

Based on a policy of human resources high quality training, post graduate courses – university extension, master's and Phd degrees – are also offered. These are carried out at institutions established in the country or abroad.

5.3. Systematization of activities

The activities carried out by the SFR's administrative units for achieving its objectives, especially in the sphere of Federal Tax and Contributions Examination are structured and documented through several instruments that allow for obtaining a homogeneous technical model for those activities.

The basic concept is that the tax administration actions should not differ, depending on which unit or jurisdiction or auditor undertakes the examination, for example.

The main instruments for systematizing those activities are:

- Orientation manuals for examination: these are manuals indicating the audit procedures that are to be carried out in relation to each tax, based on the legally anticipated hypotheses, and indicating the elements to be verified and evidence to be produced, if appropriate.
- Computerized systems to support fiscal activities: these are tools, projected and implemented by the SRF's central administration with the participation of officials working in the decentralized units who assist the officials in carrying out the activities for which they are responsible. The main tools are devoted to:
 - selection of taxpayers to be examined
 - generation of files on digital media
 - auditing on digital media
 - preparation of record of violation
 - control of fiscal activities
- Internal training, especially with the use of Intranet/SIF: through the dissemination of the Web technology, whereby it is possible to format training according to the administration's needs, dynamic and updated training on fiscal activities may be carried out. Such training may be carried out "on demand", or, that is, when a certain official requires specific training in relation to some topic, he may access a digital classroom to obtain the required knowledge at a rather reduced cost for the tax administration.

5.4. Coordination at the national level

The General Examination Coordination (Cofis), plans, coordinates, orients, supervises, controls and evaluates the activities involving the examination of taxes and contributions administered by the SFR – except for those relative to foreign trade. Its administrative structure includes the Financial Market and International Affairs Division (Dimei), which is not only in charge of supervising and coordinating the work carried out in relation to the taxpayers comprising the Financial System and those relative to transfer pricing and international taxation, but also to promote the dissemination of its results.

Currently, the General Customs Administration Coordination (Coana), which plans, coordinates, orients, supervises, controls and evaluates activities related to foreign trade – and which must also issue the normative orientation intended to standardize customs procedures – also counts on the Customs Valuation and Customs Inspection of Textiles Division (Divam), whose task is similar to that of Dimei, although centered on customs valuation procedures.

5.5. Benefits for the other SRF units

As already indicated, the geographical delimitation of the action of the two specialized units into financial institutions and the specialized International Affairs unit, only covers two of the ten fiscal regions existing in Brazil.

Although there is no doubt that these specialized units cover a quite significant segment of the Brazilian economy, especially in the financial sector and in operations dealing with international affairs as previously described, the fact is that there are still many taxpayers and many operations also requiring supervision from the tax administration which are outside the geographical jurisdiction of the Deins and the Deains.

As it occurred prior to the creation of the specialized units, in the other fiscal regions, the Delegations of the Secretariat of Federal Revenues are in charge of fiscal activities related to financial institutions and international affairs. But even so, the benefits of the establishment of the specialized units are clearly evidenced.

Topic 2.1

As described in item 5.4, there are several instruments that systematize fiscal activities. The results are twofold: on the one hand, systematization affords the auditors of the specialized units, the technical knowledge base for carrying out their activities; and on the other, it gives them the opportunity to record and disseminate the knowledge and experiences acquired in those units.

In this way, the knowledge produced by the specialized units is consolidated and disseminated to the other administrative units of the SRF, which use them for carrying out fiscal activities related to matters that are constantly dealt with by the Deins and the Deains.

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Case study

TOPIC 2.2

FRENCH TAX AUDITS OF COMPUTERIZED ACCOUNTS

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I. PREAMBLE – TAX AUDITS IN FRANCE

In 2002, the General Tax Directorate’s 2,700 general auditors conducted 45,500 accounts audits throughout the French tax fabric from very small enterprises to the largest international groups. These audits compared the sums entered in the accounts with those declared annually to the tax administration.

Of these 45,500 audits:

- 500 audits were assisted by an IT auditor [Computerised Accounts (CA) auditor] who audited the juridical, economic and accounting organization of the business, as well as the computerized organization and the progress of data from the economic event that generated it to its inclusion in the accounting and fiscal statements.
- At the same time, 375 audits were conducted by general auditors, who rounded out their traditional legal-balance sheet approach with an IT approach using audit software well-known among external auditors: the ACL software program.

These tax audits called in a total of €8.157 billion accounting for 3.6% of French tax revenues. Therefore, these figures show that only 2% of the tax audits were conducted using both a legal approach and an IT approach.

Thus far, the evident evolution of the data processing occurred during the last years has generated two significant phenomena

- ⇒ *Financial accounting is increasingly incorporated into businesses' integrated electronic data processing systems and is now nothing more than a by-product assembling and centralising the results of other applications (management, production, stock control, etc.). Automatic processes can quickly process a considerable volume of data and allow for unlimited operations to create, alter, delete, copy, select, extract and add to accounting data;*
- ⇒ *The use of computerised accounts is no longer the privilege of the largest companies. Most of the businesses audited now have computerised accounts, including the VSE/SMEs that use accounting software packages distributed on the market by software editors established worldwide.*

A preliminary analysis of the products representative of the French market has revealed that these *accounting programs are somewhat lax. The basic accounting principles can be evaded and manipulations prohibited by the accounting rules can be made even though the statements produced by the software appear to be sincere and regular.*

At the same time, information from the legal and investigation departments has brought to light that *billing and payment software* designed to record sales in cash *can be fraudulently manipulated to relatively easily hide a proportion of turnover.*

There is an extremely *wide range and spread of events that can generate accounting entries* whereas the intangible, integrated and reversible nature of accounting offers businesses *tremendously flexible ways of making accounting entries.*

Businesses' IT systems can therefore no longer be ignored.

Given that the chosen IT organisation often reflects the firm's economic organisation, *the IT approach to the audit complements the traditional legal-balance sheet approach. It provides the means for a high quality audit and re-establishes the balance of resources between the audited and the auditor,* in particular by enabling the administration to use IT for audits.

These two traditional and IT approaches are now complementary since:

- ⇒ The analysis of the IT system is used to *understand how the business is organised and run,* to make an internal audit reliability diagnosis and to detect risk areas.
- ⇒ The IT tool *exhaustively processes* entire sets of *data* to obtain *accurate findings,* hence limiting the risks of dispute associated with all sampling methods.

However, don't make the mistake of thinking that all general auditors can acquire sufficient IT skills to conduct computerised accounts audits. This should remain the responsibility of auditors specialised in IT or general auditors who wish to diversify their audit procedures and have IT knowledge of their own or a natural disposition and curiosity that would enable them to incorporate a new parameter into their audits. Not all general auditors can be expected to do this. Moreover, the investment in terms of equipment and training is substantial and should be reserved for these "hybrid" auditors.

French resources for this type of work have followed the development of society's computerisation in general. These organisational and legal resources can be summed up in four steps:

- ⇒ IT experts working in *Computerised Accounts Audit Units (CAAs)* since 1982, when the first unit was created. These units concentrate mainly on auditing large account businesses.

- ⇒ *A specific legal framework* to allow for computerised accounts audits and penalise poor practices.
- ⇒ *Specialised general auditors working on the ACL program since 2000*, when the General Tax Directorate acquired 300 licences. These auditors have hence broadened their areas of investigation, thereby improving efficiency.
- ⇒ *A new step to give all general auditors*, especially those working on the VSE/SME segment, a methodology for assessing the regularity of accounts kept on mass market accounting software packages and the sincerity of the statements produced by cash sales software.

II. THE LEGAL FRAMEWORK FOR THE COMPUTERISED AUDIT

Article 103 of the Budget Act of 1990 defines the applicable computerised accounts auditing rules and, in particular:

- ⇒ *The nature and scope* of the information subject to the right of audit;
- ⇒ *The archive-keeping obligations* binding on businesses;
- ⇒ *The audit procedures* for accounts kept on computerised systems;
- ⇒ *The penalties* incurred by businesses that do not allow the audit to be conducted under the conditions provided for by the law.

The provisions introduced by the Budget Act of 1990 concern all taxpayers who keep their accounts on a computerised system.

1) The nature and scope of the audit – the obligations to keep archives

The administration's audit covers the information, data and data processing used *directly or indirectly* to the construction of the accounting or fiscal results and to the preparation of fiscal returns, i.e. the elements of information on the IT system, as well as the routine operations conducted to process these elements (data entry, sorting, editing, etc.). Businesses are hence bound to keep all raw data (i.e. not processed or aggregated) on a computer medium along with the programs and associated documentation for a *period of three years*.

2) The audit procedures

Taxpayers can choose one of three methods for the analysis of their business' data:

a) Analyses conducted by the auditors on the business' equipment (8%):

When, pursuant to the legislation, officials conduct audits on the equipment used by the taxpayer, the taxpayer takes all the necessary measures to preserve the integrity of the data and the security of the hardware and software.

b) Analyses conducted by the business (61%):

Taxpayers may ask to conduct all or part of the analyses required for the audit themselves.

The officials responsible for the audit must provide written specifications explaining the nature of the work to be done and the deadline, in keeping with the constraints inherent in the running of the business.

c) Analyses conducted off the business' premises (31%):

Taxpayers may ask for audits not to be conducted on the business' equipment. In this case, they are bound to provide the auditor with a copy of the documents, data and analyses that the auditor has requested to carry out the audit. These copies are made by the taxpayers themselves or by a service provider. The copies must meet certain technical standards laid down by order.

The taxpayer is informed, in an oral and adversarial debate, of the means that the auditor used to analyse these copies and audit the elements contained in the tax return: programs, conditions for conducting the analysis or analyses and any computerised documentation created for this purpose.

The copies are returned to the taxpayer at the latest before the notice to pay is issued. The administration retains no duplicates of the copies of the documents sent to it.

3) The penalties incurred

The tax bases are assessed by the tax administration in the event of opposition to the implementation of a computerised accounts audit.

This procedure applies when IT audits prove to be impossible or impracticable, in particular when:

- The choice expressed by the taxpayer makes it impossible to conduct the audit of the data or analyses for technical or practical reasons;
- The data are not available to conduct the audit;
- The data are available, but the audit cannot be completed due to circumstances attributable to the business' organisation.

This procedure is exceptional and entails heavy fines. It is applied in just a few cases every year.

III. THE COMPUTERISED ACCOUNTS AUDIT UNITS' TASKS

The CAAUs were created in 1982 and now have 72 computerised accounts auditors working in *nine units*. These units report to the National and International Tax Audit Directorate. They have *national jurisdiction* and are briefed to assist audit departments throughout the French territory. They are made up of:

- ⇒ *General auditors* trained in IT and holding the qualification of *computer engineer analysts as issued by the Ministry of the Economy, Finance and Industry*; and
- ⇒ *Computer engineers* who have received additional training in taxation, accounting and auditing.

The in-house training plan is designed to generate a combination of three occupations: computer engineer, tax inspector and tax auditor. It guarantees that the CAAU auditors have high-level technical skills.

The assistance tasks assigned to these experts are in keeping with the goal of *auditing the information systems* when auditing large companies.

It is part of a CA auditor's job to *report on the tax-related reliability of the audited company's IT system* and, where necessary, to conduct or have

the company conduct the analyses required to put a figure to those anomalies found that are likely to result in an additional tax assessment. The CAAUs' assistance to the general audit units mainly covers three types of complementary actions:

- ⇒ *Audit of compliance with the legal framework that legally justifies and authorises the use of the IT tool for audit purposes in practice;*
- ⇒ *Audit of the business' IT system;*
- ⇒ *Use of the IT system for the audit.*

Audit of compliance with the obligations specific to keeping computerised accounts

The aim of the CA auditor's investigations is to promptly provide the auditor with as accurate as possible an overview of:

- ⇒ The business' IT environment;
- ⇒ *Its situation with regard to its obligations to archive data and IT documentation.*

The audit of the business' information system

CA auditors check the business' information system either in a general manner by examining the entire system or in a more targeted manner limited to certain specific processing chains.

In all cases, they analyse the audited business' information system taking into consideration two types of risks:

- *Inherent risks*, i.e. specific to the nature and type of business audited (socio-economic category, line of business, etc.), which in principle they examine with the general auditor;
- *The risks associated*, where applicable, with *the poor nature or absence of in-house audit procedures* normally supposed to guarantee the reliability of the data analyses.

Their audit approach is hence as follows:

- Firstly *check the quality and reliability* of the data entered into the IT system;

- Then *assess the extent of confidence in the procedures, management rules and algorithms* applied to these data in the process leading to the formation of the declared income.

The CA auditors liaise with the general auditors to define the audit strategy to be implemented and specify, usually as they progress with their detailed investigations, the paths they intend to explore and those they plan to drop, based on the materiality thresholds decided on with the general auditor.

Use of the IT tool for the audits

Based on the courses of investigation that the general auditor has set them or that they themselves have identified during the system audit, the CA auditors can use the IT resources to:

- Conduct conformity tests with a view to testing the IT procedures;
- Carry out various checks to establish the materiality of the presumed risks;
- Conduct IT analyses to put a figure to the anomalies or deviations, based on which the general auditor will issue any additional tax assessment that needs to be made.

These tests and analyses consist, depending on the case, of:

- ⇒ *Conducting searches and extracting data* based on a specific criterion,
- ⇒ *Checking or reconstructing a calculation,*
- ⇒ *Looking for contradictions* and evaluating the deviations observed by means of crosschecks.

To conduct the data processing required for the audit, the CA auditors use, *depending on the taxpayer's choice* (Article L47A of the Book of Tax Procedures):

- ⇒ *The business' IT resources* for work to be carried out either by the taxpayer himself or by the CAAU;
- ⇒ *The administration's IT resources* when the taxpayer provides copies of the files.

What results are produced by the CAAU work and how are they taken into account?

Depending on the assignments they are given, the CAAU investigations give rise to:

- ⇒ A comprehensive *inventory* of the information and data available on the IT system studied;
- ⇒ A *diagnosis of the system's tax-related reliability*;
- ⇒ The *detection of any flaws* in the information system that will be subject to investigation by the inspector;
- ⇒ *Quantification* of the detected anomalies likely to result in *additional tax assessments*.

In all cases, the general auditor is informed of and takes into account the additional tax assessments that can result from this work.

Although the general auditor and his computer engineer colleague should *closely liaise* throughout the work, *the department in charge of the audit* always has sole responsibility for the smooth running of the audit and *retains total control over the operations*.

What form do the CA auditors' findings take?

In general, when analyst auditors have finished their assistance work, they send the requesting department an *Internal Memorandum* containing their own conclusions, in which they present their approach and detail the investigations they have conducted.

They also draw up, *for inclusion in the notice of additional tax assessment*:

- ⇒ The *technical reasoning* justifying the additional tax assessments for which the CAAUs have helped establish the grounds;
- ⇒ The *description of the analyses* that detected and/or put a figure to the additional tax assessments to be notified;
- ⇒ And the statement of breaches found *if the audited business does not comply with its data archiving and IT documentation obligations*, with specification of the penalties incurred.

Results of CAAU action

The CAAUs conduct some *450 to 500 audits every year*, mainly in mid-size and large businesses. The work by the CA auditors provides the grounds for at least one additional tax assessment in two-thirds of all cases. The comprehensive nature of the analyses conducted guarantees accurate calculation of the envisaged additional tax assessments. Consequently, the work carried out is based on a foundation that the audited businesses cannot challenge. The rate of disputes over CAAU work following an on-the-spot audit therefore remains marginal to date.

IV. THE GENERAL AUDIT UNITS' COMPUTERISED AUDIT ACTIONS

In view of the growing computerisation of accounts by VSE/SMEs, the General Tax Directorate felt it necessary to set in motion a quality approach by providing the traditional audit services with computerised auditing resources.

The IT assistance resources provided by the expert CAAU auditors are not enough to answer the diversity of questions encountered by general inspectors during their audit work. Moreover, the direct use of files means that inspectors do not have to re-enter data and that a more comprehensive approach can be achieved that, contrary to the practice of sample-based investigations, lends a high level of reliability to the reported findings.

By fostering a greater use of computer audits for all audited businesses, the development of IT skills among general inspectors looks set to improve the diversity of their audit actions, broaden their areas of investigation and hence generate efficiency gains.

1. The development of IT audits

In 1999, an experiment was conducted with a range of audit software particularly well suited to reading accounts files regardless of the volume to be handled and the data coding system. This product assessment phase concluded with the drawing up of specifications and the signing of a public procurement contract, with the ACL (Audit Command Language) program being selected from the different suppliers' bids for tender.

In 2000, the DGI acquired 300 licences, which were redistributed to the various audit services. The CAAU computer engineers each received a program.

In support of this action, the CAAUs were asked to develop training for general auditors likely to use this new tool. These training sessions are compulsory for all general auditors interested in using the ACL tool. Training is provided in two phases:

- ⇒ *A methodological module on audits in IT environments* to discover the IT organisation of the businesses, guide the investigative approach based on the tax focuses chosen and process the information subject to the right of audit;
- ⇒ *Two hands-on ACL software initiation sessions* focusing mainly on using the functions offered by this tool following the file recuperation phase on the businesses' premises.

2. The organisation of the network of specialised auditors

When the ACL audit software was put into use in the general audit units, the decision-makers for all the structures concerned had to resolve the following question: Was it better to form specialised groups made up of a few inspectors or to provide software to auditors interested in using new tools within the units?

The National and International Tax Audit Directorate (DVNI) immediately opted for this second solution. The 30 specialised auditors working on the ACL tool are assigned to general audit units with a breakdown by professional area to ensure a more even spread of IT resources.

Nevertheless, this computerised audit mechanism based on the IT skills of isolated specialised auditors cannot go on without an experience-sharing network, in particular to encourage the circulation of details of innovative investigations. Moreover, the general auditors who have put a lot into working on the ACL program sometimes need guidance to more quickly respond to the technical questions encountered when reading the data.

This is why the DVNI set up a committee called the DVNI ACL Club in November 2000. The aim of this club is to provide active support to any IT initiative by the general auditors. It is open to all ACL software users.

It promotes experience sharing and draws on the expertise of the CAAU auditors to smooth the way for the specialised auditors. Fact sheets as well as examples of file analyses help to simplify the general audit units' IT investigation work.

In 2003, a DGI dedicated ACL Intranet site was made available to all auditors to provide information on the tool's advantages and pool knowledge on interesting practices in terms of investigative methods and results.

3. Specialised auditor practice

Specialised auditors always conduct their work in a number of phases:

- ⇒ *Work in the business to find out about its IT organisation* and the different computerised tasks situated upstream of financial accounting and hence detect the sensitive files liable to give rise to full investigations on billing, stock management, provisions, etc.;
- ⇒ *Request for a copy of the files to be provided* on a medium belonging to the audited business, in compliance with the procedure laid down by the tax provisions;
- ⇒ *Data processing on the administration's equipment using the ACL tool*, which offers a secure work environment in this area (original files preserved intact) along with many functions: sort, extract, stratify, etc.;
- ⇒ *Analysis of the findings following IT processing in liaison with the business* and explanation of the confirmed deviations in an additional tax assessment notification;
- ⇒ *Return of the copy of the files* initially supplied by the business, with the audit service retaining no medium containing the audited business' data.

The approach taken by the specialised auditors depends on the attitude of the audited business, which may not wish to supply copies of its files. Moreover, these copies should comply with certain technical standards defined by order if they are to be analysed under ACL.

Note, in this regard, that disputes concerning the determination of taxable amounts based on IT analyses are extremely rare. The standard of quality generated by an exhaustive IT analysis of the business' data

makes it impossible to dispute the sums notified, and disputes refer mainly to the procedure followed by the audit services.

When the choice is left up to the audited business, SME/SMIs tend to opt for providing the administration with a copy of the files. In this case, the tax administration bears all the costs of the IT analyses (IT and intellectual resources). This mechanism saves SME/SMIs the costly intervention of a computer service firm, since medium-sized enterprises rarely have this IT resource in house.

V. THE SPREAD OF THE COMPUTERISED AUDIT

1) Observation

The use of computerised accounts is no longer a privilege of the largest companies. Most audited businesses now keep computerised accounts on a computer network or PC using accounting software packages distributed on the market by software editors established worldwide. These mass-market products with a unit value of no more than €1,000 are widely used by VSE/SMEs.

A preliminary analysis of the products representative of the French market shows that *these accounting programs are somewhat lax.*

The basic bookkeeping principles can be evaded and manipulations prohibited by the accounting rules can be made even though the statements produced by the software package appear to be sincere and regular. In other words, it is extremely hard for a general auditor to suspect this type of irregularity based solely on an examination of the accounts documents produced by the software package and presented during the audit without having made an IT analysis of the file of accounting entries.

At the same time, information from the legal and investigation departments has brought to light that *billing and payment software* designed to record sales in cash can be fraudulently manipulated to *relatively easily hide a proportion of turnover.* This software is generally installed on cash transaction systems and is therefore disconnected from the accounts and operates independently. It is more often than not dedicated to a socio-professional sector and generally offers dishonest users hidden functions that they can use, among other things, to:

- *Automatically reduce the sum of income received* without ultimately leaving any trace in the accounts, but providing a coherent distribution of payment methods (cash, cheques and credit cards) to smooth out anomalies symptomatic of the intentional reduction of taxable income;
- *Present to the auditors altered invoices* that appear to be totally regular.

As with the accounting software, *classic audits by general auditors come up against the problem of the apparent regularity of the accounts*. In addition, fraudulent adjustments are made in a way that does not strongly compromise the profits declared by the business so as not to affect the profitability indicators.

In view of these circumstances, the DGI's operational services were asked to conduct an IT expert assessment to:

- Define a methodology for accounting software packages able to be used by the auditors to assess the reliability and sincerity of the accounts presented.
- For the billing and payment software, determine the existence of any computer traceability of changes made by the implicated software.

Two courses of action were hence taken:

- An in-house *technical expert assessment of four accounting software packages*;
- Co-ordinated investigation and audit department fieldwork to determine *whether fraudulent operations could be traced*.

2) Expert assessment

a. Expert assessment of four accounting software packages

An analysis of the leading software sold on the French SME and VSE market showed that software *designers*, who prioritise the user-friendliness of their software, do not always provide for computer locks to make users comply with the accounting and tax rules in force.

Moreover, *users* are often unaware of these rules and breach them unwittingly, generally without weighing up the risks run in the event of

an audit. The IT audits conducted in this business category also show that VSE/SMEs find it extremely hard to comply with the legal framework governing computerised bookkeeping.

The first tests made for example revealed:

- ⇒ *The alteration or deletion of accounting entries* in breach of the irreversibility of such entries;
- ⇒ *The absence of closure or the re-opening of a closed period*, likely to make the accounts presented irregular and incoherent.

The expert assessment detailed the failings found and described as such in the technical guides drawn up for the purpose, and this for the accounts management and sales management modules.

b. Billing and payment software

Based on a list of reported software, *tax searches followed by on-the-spot audits* were conducted in the catering and hairdressing sectors. The searches carried out in partnership with the CAAUs seized payment files before and after fraudulent manipulation. The implicated software was also seized at the same time.

The findings revealed the lack of traceability of the alterations made. In general, this software proved extremely opaque in terms of both management reports and file formats. The work carried out for this expert assessment revealed an insidious and swift propagation affecting all socio-professional sectors, but more particularly the service sector.

This phenomenon is especially hard to stamp out since it is impossible for a classic audit to find fraudulent alterations.

3) In-house plan of action

a. Accounting software packages

In addition to preventing risks and simplifying archiving rules, the task of the auditing staff should be made easier. Moreover, relations with the audited businesses will be improved by reducing the lead times for work done on the businesses' premises if they have set up the recommended accounts storage mechanisms.

The auditors are faced with all types of problems as regards accessing the computerised accounts and especially assessing their regularity and cogency. Consequently, the recommendations to professionals regarding keeping computerised accounts (see below) will also probably facilitate relations between the audited businesses and the auditing services by simplifying access to information and the provision of the data required to examine the accounts. Businesses will find it easier to meet the administration's requirements without having to call on external assistance.

At the same time, it is recommended to raise auditor awareness of the importance of critical analyses of computerised accounts to prevent their coming to any hasty conclusions about presumed IT risks, which could lead them to envisage rejecting the business' accounts. The assessment of the accounts' sincerity and cogency depends on the ability to detect IT anomalies and assess their real impact on the accuracy of the accounts presented.

As mentioned above, with the four assessed programs representing 40% of the market, it seemed logical to use the failings found and described as such in the technical guides drawn up for the purpose to develop a generic audit approach able to be used for all accounting software. This method was introduced at the beginning of 2004 with training for all auditors to familiarise them with the shortcomings of accounting software packages and infringements likely to be detected and penalised. These training sessions based on the legal framework governing computerised accounts are broken down into two phases:

- ⇒ *A one-day session to raise awareness of the computerised accounts audit principles* by recapping and illustrating the investigation methods authorised by the legislation in force regarding breaches of the irreversibility of accounting entries;
- ⇒ *A three-day session on audit methodology applied to computerised accounts* to provide general auditors with an investigative approach tailored to computerised environments and more specifically to the accounting software packages used in the VSE/SME sector.

The aim of these training actions is to familiarise auditors with the accounting and tax risks involved in using accounting software packages on a daily basis while providing much-needed information on the methods of access to information, data and data processing authorised by the legal framework.

b. Software exposed to the risk of fraud

The priority aim should be to contain the spread of software able to be used for fraudulent purposes.

The expert assessment of software exposed to the risk of fraud and the analysis of the conditions whereby they are widespread in certain activity sectors show that the administration is relatively powerless to prove actual use of suspicious functions and evaluate their financial consequences when conducting audits, without using sizeable human and procedural (tax searches) resources. Two courses of action should be taken from this point of view:

- *Prevent the propagation of software exposed to the risk of fraud by setting up a monitoring group to centralise information from the audit and investigation departments and outline the risk profile of the associated software. This group would also provide the audit services with methodological assistance on a dedicated Intranet site;*
- *Crack down on the use of software exposed to the risk of fraud. Some software editors intentionally market software that can be used to conceal earnings. When the DGI audits a user of such software and finds evidence of this, the editor in question (more often than not informed by his customer) is prompt to erase all trace of fraudulent use in the other businesses using the same software. Moreover, regardless of the sector, the fraud always concerns a relatively small proportion of turnover to thwart any detection of the concealment of earnings and undermine any traditional income reconstruction method.*

Given these circumstances, steps should be taken for an ad-hoc steering committee to develop a strategy based on targeted actions, including the implementation of tax search operations followed by on-the-spot audits and aiming to impose sanctions on any fraudulent cases found.

4) External plan of action and communication

a. For businesses using accounting software

In the first place, it was deemed that there was no need to amend the existing regulations on keeping computerised accounts. Accounts, whether manual or computerised, can actually be rejected in the event

of an audit if the auditor considers them to be irregular and incoherent. However, the framework governing the use of accounting software needs to be reformed to give businesses a *clear and definite framework* so as to protect those businesses using accounting software packages from any controversy with the administration.

- Clarification of the mechanism guaranteeing a regular use of computerised accounts acceptable for tax purposes entails, for example, guaranteeing the irreversibility of the statements of accounts produced and guaranteeing them a definite date via use of closure procedures;
- Simplification of the archiving methods with the presentation of tax backups on a non-rewritable IT medium that the auditor can use with an ACL-type audit program. Businesses could hence dispense with all paper archives.

b. For the businesses that design accounting software

The recommendations made concern the accounting rules. Based on the best practices found, they aim to:

- Provide editors with a secure framework that they could use as a marketing argument with their customers by introducing functions designed to ensure that all accounting entries and invoices are taken into account by guaranteeing, for example, sequential numbering and their irreversible incorporation into the accounts.
- Prohibit certain functions that could be used to alter or delete an accounting entry or alter closed accounts.

Nevertheless, the tax administration has no plans to introduce a software certification process.

c. For the businesses that design billing and payment software

The priority aim should be to contain the spread of software able to be used for fraudulent purposes. This is why steps should be taken to:

- *Raise the awareness of designers* and users of software exposed to the risk of fraud by informing them of the risks of penal sanctions to which they are exposed;

- *Recommend the use of a trace file* to preserve the user friendliness of cash transaction software, especially for correcting errors, but keep the log of operations.

VI. CONCLUSION

The use of computerised accounts is no longer the privilege of the largest companies. The level of intervention by CA auditors from the computerised accounts audit units and auditors working on audit software is no longer sufficient to deal with the widespread use of IT in businesses.

France has hence adopted a *proactive approach*:

- *The rules for keeping accounts on IT media have been clarified* by transposing, on the basis of established law, the obligations associated with keeping paper accounts. Designers and users of accounting software packages have been informed of the risks they run in the event of non-compliance with the rules, which could lead to the rejection of accounts.
- *Training has been set up for all tax audit players* to enable auditors to efficiently conduct their auditing task when faced with an IT environment.
- Last but not least, the creation of a *steering committee* will enable an overall strategy to be implemented to curb the propagation of fraudulent software by means of monitoring by the group created for this purpose.

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Case study

TOPIC 2.3.

SPECIFIC INFORMATION REQUIREMENTS – BOLIVIA’S EXPERIENCE

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*CONTENTS: 1. The Importance of Information in the Examination Function.-
2. Information Management.- 3. Tax Intelligence.- 4. Case Selection.-
5. External Information Requested from Large Taxpayers.- 6. Other
External Information Requested.- 7. Project for the Request of External
Information.- 8. Operations Performed with the Information Obtained.-
9.- Results Obtained from Operations.- 10. Conclusions.*

SUMMARY

The Examination area of Bolivia's Tax Administration has defined as part of its strategic planning to base its work on the processes of the Tax Intelligence Department.

Tax Intelligence is an activity directed towards the economic-fiscal analysis, to the study of fraudulent behavior and the definition of the corresponding course of action. Analysis and studies performed allow the establishment of efficient control strategies regarding the taxpayers' compliance with their tax obligations.

Internal and External Information are two of the most important instruments of Tax Intelligence, both provide all the necessary information so that the Tax Intelligence may perform all previously mentioned analysis and studies. On the other hand, Tax Intelligence based on determinate investigations establishes the requirement that any Company, association, institution or person has to present to the Tax Administration certain information that will then turn into External Information.

Large Taxpayers are the main suppliers of External Information, the Bolivian Tax Administration currently has 1,835 taxpayers classified as Large Taxpayers (GRACOS, in Spanish) y 85 taxpayers classified as Principal Taxpayers (PRICOS, in Spanish), both, represent 0.7 % of the total of our Register.

However, this 0.7% represents 76% of the annual collection of our Administration, of which 56% corresponds to Large Taxpayers and 20% to Principal Taxpayers. These, due to their importance in the economic movement of the country have sufficient information, not only to be themselves efficiently controlled but also control the rest of the taxpayers.

The information that the Bolivian Tax Administration currently has and which is provided by these taxpayers is the following: Purchases and Sales performed during each period (month), External Audit Opinion, Credit Card Transactions, Electric Power Consumption, Clinics and National Customs that has turned into the main information provider in everything pertaining to foreign trade transactions.

Furthermore the Tax Administration has three projects for the request of External Information, initially from Large Taxpayers, these will be implemented in the short term: Financial Statements, Inventories and Information on Production Processes associated with the Specific Consumption Tax.

With all the information requested and received the Bolivian Tax Administration has generated a series of operations by cross referencing information enabling it to cover a large amount of items of Bolivia's economic activities, such as: Purchases Informed versus Sales Declared, Duplicate Fiscal Notes, Observed Fiscal Notes, Sales Declared versus Sales Informed by Credit Card Administrators, Services Declared by Customs Dispatch Agents versus Services Informed by National Customs, Declared Sales versus Informed Imports, Services Declared by Cargo Transportation Companies versus Services Informed by National Customs and Electric Power Consumption versus Registry Incriptions.

The results of exploiting all the information in the hands of the Tax Administration has been extremely positive, because cases have been generated over 10% of the taxpayers Registered during one proceeding, by directly obtaining over 20% of the collections from the Examination area and, what is even more important, there has been an increase in the risk sensation in taxpayers achieving greater voluntary compliance which has caused an increase in collections.

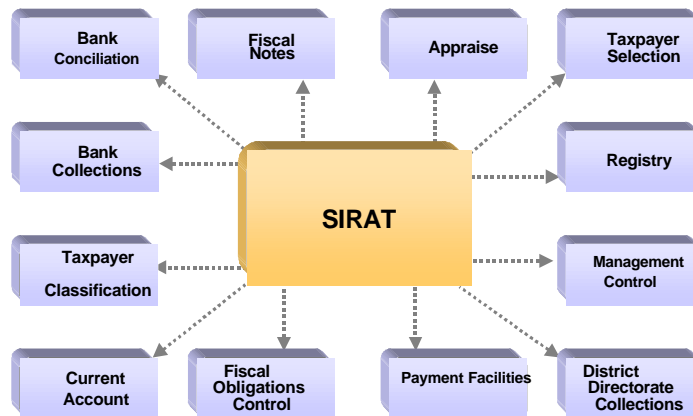
1. THE IMPORTANCE OF INFORMATION IN THE EXAMINATION FUNCTION

If we start off from the premise that the Examination function is based on the systematic, sustained and integral control of taxpayers' compliance with tax obligations, in this manner leading them into the voluntary compliance thereof, and taking into consideration that the human resource that it has in this area is not sufficient (238 officials for 285,000 taxpayers) and that the same must be used efficiently; we can assert that the most important tool that the Examination area has to satisfy these premises is: Information.

The sources of information that the examination area has are clearly identifiable:

Internal Information

Internal Information is all data that the Tax Administration has on each taxpayer, it is important to mention that all information managed by existing computer applications.



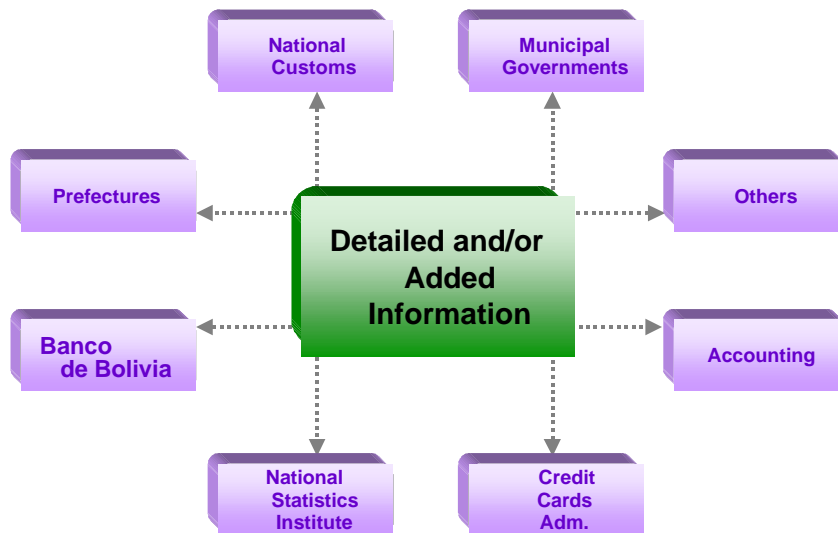
The examination area uses this information in two forms:

Through inquiries and reports that are already defined, that is, as mentioned, each application presents information stored in the database.

Through information processed when determinate information may be the object of special treatment that allow the obtainment of aggregates, averages, ratios etc., i.e., the consolidation of tax returns made by taxpayers by tax, economic sector, etc.

For the correct exploitation of all this information it is necessary to guarantee the total quality of the data, this is achieved through the validation processes incorporated into each application.

External Information.



External Information is all data that the Tax Administration obtains from companies, associations, institutions or persons, to assist in the work of the examination area.

Similar to Internal Information, the Tax Administration requests to types of External Information:

- Detailed information; is information that separately contains all transactions, movements, status changes, etc., on determinate company, association, institution or person, at the same time this information may be divided into:
 - ❖ General; detailed information on economic operations regarding any information agent, i.e.: purchases, sales, imports, suppliers, etc.
 - ❖ Directed to specific sectors; detailed information request made to any entity to control specific economic activities.

- Added information; is information that has been previously processed, this information may contain summaries, averages, ratios, etc., this information can be divided into:
 - ❖ General; economic information, i.e. information from the National Statistics Institute.
 - ❖ Directed to specific sectors; information processed and requested from any entity, i.e. the Bolivian Construction Chamber, the Bolivian Transportation Chamber, the National Industries Chamber, etc., which allows the performance of economic analysis on specific sectors or activities.

Decision on what entities must request information and which is the content thereof, is the result of a series of analysis and studies to avoid the possibility of requesting unnecessary information or to who it does not pertain to require it from all data received has an objective, on the contrary its information that is useless to the Tax Administration.

All information received undergoes a cleansing and quality control process, each process is different according to the source, the amount and the type of information, only the information that undergoes cleansing and quality control process is used for its exploitation.

It is important to stress that the growth of External Information is unlimited, because it depends on the information requirements that the Tax Administration determines to perform, obviously an aspect that must not be neglected is the existence of the support from the necessary computer equipment to be able to receive, cleanse, process and exploit all External Information received.

2. INFORMATION MANAGEMENT

All information that it has or is sent to the Tax Administration is treated in two forms:

2.1 Information Cross Referencing

By using all the information that the Tax Administration has, the examination area performs a series of information cross-referencing with the purpose of detecting possible fraud cases or abnormal behavior in taxpayers.

Information cross-referencing is defined by the Tax Intelligence Department, then it is sent to the Information Technology area of the Tax Administration where they are programmed and executed. Later, the results are known by the Tax Intelligence Department, which then evaluates if the cross-reference defined produced the results expected or on the contrary it is necessary to perform a redefinition thereof. If the result of the information cross-referencing is positive, the Tax Intelligence Department determines that this be done periodically and routinely, on the other hand, with the results of the information cross-referencing, the Tax Intelligence Department defines new cross-referencing.

The results of the information cross-referencing, in the event of being positive, are transferred to a Case Selection process to Audit. Depending on the characteristics of the results, selected taxpayers may pass to a determinate type of tax control process.

The types of information cross-referencing that are possible to be performed are:

- Cross-referencing between Internal Information, with all the information that the Tax Administration has as a result of taxpayers' compliance with formal obligations and which have defined a series of internal cross-referencing of information.
- Cross-referencing between External Information; with the information that the Tax Administration receives from companies, associations or persons and which have defined a series of internal cross-referencing of information.
- Cross-referencing between Internal Information and External Information; by using two types of information that the Tax Administration, a series of cross-referencing is performed.

2.2 Information Processing

Internal Information as well as External Information originates a series of processes that achieve to obtain added or summarized information, which enables the performance of different types of analysis and studies.

For example, in the case of Internal Information, through determinate processes on existing information, historic information is obtained by groups of taxpayers, economic sectors, taxes, regions, regimes, etc. with the purpose of analyzing tax behavior trends.

In the case of External Information processes are defined, i.e., processes on information that totalizes annually or monthly the purchases and/or sales of determinate taxpayer.

3. TAX INTELLIGENCE

Tax Intelligence is an activity intended for economic-fiscal analysis, to the study of fraud behaviors and to the definition of the corresponding courses of action. Analysis and studies performed allow the establishment of efficient control strategies on taxpayers' compliance with their tax obligations.

Two the main instruments of Tax Intelligence are Internal Information and External Information, both provide all the necessary information so that Tax Intelligence can perform all previously mentioned analysis and studies. On the other hand, Tax Intelligence based on determinate inquiries establishes the need for any Company, association, institution or person to present to the Tax Administration certain information that shall then pass to form part of External Information.

Tax Intelligence also uses as raw material the result of the different processes that are done with Internal Information as well as with external information, as well as the result of the information cross-referencing performed. At the same time, Tax Intelligence based on analysis and studies defines determinate processes or cross-referencing to be applied on existing information.

Information technologies are used to facilitate analysis and studies, by assisting in the detection of possible fraud in a fact, simple and efficient manner on the basis of the definitions performed by Tax Intelligence.

As a result of all the work performed by Tax Intelligence, it defines the Case Selection method of the cases to be examined and the type of examination process to be applied pursuant to the operational capacity of the examination area.

As previously mentioned, information is the raw material to comply with the objective of Tax Intelligence, the main task of this area is to perform analysis and studies on existing information or on the results of processes and cross-referencing. Only by means of the performance of high-level research processes can products be obtained which allow differentiating and evaluating taxpayer segments, trends and compliance characteristics.

Tax Intelligence performs continuous analysis on the Bolivian tax situation, it performs the following processes as well:

- Added tax behavior studies and by economic sector on each of the national taxes and foreign trade operations.
- Analysis of the Master Taxpayer File on inscriptions to determinate taxes with the purpose of obtaining taxpayer segments, trends and forms of compliance.
- It establishes streamlining and exploitation strategies on External Information received by the Tax Administration.
- Tax behavior studies by tax, taxpayer, taxpayer groups, regions, economic activities, etc.
- Detailed and specialized analysis on activities subject to Special Hydrocarbon and byproducts Tax and the Specific Consumption Tax, with the purpose of:
- Defining particular strategies which permit to have specialized studies, in economic and financial aspects as well as operational and production aspects.
- Proposing standardized policies which enable the exercise of systematic controls.
- Economic-fiscal and sector evasion analysis to fine tune control process and taxpayer selection.
- Detailed analysis of the taxpayer groups that benefit from securities returns with the purpose of establishing and improving control policies.

4. CASE SELECTION

As a result of the exploitation of all information that exists in the Tax Administration through information processing, information cross-referencing and definitions made by Tax Intelligence, the examination area finds itself with a large amount of possible cases to be

examined. The determination of what cases to execute is a decision of the authorities based on a series of factors:

- Strategies in the hands of the National Tax Service or National Examination Management.
- Amount of human resources in the examination area.
- Objectives expressed by the National Examination Management as well as by the District Managements.

Case Selection takes into consideration the origin of the cases, if they are product of Internal or External Information, if they are the result of cross-referencing information or the result of determinate processes, if they are product of analysis and studies defined by Tax Intelligence and the possible amount for repairs. Then it is decided whether if the cases selected will undergo an Internal Verification, Preventive Control or External Examination External process; in general terms the characteristics of each process are:

- Internal Verification; taxpayers appear in person to the Tax Administration to clarify differences detected or doubtful aspects of their tax situation.
- External Verification; examination area officials visit the taxpayer to apply specific control and revision based on what was detected by the Tax Administration.
- Preventive Control; visit taxpayers groups to verify compliance with formal obligations.
- External Examination; only very important cases that deserve complete audits as a result of evidence obtained with strong indications that the fraud is greater than the information acknowledged and available.

The decision on the type of examination process to follow depends on the type of process or information cross referencing which gave place to the selected taxpayers, the amount of taxpayers that result selected through information cross referencing or the process and the type of information or evidence that it has on abnormal behavior.

Subsequently the quantity of selected cases is determined basing on the quantity of available human resource and finally are selected the taxpayers to be examined in function to its fiscal importance or the degree of the possible fraud detected.

5. EXTERNAL INFORMATION REQUESTED FROM LARGE TAXPAYERS

The Bolivian Tax Administration currently has 1,920 taxpayers classified as Large Taxpayers (GRACOS) representing 0.7 % of the total of our Registry.

However, this 0.7% represents 76% of the annual collection of our Administration.

External Information Obtained from these taxpayers has resulted to be fundamental for tax control, not only for themselves, but also for the totality of taxpayers.

The information that the Tax Administration currently has and that is furnished by these taxpayers is the following:

5.1. Purchases and Sales performed during each period (month)

During the 1997 administration a study on the need of having in Bolivia's Tax Administration, detailed information on commercial transactions (purchases and sales) performed by taxpayers, with the purpose of making the controls of the examination area more efficient and effective.

As a result of the study in mention, the development of an application that may be distributed free of charge among taxpayers was developed and where they may be registered in detail or obtain from their own computer systems all fiscal notes on purchases and sales performed during each period and deliver this information, in magnetic means to the Tax Administration.

As from the month of August 1998, the receipt of information generated by the Software of the VAT Purchases and Sales Book took place, in a first instance information on 757

taxpayers was received, all GRACOS named as Information Agents by means of Administrative Resolution, to date and then the different movements regarding re-classified taxpayers and gradual increases of taxpayers required to carry the Software of the VAT Purchases and Sales Book have produced 3,087 taxpayers that are required to present the information generated by the mentioned Software (all GRACOS including the most important from the rest of the taxpayers, in addition to Municipal Government, Prefectures and Ministries).

Currently the Tax Administration receives on average 3,500,000 registries monthly, all commercial transactions for purchases and sales made by taxpayers during a period are included.

All this information, began to be exploited completely as from the 2002 administration, thanks to this information the examination area has been able to detect a large amount of evasion and fraud and has achieved to support repairs detected in control processes.

One of the objectives of the Tax Administration is to increase the amount of taxpayers that are required to present the information generated by the Software of the VAT Purchases and Sales Book to the largest amount of these and not only circumscribe the obligation to large taxpayers.

5.2. Credit Card Transactions

In Bolivia the two Credit Cards Administration companies are classified as Large Taxpayers, both have been appointed as Information Agents and each must present, bi-annually detailed information on all sales that their associates performed when accepting a credit card as a payment form.

Information is delivered centrally by both companies in text mode files under formats that have been established by the Tax Administration.

The obligation has been imposed since 2000 and to date the 2000 and 2001 Administrations have been processed.

Currently the Tax Administration receives an average of 800,000 registries bi-annually, all sales transactions made by associates with Credit Cards are included.

5.3. Electric Power Consumption

Currently, according to studies performed by the National Chamber of Industries, clandestine industry in Bolivia has increased considerable; in cities such as Santa Cruz and El Alto clandestine factories have proliferated; this means a high percentage of tax evasion, since these industries are not enlisted in the Registry.

The Tax Intelligence area, based on a series of studies, has determined that one of the means to be able to detect these clandestine industries is through the consumption of electric power, through this information we can detect high levels electric power consumption in places where apparently there is no industrial company.

Similarly, with information on electric power consumption, the examination area detects possible fraud actions by comparing electric power consumption levels with the sales volumes declared by taxpayers.

Lastly, as an added value, the information provided by electric power companies is also used as an instrument to cleanse information on taxpayers' addresses in our Registry, this by taking into consideration that these companies have the correct and exact addresses of each of its associates.

Based on the above Bolivia's Tax Administration made a decision to appoint the electric power companies of the capital cities of each department as Information Agents.

These companies, all classified as Large Taxpayers, must present in detail, in magnetic means and in the format established by the Tax Administration, on a month-by-month basis information regarding all those associates that consume 2,500 Kwh or more.

5.4. Clinics

Upon performing specialized controls by professional entries is a strategy defined by the examination area of the Tax Administration, these controls allow the performance of follow-up on the tax behavior of lawyers, architects, builders, civil registry officials, notaries, doctors, etc.

The physicians line item turned out to be very interesting to control, due to its low tax compliance, due to this characteristic, the Bolivian Tax Administration decided to develop a computer tool that was distributed to main private clinics of the country (all classified as Large Taxpayers), so that they can provide information on surgical interventions.

The information provided includes: the date and time of the use of operation rooms, intervention costs and physicians that participated in the same.

6. OTHER EXTERNAL INFORMATION REQUESTED

National Customs has turned into the main information supplier for the Bolivian Tax Administration in everything pertaining to foreign trade transactions.

Import Policies allow the performance of tax on Customs Dispatch Agents and Importers, and mention must be made of the recently disappeared Verifying Companies.

International Cargo Manifests allow the performance of follow-up on the tax behavior of International Cargo Transportation Companies this line item moves millions of Bolivians in our country.

Export Policies help to control Tax Refund Certificates, which are an incentive for exports, precisely for those taxpayers that effectively perform exports by complying with all legal provisions in force.

7. EXTERNAL INFORMATION PROJECTS TO BE REQUESTED FROM LARGE TAXPAYERS

Currently the Bolivian Tax Administration has three projects for the request of External Information, initially to Large Taxpayers, which shall be implemented in the short-term:

7.1. Financial Statements

Currently the Bolivian Tax Administration receives annually Financial Statements from taxpayers that comply with determinate conditions in their sales levels or gross income levels.

This information appears in paper and is filed by the Tax Administration, its use is almost null since in the case of generating a tax control on any taxpayer that presents its Financial Statements, the process of locating in file, the document files, takes many days and often it is not located.

Financial Statement information must be filed in magnetic formats, in this manner it will be made available quickly and simply at all times for any control process.

However, the presentation of Financial Statements in magnetic format does not solve the standardization problem, that is, each taxpayer carries their own Financial Statements with their own Account Plans and there is not standard form, with this characteristic the Tax Administration cannot perform studies or analysis on the information filed.

The solution set forth by the Tax Administration, is the creation of a standard Account Plan, stored in a software to be distributed among taxpayers so that they can use the application and record their Financial Statements in that Account Plan, and then later generate it in magnetic media and file this information at the Tax Administration.

The purpose of this is for the Tax Administration to have information on the Financial Statements of determinate taxpayers in a simple and quick manner and to perform vertical and horizontal analysis by taxpayer, to obtain financial indexes for each taxpayer, obtain average Financial Statements by

economic activity and compare the behavior of a taxpayer against the mean behavior of its activity, and similarly obtain financial indexes by economic activity and compare the financial indexes of a taxpayer against those of its activity. With all these comparative studies and analysis, the examination area may detect abnormal financial behavior, which can possibly have repercussions on the tax bases.

7.2. Inventories

One of the most important mechanisms in controlling the processes of Integral External Examinations is the reconstruction of inventories, a very long and difficult process that permits the identification of possible undeclared sales.

Due to the important and difficulty entailed in this process the Bolivian Tax Administration has made the decision to develop a computer tool to be distributed among Large Taxpayers where they carry the digital registry of all inventory movements in a standard manner, from the point of view of the Tax Administration, and simple and useful from the taxpayer's point of view.

With this tool the Tax Administration can have information on inventories, in a fast and simple manner and make inventory control more efficient.

7.3. Information on Production Processes associated with the Specific Consumption Tax

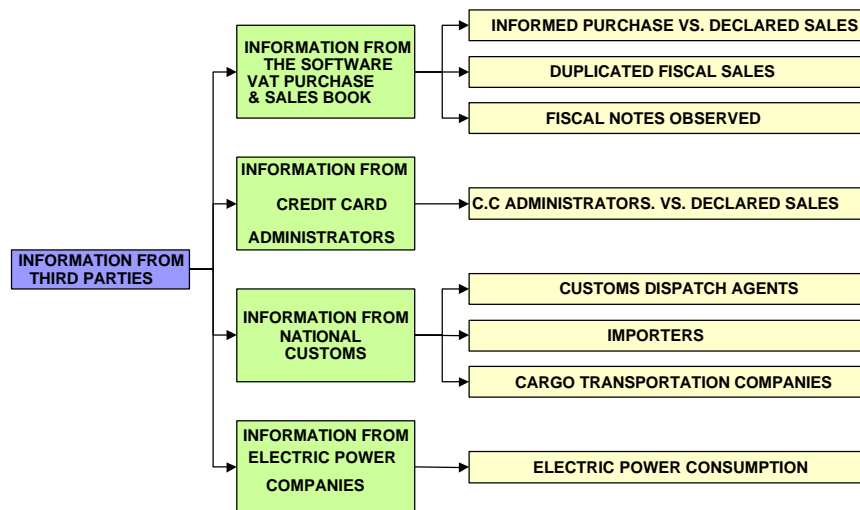
Control on the Production Processes of products taxed by the Specific Consumption Tax (ICE, in Spanish), such as beer, soft drinks, alcohol, wine, etc, becomes complicated when having to know the processes itself, the input, cost – production matrixes, measurements, etc.

Due to the importance of having efficient controls on the ICE and knowing that this depends on mainly controlling Production Processes, the Bolivian Tax Administration has decided to develop a computer tool with which the taxpayer can perform a registry of all inputs that enter into the process, the use of these and the product output.

With all this information the Tax Administration will be able to perform more efficient controls on the Production Processes of products taxed with the ICE.

8. OPERATIONS PERFORMED WITH THE INFORMATION OBTAINED

With all the information mentioned above and under the guidelines stipulated by Tax Intelligence, the examination area of the Tax Administration, defined a series of operations, which resulted from cross-referencing or information processing.



Hereinafter the most important are detailed:

8.1. Informed Sales versus Declared Sales

Detailed information on all purchases, which Information Agents declared to have performed, is stored and grouped by Master Taxpayer File number (RUC, in Spanish), supplier and period (month), in this manner we obtain the total sales that have been performed by each supplier during each period.

This data is then capered with sales registered in the tax return for that period by the supplier.

In the case that the sales declared, from these suppliers are less than the supposed sales obtained from Information Agents or informers, communications are generated where the difference is detailed and the taxpayer is called to visit the Tax Administration to clarify this situation (Internal Verification).

When the taxpayer comes to the offices of the Tax Administration two possibilities may occur. The first one is that he accepts that he did not declare those sales; therefore, he pays the tax omitted. The second is that he proves that he did not perform those sales, therefore he is an informant on the person who lied regarding his purchases, and therefore that taxpayer must assume the tax omitted (credit cleansing).

8.2. Duplicated Fiscal Notes

All fiscal notes informed by purchases are compared to locate duplicated, triplicated fiscal notes, and even quadruplicated fiscal notes, of all these abnormal fiscal notes found, communications are generated for suppliers and they are summoned to appear before the Tax Administration and are requested to inform the person on which that fiscal note was issued.

Informers that are not mentioned by suppliers are summoned and they must assume the payment of the tax omitted (credit cleansing).

However, in this operation many interesting figures have been found; for example:

- Fiscal Notes in more than one accounting system of companies that belong to the same group.
- Fiscal Notes issued more than once (double billing).
- Originals of fiscal notes that do not coincide with their own copies.

8.3. Fiscal Notes Observed

All fiscal notes informed by purchases are passed through filters where the following is detected:

- Unnumbered Fiscal Notes.
- Fiscal Notes with invalid RUC numbers.

- Fiscal Notes with RUC numbers belonging to the General Regime but not registered in the Value Added Tax.
- Fiscal Notes issued by taxpayers belonging to the Simplified Tax Regime.

All these fiscal notes are invalid for fiscal credit and are cleansed from the credit of the informers, but the suppliers who truly issued these fiscal notes are sanctioned as well.

8.4. Sales Declared versus Sales Informed by Credit Cards Administrators

Detailed information on all sales that have accepted credit cards as a payment form, informed by Credit Cards Administrators, stored and grouped by RUC supplier number and the period (month), in this manner we obtain total sales performed by each supplier during each period where Credit Cards have been accepted.

This data is then compared with sales registered in the tax return of that period by supplier.

In the case that the declared sales of these suppliers are less than the sales obtained from Information from Credit Cards Administrators, communications are generated where the difference is detailed and the taxpayer is called to come to Tax Administration's offices to clarify this situation (Internal Verification).

When the taxpayer comes to the offices he generally accepts to not have declared some of those sales, therefore he assumes the tax omitted.

In this same operation, taxpayers that still perform transactions when they no longer have a RUC in the Tax Administration are detected, as well as taxpayers comprised in the Simplified Tax Regime and which sales amounts are higher than those allowed for that regime.

8.5. Services Declared by Dispatching Customs Agents versus Services Informed by National Customs

Information on import policies provided by the National Customs is grouped by the RUC number of the dispatching agent that provided the customs clearance service. Once grouped, taking into consideration the CIF values of the imports and the tariffs in force on that date, the approximate annual income that that taxpayer obtained during these proceedings is calculated.

That data is then compared with the entry registered in the tax return of that year by the Dispatching Agent.

If income declared is less than income obtained from the information from National Customs, communications are generated where the difference is detailed and the taxpayer is summoned to appear before the Tax Administration with the purpose of clarifying the entire situation (Internal Verification).

When the taxpayer comes to the offices he generally accepts to not have declared some of those sales, therefore he assumes the tax omitted.

8.6. Sales Declared versus Informed Imports

Information on import policies provided by National Customs is grouped by the Importer's RUC number. Once grouped, the CIF value of the imports of an administration is totaled.

This data is then compared with the sales registered in the tax returns for that year by that Importer.

If income declared is less than the CIF values obtained from the information from National Customs, communications are generated where the difference is detailed and the taxpayer is summoned to appear before the Tax Administration with the purpose of clarifying the entire situation (Internal Verification).

If the taxpayer alleges that the difference is because he has not sold the goods, he must prove the existence thereof in his inventories, on the contrary they are considered as undeclared sales.

8.7. Services Declared by Cargo Transportation Companies versus Services Informed by National Customs

Information from international cargo manifests provided by National Customs is grouped by the RUC number of the Cargo Transportation Company that provided the service. Once grouped, taking into consideration the weights of the cargoes, the routes covered and the tariffs in force at that date, the approximate annual income that that taxpayer had is calculated.

That data is then compared with the income registered by the Transportation Company on the tax returns for that year.

If the income declared is less than the income obtained from the information registered at National Customs, communications are generated where the difference is detailed and the taxpayer is called to come to the offices of the Tax Administration with the purpose of clarifying this situation (Internal Verification).

When the taxpayer comes, generally he accepts that he did not declare some of these services, therefore he assumes the tax omitted.

8.8. Electric Power Consumption versus Registry Inscriptions

With the information furnished by Electric Power Companies lists with high electric power consumptions that did not have RUC numbers were obtained.

All these addresses were visited and often clandestine industries were detected and were forced to regulate their tax situation.

This information is also used against those taxpayers that have high electric power consumption levels that declare sales levels that do not even cover the payment of power consumption.

9. RESULTS OBTAINED FROM OPERATIONS

The Results Obtained through the exploitation of all External Information owned by the Bolivian Tax Administration have been completely positive, not only because greater controls have been obtained on Large Taxpayers, which are the ones that provide the largest amount of information, but because through this information tact control has been improved for the rest of the taxpayers.

All this Information has allowed the generation of tax control cases for over 10% of the total taxpayers of our Registry in each administration.

The exploitation of the information has directly achieved collections in over Bs. 14,000,000 during the previous administration representing over 20% of the collection achieved by the examination area.

On the other hand, and what is even more important, all operations mentioned have largely increased the subjective risk sensation, which has determined an increase in voluntary compliance, which has been reflected in the increase of the collections of Bolivia's Tax Administration.

10. CONCLUSIONS

The examination area of Bolivia's Tax Administration has defined as part of its strategic planning to base its work on the processes of the Tax Intelligence Department, and at the same time the latter has determined that its main inputs are Internal and External Information.

The External Information providers are the Large Taxpayers, who due to their importance in the economic movement of the country have sufficient information, not only to be efficiently controlled themselves, but also to control the rest of the taxpayers.

With all the information requested and received the Bolivian Tax Administration has generated a series of operations by cross-referencing information, and this has permitted to cover a large amount of line items in Bolivia's economic activities.

The results from exploiting all the information that the Tax Administration has, have been very positive since over 10% of the cases from the Taxpayer Registry have been generated, by directly obtaining over 20% of the collection from the examination area and, even more importantly, the risk sensation of taxpayers has increased noticeably, hence achieving greater voluntary compliance, allowing an increase in collections.

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Case study

TOPIC 2.3.

SPECIFIC INFORMATION REQUIREMENTS FOR THE ASSESSMENT AND CONTROL OF NATIONAL TAXES

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General Director

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(Colombia)

CONTENTS: I. Background.- II. Information to be Submitted by the Taxpayers, Non-taxpayers and Other Entities on Magnetic Media.- III. Information on Third Parties Abroad.- IV. Who Should Report this Information on Magnetic Media?.- V. How the Exogenous Information Is Stored?.- VI. The Effects of the Reported Information.- VII. Toward a Proposal on Information Requested in the Tax Examination and Auditing Process from Entrepreneurial Groups and Conglomerates.- 1. The problem is not in the means and techniques available but rather in the purpose of the source and the information required.- 2. Information requirements: basic input for the tax control and follow up of entrepreneurial groups and conglomerates.

I. BACKGROUND

In Colombia, until the late eighties, the tax administration received at the tax offices corresponding to the taxpayer's jurisdiction, the tax returns along with the explanatory annexes for each of the times, as well as the description of advanced income tax payments.

This involved the physical handling and necessary custody of numerous documents and the execution of multiple manual processes. At the same time, it became a great obstacle for adequately controlling national taxes through the application of jeopardy assessment and collection of delinquent debt programs.

Starting in 1987, and based on the authorizations granted through Law 75 of 1986, a series of measures were adopted, aimed at simplifying taxpayer obligations and improving the operativeness of the tax administration.

Among others, the most significant change which is related to the general theme of this Assembly was the elimination of the obligation to submit the annexes that justified the data shown in the tax return items. Of course, there was still the obligation to maintain the justifying information at the taxpayer's domicile, so that it would be available for whenever the tax administration could request it in exercising its control functions.

This was a first step, which then allowed for establishing for the more representative taxpayers, and especially for those having significant automated developments in their businesses, the obligation to report on magnetic media the information supporting that registered in the tax return items.

Our memory still allows us to recall the use of spools of magnetic tape, whose processing involved the burdensome work of reading, printing and distributing lists to the different regional tax administrations for inclusion in their examination programs. As may obviously be assumed, at that time one could not guarantee that the information would even have the necessary reserve for adequately complying with the purpose for which it was generated.

At present, we can all attest to the significant progress achieved worldwide, especially in the sphere of information management and communication systems. This has been so, to the extent that today we consider information as the main input of the tax administrations, in their management as well as control tasks. The challenge is to achieve that legislators act accordingly and include those modernizing trends in such aspects as information requirements and the necessary procedures for having it available, processing and using it with the quality and timeliness which the citizens would expect.

In Colombia, thanks to the priority attributed to effective compliance with the tax obligations, the regulations afforded the National Directorate of Taxes and Customs broad examination and investigation powers. In that sense, our tax administration may, without any type of restriction:

1. Verify the accuracy of the tax returns and other reports, when it may deem it necessary.
2. Carry out investigations when it may deem it appropriate to establish the occurrence of events generating tax obligations that were not declared.
3. Summon or request the taxpayer or third parties to provide information or answer questionnaires.
4. To demand the taxpayer or third parties to submit documents recording their operations when one or the others are obliged to maintain registered records.
5. Order the presentation and partial examination of books, vouchers and documents, from the taxpayer as well as third parties legally obliged to maintain accounting records,
6. In general, undertake all necessary proceedings for the correct and timely assessment of taxes, by facilitating the taxpayer the clarification of any doubt or omission that may lead to a correct assessment.

Taxpayers as well as non-taxpayers must respond to the request for information and evidence related to investigations carried out by the tax administration, when in the latter's opinion, they may be necessary to verify the tax situation of one and the others or third parties related to them. In addition, for tax control purposes, individuals or entities, whether taxpayers or not, must maintain for a minimum five-year period, starting on January 1st of the year following that of their elaboration, issuance or receipt, the following documents, information and evidence which should be made available to the tax administration when the latter may require them:

1. Accounting records together with external and internal vouchers that originated the accounting entries, in such a way as to render it possible to verify the accuracy of the assets, liabilities, net worth, revenues, costs, deductions, exempt income, discounts taxes and withholdings shown therein. When accounting is computerized, the magnetic means containing the information as well as the respective programs must be preserved.

2. The information and specific evidence provided by the rules in force which entitle or allow for proving revenues, costs, deductions, discounts, exemptions and other tax benefits, credits, assets and liabilities, withholdings and other necessary factors for establishing the liquid net worth and liquid income of the taxpayers and, in general, for correctly determining the taxable bases and assessing the corresponding taxes.
3. The evidence of consignment of withholdings at the source made in the capacity of withholding agent.
4. Copy of the tax returns filed, as well as the receipts for the corresponding payments.

II. INFORMATION TO BE SUBMITTED BY THE TAXPAYERS, NON-TAXPAYERS AND OTHER ENTITIES ON MAGNETIC MEDIA

In Colombia, taxpayers, non-taxpayers, public entities and other entities, annually provide the information indicated below, which is used to perform tax behavior studies and information crosschecks to generate examination programs:

1. Entities supervised by the Banking Superintendence, by the Superintendence of Joint Economy, the Securities Funds, Pension Funds and Mutual Investment Funds must annually file on magnetic media the information on their account holders, cardholders, savers, users, depositors or customers, indicating the tax identification number, name or trade name, address, the number of current or savings accounts and the amount of their annual transactions.
2. The Chambers of Commerce inform on magnetic media, the trade name of the corporations created or liquidated, identifying the partners or stockholders and the capital contributed by each of them in the case of establishment of a corporation.
3. The Securities Exchange provides the surnames and names or trade name and tax identification number of each of the registered members.
4. The administrators of parafiscal contributions must report who are not up to date in their contributions to said entities.

5. The National Civil Registry must provide information on the identity cards of individuals who have passed away.
6. The Securities Exchange members must provide the surnames and names or trade name and tax identification number of each of the persons or entities who, through them, sold or acquired stock and other securities dealt with at the exchange.
7. The Notaries Public must report the surnames and names or trade name and tax identification number of each of the persons or entities that carried out the sale or properties or rights in the respective notary's office.
8. The companies elaborating sale invoices or equivalent documents must provide the surnames and names or trade name and tax identification number (TIN), with an indication of the numbering interval of the invoices elaborated for each one of its customers.
9. In order to perform studies and information crosschecks, one may request the persons or entities, taxpayers or non-taxpayers, information for the control of taxes, such as name, surname, TIN and more detailed information according to the requirements:
 - Surnames and names or trade name and TIN of the partners or stockholders, collaborators, joint owners or associates.
 - Surnames and names or trade name and TIN of persons or entities that are subject to withholding at the source, indicating the concept, amount of payment or installment and amount withheld.
 - Surnames and names or trade name and TIN of each of the beneficiaries that would have made withholding at the source.
 - Surnames and names or trade name and TIN of each of the beneficiaries of the payments that allow for tax discounts.
 - Surnames and names or trade name and TIN of each of the beneficiaries of payments or installments that may constitute cost or deduction or may entitle one to tax discount.
 - Surnames and names or trade name and TIN of each of the persons or entities, from whom revenues were received, with an indication of the item and sales tax paid.

- Surnames and names or trade name and TIN of each of the persons or entities from who revenues were received for third parties and of the third parties in whose name the revenues were received, indicating the amount thereof.
 - Surnames and names or trade name and TIN of each of the creditors for liabilities of any nature, with an indication of the amount.
 - Surnames and names or trade name and TIN of each one of the debtors by way of active credits, with an indication of the amount of the credit.
 - Description of fixed assets acquired during the year, with an indication of the net worth value and the fiscal cost.
 - Total or partial differentiation of the items shown in the tax return forms.
 - The global amount of sales or rendering of services for each of the commercial establishments with an indication of the number and type of cash register and/or intervals of sales numbering used during the year, city and address of the establishment.
 - The number of the sales invoice must be provided, with an indication of the surnames and names or trade name and TIN of the third party, of each of the beneficiaries of payments or installments, which constitute cost or deduction or grant the right of tax discount.
10. The Economic and/or Business Groups registered in the commercial registry of the Chambers of Commerce must annually send their consolidated financial statements, together with their respective annexes. The obligation should be fulfilled by the company controlling each group.
11. The State Entities must submit information showing the beneficiaries of payments made and charged to the national treasury resources which are delivered for administration by third parties.

III. INFORMATION ON THIRD PARTIES ABROAD

Third parties abroad must report the beneficiaries of payments or installments on accounts abroad for the import of goods, either fixed or movable, and other payments made abroad, along with the amount of tariff paid on the import, the sales tax, the withheld VAT and the withholding by way of income and remittances; revenues received from abroad should also be reported, as well as liabilities abroad, active credits and the amount of the balances of current or savings accounts maintained abroad.

IV. WHO SHOULD REPORT THIS INFORMATION ON MAGNETIC MEDIA?

Until the 2001 taxable year, there were 14,085 such taxpayers in Colombia, among corporations, individuals, financial entities, public entities, consortiums and temporary mergers, chambers of commerce, commission earners, notaries, printers and lithographers, stock exchanges and controllers of economic and/or business groups.

In order to control a larger number of taxpayers subject to tax obligations, starting in the 2002 taxable year, and based on the powers provided in Law 633 of 2000, the universe of those obliged to report on magnetic media was expanded, through the reduction of the peak amount of gross revenues on which information should be reported. For that taxable year, information was received from 17,909 taxpayers, which represented a 27 per cent increase.

For the taxable year of 2003, whose income returns will be received next April, The National Directorate of Taxes and Customs hopes to significantly increase the receipt of information on magnetic media. This will certainly allow for performing a larger number of studies on the tax behavior of the taxpayers, through information crosschecks.

The number of individuals or entities that carried out transactions according to the information criteria requested, increased by 26.5%, that is, from 2,088,669 to 2,642,442 between the taxable years of 2001 and 2002.

There will be a monetary sanction of up to \$266,094,000 (some US\$96,500), for those obliged to provide information, but who fail to do so within the established term, or who present it with errors or when the information filed does not correspond to what has been requested.

V. HOW THE EXOGENOUS INFORMATION IS STORED?

The National Directorate of Taxes and Customs has a computerized tool called Exogenous Information and Invoicing System-EIIS wherein the information of those obliged to file reports is stored, along with the data from third parties annually reported on magnetic media. The tool, built to support Tax Examination, interacts with the entity's corporate systems and is useful for detecting noncompliance with tax obligations; along with several modules that allow for entering, validating, consolidating and duplicating the information for the different administrations in the country, in addition to allowing for carrying out automatic crosschecks.

Information receipt: The information is received and subjected to general validations with respect to technical specifications and the TIN. Once accepted by the system, one proceeds to consolidate the information of each of the informing third parties according to the TIN and the concept for which it was reported. Following the consolidation, one continues to the crosscheck module.

The EIIS includes the following modules:

- 1. Receipt module:**
Provides the necessary options to establish, validate and consult the exogenous information presented by an informant with a specific period.
- 2. Informant control module**
Allows for detecting and consulting the informants who have failed to, or provided inaccurate information. Also allows for selecting said informants.
- 3. Parameters module**
Allows the maintenance of the information dealing with the exogenous information receipt processes, control of informants, crosschecks and statistics, by adapting to the regulations provided by the Law.

4. Information crosscheck module

Allows the crosscheck between exogenous and endogenous information (tax and customs declarations), for detecting inconsistencies. In this way, one may detect the informants who have failed to file returns on the basis of these same crosscheck processes. The examining official detects inaccuracies or omissions based on the development of formulas applicable to the endogenous and exogenous information included in the EIIS.

5. Statistical module

This module of the EIIS endeavors to facilitate the handling of the exogenous information and the tax returns in a statistical manner to facilitate the directors of the entity and the managers of the examination area the making of decisions dealing with the behavior of the annual information figures.

VI. THE EFFECTS OF THE REPORTED INFORMATION

It is clear that the exogenous information obtained by the tax administration may be used for detecting total noncompliances with tax obligations and to establish the inaccuracies in income reporting by the citizens and businesses.

With this information and that reported by the taxpayers in their tax returns, tax control programs have been carried out, with the subsequent effects of greater collection and improvement of taxpayer behavior.

In this sense, in the case of the Special Administration of Large Taxpayers of Bogota, which represents approximately 65% of collection from taxpayers classified as the large taxpayers of the country and 50% of national collection of internal taxes, revenues were obtained after carrying out omission (noncompliance), control (compliance with formal obligations such as registering in the files, invoicing, etc.), management (massive persuasive) and research (integral verification of compliance with substantial obligations) programs, in amounts equivalent to US\$48 million and US\$66 million for 2001 and 2002, respectively.

VII. TOWARD A PROPOSAL ON INFORMATION REQUESTED IN THE TAX EXAMINATION AND AUDITING PROCESS FROM ENTREPRENEURIAL GROUPS AND CONGLOMERATES.

Any task where the statistical and mathematical analysis of events and economic situations is a priority, and tax auditing is not the exception, requires at least statistical data and information of a varied nature that may be verifiable and validated, such as, for example, the case of prices.

If prices are known, the task is to analyze and interpret. To this end, one should select a technical and operationally valid measure. Its scope is generally determined by the tax procedure. The result originating therefrom, describes a reality, in keeping with the standards and objectives, in any case subject to national and international commercial, financial, economic and tax legislation.

Accordingly, one should take into consideration the economic rationality present in the taxpayers. Even in the case of taxes, it is necessary to be aware of the logic and sense used by the taxpayer for making decisions, in the same way as it is useful to know which methods were applied to calculate, project and process the information, as well as the strategy associated to the planning of businesses and the eventual tax fraud.

The ideal would be that the payment of taxes was considered a joint duty. Actually, for taxpayers, taxes are a cost and decisions as to how much and when to pay, are subjected to financial calculation. For purposes of auditing, it is an economic and not merely an accounting fact, since accounting goes beyond the limit, to the extent it describes an economic event and not otherwise.

The Colombian tax administration has been working on the design of an integral tax examination strategy for the entrepreneurial groups and conglomerates. Its main concern has been the structuring of a methodology that may allow the economic analysis.

The initiative has consulted auditors who have carried out thorough investigations, by applying auditing techniques that require considerable pertinent information as well as more detailed financial and statistical information. Usually said information is not required

by the auditors, but in the cases consulted they allowed the auditor to arrive at a specific idea regarding the nature of the business, identify and describe the sectorial environment where their economic activity is carried out, and identify elements, factors and events of a varied nature that were not taken into account in the traditional verification and auditing, but which affect or determine the result of the operation carried out by the large taxpayers, as well as their fiscal performance.

Until now, the Colombian tax administration lacks specialized knowledge by sectors. Nevertheless, there is a population of taxpayers subject to income tax (see Chart 1) that require such specialization, as would be the case of the multinationals and large enterprises related to conglomerates with significant cross-border operations (Large Taxpayers spent abroad in 2002, approximately \$1.8 billion (some US\$700 million).

One must admit the current lack of technical capability, expertise and availability of sufficient tools and resources for handling the complexity of auditing said group of taxpayers. For us, it is a problem to be overcome and we are precisely working on that.

CHART No. 1. LARGE TAXPAYER COOPERATIONS OF BOGOTA
TRANSACTIONS ABROAD

2002 INCOME RETURN (AMOUNTS IN MILLIONS OF PESOS)

SECTOR	TOTAL COMT.	TOTAL SOCIETIES					
		II - Expenses incurred abroad		I - Withholding Tax		IX - Withholding on payments and remittances abroad	
		No.	VALUE	No.	VALUE	No.	VALUE
AGRICULTURE AND LIVESTOCK FORESTRY	16	2	858,336	0	0,000	0	0,000
MINING	62	24	160,454,727	4	2,105,864	40	23,442,156
FOOD	67	24	420,845,877	0	0,000	1	1,013
TEXTILES, CLOTHING AND LEATHER	57	11	49,199,524	0	0,000	1	0,005
LUMBER, COOK AND PAPER INDUSTRY	44	16	8,163,384	0	0,000	1	0,408
MANUFACTURE OF MINERAL PRODUCTS	126	58	77,077,477	0	0,000	1	3,020
MANUFACTURE OF MINERAL PRODUCTS	142	56	75,051,450	0	0,000	3	8,690
ELECTRICITY, GAS AND VAPOR	15	3	105,957,267	0	0,000	0	0,000
CONSTRUCTION	43	6	3,109,569	0	0,000	1	47,997
WHOLESALE, RETAIL, VEHICLES ACCESSORIES	69	11	13,577,906	0	0,000	1	52,174
WHOLESALE	237	73	110,573,871	2	3,512,697	6	1,758,864
RETAIL	67	22	44,462,961	1	65,203	3	2,109
HOTEL, RESTAURANT SERVICES	39	10	2,369,192	0	0,000	1	12,829
TRANSP. STOR. COMM. SERV	118	41	249,961,567	1	0,366	8	1,888,651
FINANCIAL SERVICES	220	46	247,439,508	0	0,000	1	16,582
OTHER ACTIVITIES	334	98	247,464,643	3	118,575	8	207,456
TOTAL	1,666	505	1,816,567,060	11	5,802,705	76	27,441,954

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SECTOR	FOREIGN SOCIETIES						
	TOTAL EXTR.	DR - Expenses incurred abroad		LF Remittance Tax		RA - Withholdings on payments & remittances abroad	
		No.	VALUE	No.	VALUE	No.	VALUE
AGRICULTURAL & LIVESTOCK, FORESTRY & FISHING	0	0	0,000	0	0,000	0	0,000
MINING	39	19	26,598,521	4	2,105,864	35	20,004,353
FOOD	7	7	13,313,794	0	0,000	0	0,000
TEXTILES, CLOTHING & LEATHER	0	0	0,000	0	0,000	0	0,000
LUMBER, COOK AND PAPER INDUSTRY	1	1	462,020	0	0,000	0	0,000
MANUFACTURE OF CHEMICAL SUBSTANCES	23	23	33,709,873	0	0,000	0	0,000
MANUFACTURE OF MINERAL PRODUCTS	19	19	18,367,622	0	0,000	2	6,302
ELECTRICITY, GAS AND VAPOR	1	1	85,962	0	0,000	0	0,000
CONSTRUCTION	1	1	211,668	0	0,000	0	0,000
WHOLESALE RETAIL VEHICLES ACCESSORIES	4	4	6,426,595	0	0,000	1	52,174
WHOLESALE	40	39	94,648,043	2	3,512,597	3	1,726,887
RETAIL	8	7	41,035,992	1	65,203	2	0,576
HOTEL, RESTAURANT SERVICES	2	2	313,924	0	0,000	0	0,000
TRANSP. STOR. COMM. SERV.	16	15	36,798,453	1	0,368	3	441,717
FINANCIAL SERVICES	7	7	171,024,327	0	0,000	0	0,000
OTHER SERVICES	45	41	67,891,209	3	118,576	4	167,859
TOTAL	213	186	510,890,403	11	5,802,705	50	22,393,568

Source: Tax returns of 2002 taxable year SIAT, October 2003 cut

It is likewise important to emphasize that the information, as well as the availability of tools for processing it, are strategic factors of unavoidable technical value for tax auditing. However, for making better use thereof, it is also essential to advance in the design and establishment of institutional mechanisms between government authorities and national and international private entities, for the exchange of certified information.

It is worthwhile mentioning some obstacles to this purpose wherein most of the tax administrations coincide. We all know that the operational scope of traditional auditing is determined by two factors: the time or term legally established for carrying out the investigation or auditing stage and the limitations of a legal, technical and operational nature that render difficult a thorough investigation with the scope proposed herein.

At present, for example, it is very time consuming and burdensome to efficiently process a request for accounting or financial information on a taxpayer, in spite of the efforts of the administration for creating data bases with significant information, and the existence of information exchange with external sources such as Chambers of Commerce, Superintendencies, Bank of the Republic, National Administrative Statistics Department, Registries, associations, etc., so far, it has been impossible to formulate methods and guides that may lead to more adequate and productive use of the information available. We trust that the experience of SICAT and SIAT in relation to these issues will bring us closer within short term, to the conception and implementation of an integral information matrix.

By the way, Colombia has been working on a Single Model of Revenues, Service and Automated Control, "Muisca" which is being developed by the National Directorate of Taxes and Customs, with the invaluable support of the State Agency of Tax Administration of Spain. This model is designed as a structural solution that will allow full use of the information found and entering the DIAN, to effectively verify all the agents intervening in tax, customs and exchange management.

Through Muisca, whose first results will be seen in the first semester of this year, data entry, their use, the connection with other systems, the exchange of information with external entities and the elaboration of reports and statistics will be automated.

However, it is clear that the strong variable is not only the lack of versatile methodologies, but also restrictions involving timeliness, location of the source and reliability that are involved in the process of collection, processing and basic validation of the information, and which takes between one and one and a half month, in the case of verifications and crosschecks for specific audits, and a longer time in the case of regular requests for information in thorough audits.

In the analysis stage where the information is to a certain extent justified, the administration resorts to systematized information of an internal and external nature, which is useful in the description of the taxpayer's commercial, financial and economic background, but lacks the time to make a detailed verification and crosscheck. There is, however, the doubt as to the reliability and validity of the information.

When the source on which one depends suggests additional institutional and formal procedures and in addition, due to its geographical or extraterritorial situation, it must resort to much more burdensome procedures and the results expected from the auditing are subject to the source which provides and certifies the information.

It is understood that the exchange and cooperation between the administration of taxes and their colleagues abroad are crucial. The question is how to make an optimum use thereof; and what is even more relevant is that success is only possible to the extent that the procedure, as well as the methods and techniques applied, correspond to the increasing need and complexity of businesses in these times of commercial integration and economic liberation.

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We understand that in Colombia there is still no definitive, unique and exclusive model or methodology for determining the source, the type and quality of the information required, in the taxpayer identification, selection and verification processes, as well as in the specific activity. We have not yet determined either, the design and scope of mechanisms that may facilitate the organization and systematization of the information in keeping with the audit objectives. Currently, even in spite of the fact that there are sources and several computerized systems which may be consulted, the auditor applies his knowledge and experience, always responding to the order of not going beyond what the norm and time allow.

We also observe that a change of approach has been insinuated in the conception of auditing, in the case of large taxpayers.

The specific audit program serves in a certain way to debug the base and achieve results within short term. Experience tells us that, of the 1,893 large taxpayers of Bogota, 95% regularly observes all the tax formalities and that no more than 455 corporations are part of an approximate 694 conglomerates and economic groups (Chart No. 2), while 213 are foreign and multinational enterprises with a high level of sophistication and complexity in the handling of its accounts abroad, with an approximate volume of US\$700 million, as observed in Chart No. 1.

CHART No. 2. CORPORATE ECONOMIC GROUPS IN COLOMBIA

SECTOR	CORPORATE ECONOMIC GROUPS			
	LARGE TAXPAYERS	REST OF COUNTRY	FOREIGN	TOTAL
AGRICULTURE & LIVESTOCK FORESTRY & FISHING	2	118	0	120
MINING	4	30		34
FOOD	21	97	18	136
TEXTILES, CLOTHING & LEATHER	5	34	2	41
LUMBER, COOK & PAPER INDUSTRY	13	73	15	101
MANUFACTURE OF CHEMICAL SUBSTANCES	31	84	22	137
MANUFACTURE OF MINERAL PRODUCTS	41	135	16	192
ELECTRICITY, GAS & VAPOR	5	38	1	44
CONSTRUCTION	18	143	0	161
WHOLESALE RETAIL VEHICLES ACCESSORIES	11	68	0	79
WHOLESALE	43	131	6	180
RETAIL	14	73	5	92
HOTEL RESTAURANT SERVICES	6	23	1	30
TRANSP. STOR. & COMMUNIC. SERVICES	21	133	6	160
FINANCIAL SERVICES	153	416	21	590
OTHER SERVICES	67	430	8	505
OTHER ACTIVITIES	0	68	19	87
TOTAL	455	2,094	140	2,689

Source: Supersociedades - Chamber of Commerce Reports, cut at 31 December 2002

Undoubtedly, the largest sources of revenues originate from public sector enterprises, as is the case of telecommunications, oil, telephone, energy enterprises, etc., and the groups and conglomerates which concentrate the greater part of increasing operations and transactions in the volume of cross-border operations where the multinationals have a great weight. Reality imposes a great challenge to the tax administration.

1. The problem is not in the means and techniques available but rather in the purpose of the source and the information required

One thing are the technological means that render possible the compilation, processing and dissemination of data and information and another very different one is the nature of information required for the tax auditing process.

And indeed it is true; the primacy of problems originating from technological advance and globalization brings forward the risk associated to the loss or collapse of the sense and significance of the tax problem. It is not by chance that greater importance is being attributed to technical developments of the tax administration than to the development of tax systems.

The development of local tax systems is no longer the core problem. What appears to be interesting is the way those systems are affected by their administrative and operational structures in response to the priority needs of commercial integration, while new competencies are being generated which would expand the spectrum of action of the tax administrations, less local and more of a cross-border nature. However, and that is the issue to be discussed: How does integration take place, and matters of an institutional and legal nature as well as technical are solved, in order to learn with a better level of understanding and within a minimum time frame, the tax situation of taxpayers in the national territory, but which operate in a transitory manner through branches, subsidiaries or related companies in other countries.

One talks about the increasing complexity of businesses, markets and economic activities within the framework of the globalization process, as well as the ambiguity of local legislation, the instability and insecurity still present in the tax legislations. Nevertheless, the

same importance is not attributed to the existing qualitative disadvantages between the administration of taxes and the taxpayers. In our opinion, clear rules of technical competency and transparency should be established, which are ever more necessary and, why not, ever more demanding the search for consensus at least between the tax administrations.

The core problem is the level of credibility and reliability in the sources as well as in the information provided. Therein lay the challenges of the administration with respect to taxation, when it faces concrete cases of audits whose results depend on detailed, classified information, with a high aggregate value in its processing. Concretely, very precise economic information which, as in the case of the financial sector, changes regularly at an extraordinary pace, like the information systems and the calculation and estimation methods.

Another problem is the timeliness and equal access to the information and capability for processing the latter with the required quality and consistency. That is:

- That the reports and information provided by the regular information sources adequately and faithfully reflect and describe the taxpayer's economic reality, the nature of the business, the nature of the transactions or operations carried out and how prices are determined.
- That it correspond to the strategic approach of follow-up of the operations, preceded by a review and (inter-temporary) verification within a specific period, of the financial behavior and fiscal performance of the corporate large taxpayers, not as a single entity, but as part of a conglomerate, or economic group, or part of a context wherein its intervention is not only significant because of the volume of operations, but by the very nature and characteristics of the large taxpayer. In other words, the information must be sufficient and clear so that it may allow for structuring a joint overview.
- The strategy is undoubtedly important for developing examination policies focused on taxpayer cases, sectors or segments whose particular characteristic requires from the administration a more detailed and in-depth knowledge of the taxpayer and the environment wherein it performs.

- With respect to the environment, one cannot disregard the economic circumstances or the events that model the economic behavior of businesses. It is necessary to be aware of them and fully understand them. Otherwise, the tax administration would be exposed to risks that would be very difficult to estimate.
- To mention an example, economic information on the markets is of the greatest importance in the assessment and description of the auditing cases. An unforeseen change in the behavior of capital markets, the discovery of an oil well, or the decrease in crude reserves affect the determination of the prices of fuel and its by-products. Generally, that reality is not reflected in the accounting and financial statements, since the time and terms given by the tax administration are sufficient to adjust the accounts to the most advantageous situation.
- Avoidance is a structural and very complex phenomenon that should be deciphered by the Tax Administration. But that can only be done on the basis of a likewise well structured knowledge of the markets and transactions in which the large taxpayer is involved. The basic input is information.

2. Information requirements: basic input for the tax control and follow up of entrepreneurial groups and conglomerates.

The possible perspective for tax control and follow-up begins with focusing the technical effort and experience in structuring a methodology aimed, first of all, at establishing and describing the intra-group economic, commercial and financial relationships. It is based on the assumption whereby, in tax terms, there is synchrony between the corporations of the 'group' and it is an almost identical reflection of the type of economic and formal relationship between the countries comprising it. This is thus, because conglomerates act under the same financial strategy.

The ideas of entrepreneurial group, economic group and conglomerate have some similarity, but in practice, they are not the same. When it comes to verifying the reality of operations between related companies and between other groups, the results achieved are different. In Colombia, we intend to follow up and evaluate the

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tax behavior of the groups or conglomerates, in order to improve the fiscal auditing of this group of taxpayers.

On the other hand, the Colombian tax law, on introducing the provisions on transfer prices, allows a greater control of operations carried out by income taxpayers with their economic or related parties abroad. In this sense, the tax administration is authorized to request taxpayers subject to this regime, for information and documents to verify the correct application of the rules in relation to this matter. That is, that revenues, costs, deductions, assets and liabilities may have been determined by considering for such operations, the prices or profit margins that would have been used in comparable operations with or between independent parties.

In this way, the taxpayer is not only obliged to provide information on his business, but must also do so with respect to related third parties with residence or domicile abroad with whom he carries out operations and, accordingly, it is possible to count, among other things, with their identification, the description of their activity, organizational and functional structure, financial statements and contractual conditions under which these operations are carried out.

Likewise, the obligation to file an information return on operations carried out with related parties broad, listing in detail the type of operation, amount and date carried out was established for taxpayers subject to transfer pricing regimes.

Currently, work is being carried out on the regulations that may precisely determine the required level of detail of the aforementioned information.

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TOPIC 3

**EVALUATION AND CONTROL OF
EXAMINATION ACTIVITIES**

Lecture

TOPIC 3.

EVALUATION AND CONTROL OF EXAMINATION ACTIVITIES

Matthijs Alink

Deputy Director International Affairs
Directorate General of the Tax and Customs Administration
(The Netherlands)

CONTENTS: Introduction.- Law Enforcement Policy.- Law application.- Client Treatment.- Service provision.- Supervision.- From supervision to fraud detection.- Duty of secrecy.- Professional integrity.- Risk Management.- Identification and classification of risks.- Selection.- Evaluation.- Treatment strategy translated in forms of treatment.- Why proactive testing.- Validation.- Verification.- Audit.- Keeping files.- Planning and Control.- Planning.- Control.- Developing the control function.- Scorekeeper.- Financial controller.- Management controller.- Quality Assurance.- Critical success factors.- The Fiscal Quality Index (FIX).- The Fiscal Monitor.- Performance Management.

INTRODUCTION

The core business of Tax Administrations is the levying, collection and control of taxes, imposed by the government including the detection of tax fraud.

Administering the tax laws of a country should serve the public interest. That is, it should meet the needs of the government and of the people of the country served by the government. The Tax Administration and the tax employees must therefore have the confidence and esteem of the public they serve.

The primary responsibility of a Tax Administration is to collect the proper amount of tax due to the government at the least possible cost to the public. In addition, it is essential that a Tax Administration carries out his responsibilities in a manner, which warrants the highest degree of public confidence in the organization's efficiency, integrity and fairness.

The taxpaying public should be able to expect that the organization responsible for administration of the country's tax system will administer the tax laws consistently and fairly so that the similarly situated taxpayers will be treated the same under the laws. Taxpayers should also receive good value for the dollars spent by the Tax Administration in administering the tax laws. That is the Tax Administration should operate as efficiently and cost-effectively as possible. In addition to receiving value for their money, the public expects the Tax Administration and its employees to be free from any type of corruption or undue influence.

The most cost effective means of collecting taxes is through the voluntary compliance of the public with the tax laws. The more enforcement activities are necessary, the more expensive is the administration of the tax system. In order to encourage taxpayers to comply with their taxpaying responsibilities voluntarily, it is important that the Tax Administration assists them in understanding those responsibilities. This can be done through taxpayer assistance and by taxpayer education activities.

Also critical to the concept of voluntary compliance is the belief on the part of the taxpaying public that the Tax Administration respects the rights of taxpayers and operates on the principles of integrity and honesty. For having confidence in the tax system, people must believe that it is a fair system administered in an even-handed manner. It is important for the Tax Administration to strike the proper balance between customer service and fair enforcement of the tax laws.

Taxpayers expect the employees of the Tax Administration to be well trained in their area of technical responsibility. Employees are also expected to have an overall understanding of the Tax Administration's operations to guarantee that taxpayer problems can be resolved without forcing them to make numerous contacts.

Proper attention must be paid to the training of employees in order to ensure that the Tax Administration has a technically proficient and professional workforce as well as one that respects the rights of taxpayers.

For proper decision-making and evaluation the Tax Administration needs a management information system. This system should provide sufficient information so that the Tax Administration can be responsive to inquiries by government bodies charged with supervisory responsibility as well to internal organizations charged with review and evaluation of Tax Administration procedures, processes and practices. Key factor is determining the critical factors to be measured in order to gauge the effectiveness of the operations and the performance of the Tax Administration.

LAW ENFORCEMENT POLICY

The manner in which enforcement of the legislation is done is of great importance. Enforcement of the law is interpreted from two different angles: law application and client treatment. What matters first of all is that the Tax Administration executes legislation and regulations properly. In essence, this means the correct interpretation of fiscally relevant facts. This is the perspective of law application. Lawfulness, legal certainty and equality before the law are core concepts in this respect.

At the same time, the Tax Administration should make an effort to prevent or reduce the risk of non-compliance by taxpayers as much as possible. Supporting the taxpayer where necessary in observing the tax obligations does this first and foremost. This makes service provision an essential part of client treatment. It is also important to ensure, by means of extensive, general supervision, that the taxpayer indicates the fiscally relevant facts correctly, completely and in a good time. Supervision therefore constitutes the second element of client treatment. In cases where taxpayers do not comply with their tax obligations on purpose, the Tax Administration will act by means of specific fraud combating and detection.

Effective enforcement of the law takes place when both angles – attention to the tax method and attention to the taxpayer – are considered equally and in relation with one another in the execution of the law.

Law application

Taxpayers should be able to count on the fact that the law is applied correctly to their tax situation. They should have the certainty that the law is applied correctly to other taxpayers too. The strategic goal for law application is unity of policy and execution. To guarantee unity of policy and execution there is a need for quality requirements:

- Test new legislation and regulations for aspects of enforceability and executability.
- Evaluate existing legislation and regulations periodically.
- Publicize new legislation immediately.
- Regular consultation with sectors of society involved.
- Where useful and necessary, publicize agreements on law application for industries and target groups.
- Embed the execution of legislation and regulations in a system of quality assurance.

Tax administrations are under increasing pressure to account for how it strives to achieve unity of policy and execution in respect of taxpayers, principals and external supervisors, as well as other legislative enforcement organizations with which they cooperate. Choices should therefore be explicit and convincing. The organization should be transparent and accountable for the manner in which it executes its legislative enforcement task. The Tax Administration should present itself as a single unified Tax Administration; this requires clear and recognizable policies that are executed unambiguously.

CLIENT TREATMENT

In terms of client treatment, the main focus is on the attention paid to the taxpayer. The type of client treatment is based on the taxpayer's specific situation. Points of departure in this respect are fiscal interest and risk. A selective approach guarantees an effective use of the available capacity. The guiding principle for client treatment is that, "each taxpayer should receive the attention required in his situation".

Client treatment involves different processes like service provision, supervision and fraud detection. Service provision strives to support the taxpayer in observing the obligations resulting from legislation

and regulations. In addition to service provision, the process of supervision also aims to ensure that taxpayers observe their obligations. By monitoring the submission of correct, complete accounts of fiscally relevant facts in a timely manner the Tax Administration ensures that legislative application is provided with a solid basis. Fraud detection and prosecution is the ultimate remedy within the spectrum of client treatment.

Service provision

Starting-point is a service-providing attitude. This requires an open, helpful attitude and imposes high demands on communication and service provision. Taxpayers should be aware of their rights and obligations, and be well informed of any changes. They should feel sufficiently supported by the Tax Administration to comply with the obligations themselves and to exercise their rights. This means also that taxpayers should acquire certainty about their tax state of affairs as soon as possible. The DTCA's service provision is characterized by contactability, accessibility and customer orientation.

SUPERVISION

From the Administration's point of view, supervision means rectifying or combating failures to comply with tax obligations. The aim is for supervision to be as focused as possible. An important means of achieving this is risk management. Knowledge groups are formed to identify what risks of non-compliance existed in different sectors and to find ways of anticipating and tackling them. Based on the information provided by the knowledge groups the Tax Administration will each year designate a number of risk sectors for special attention. The updating of selection rules is an ongoing process.

The process of supervision aims to involve all the relevant facts for taxation in the treatment on time and in the correct way. An important element in an effective supervision strategy is timing. Linking the time when the tax fact occurs as much as possible to the tax treatment of this fact limits the risk of non-compliance. That's why supervision is based increasingly on the current situation: starter visits, on site observations, book inspections based on the annual business report and accounts, and control on the basis of pre-arrival information at the Customs Administration are examples of this. It is important in this respect that information is made available and

is processed quickly: well-structured supporting logistic processes and quick treatment are preconditions for effective supervision. Another objective of this is the optimization of cash flow (pay as you earn).

Supervision takes place on the basis of “insight into the client’s situation” and “insight into the target group”. The specific situation of the taxpayer and the tax interest and tax risk related to this provide the basis for the treatment approach. Selectivity is of great importance in this respect. Concentrating mainly on the entries involving risk increases effectiveness. In order to avoid inequality before the law at the regional or local office level, selection criteria are used at the national level. Selection is increasingly an automated process.

Having knowledge of specific industries and targets groups is important for adequate treatment. For this purpose, target-group-adoption offices fulfill the role of knowledge centres. The use of segment treatment plans and standard treatment modules promote the efficient and unambiguous execution of the enforcement policy.

Collecting and using contra-data forms an extremely important part of supervision. Extensive data streams are processed as much as possible by computer, and incorporated in the assessment. The exchange of information and knowledge and operational cooperation with other agencies within and outside the country – but especially within the administration itself – is an additional condition. The use of the unique social fiscal number (SOFI number) is crucial for the registration and exchange of the huge amount of data. Even more crucial is the completeness and the quality of the basic information system, the registration of all persons liable to pay taxes.

From supervision to fraud detection

The criminal prosecution of tax fraud is a necessary concluding factor of client treatment. Taxpayers who display the most far-reaching form of non-compliance fraud are dealt with repressively. This approach serves first of all to correct non-compliant behaviour, but also to achieve preventive effects so as to promote compliance. The local offices report any suspected cases of fraud to the Fiscal Information and Investigation Service (FIOD). The FIOD deals with cases that are worth prosecuting. Depending on the cases’ suitability, warrants will be issued to the Public Prosecution Service.

An important condition of a good detection rate is having excellent information. Through analysis and research, fraud risks are listed for use in client treatment, and risk warnings are given that help to discover any committed fraud and provide insight into fraud patterns.

The DTCA uses the following quality standards in fraud detection:

- Fraud patterns and risks are analysed systematically.
- Reported fraud cases are worth prosecuting.
- Fraud cases are brought to a conclusion quickly and efficiently.
- Subject detection receives special attention.

Duty of secrecy

The great importance of the duty of secrecy is widely recognized in society. This importance is two-sided: for the taxpayer it is reassuring to know that at the Tax Administration his information is in good hands, while for the Tax Administration the success or failure of taxation depends on the taxpayers' preparedness to be open and honest towards the Tax Administration. The more the taxpayers trust that the Tax Administration is careful with the data provided; the more they will be inclined towards openness and honesty.

An important aspect of secrecy is the physical security of buildings and equipment. A daily duty for managers is to secure clean desk management, protect passwords, limit access to data for employees to information they need for the handling of their own clients, secure employees are careful in discussing cases in public places.

Professional integrity

Integrity is one of the essential characteristics of public governance. The legitimacy of the actions of the public sector is based on the trust citizens should be able to have in politics and governance. Citizens expect an honourable public sector. Clearly, taxpayers cannot be expected to comply with their tax obligations if the Tax Administration itself is not honourable. Integrity, therefore, is a self-evident aspect of the DTCA's business conduct. It involves measures in the field of physical protection, the protection of information, the separation of positions, administrative organization and internal control, and the formulation of Rules of Integrity and the promotion of internal discussions about the subject.

RISK MANAGEMENT

Law enforcement consists of three components: interpretation and execution of the law, examination and providing services. Verification and audit is part of examination. To make rational choices for a client treatment strategy you need a system of risk management. Risk management can be defined as the systematic process in the course of which people and resources are deployed, based on risk analysis aiming to achieve an optimum result.

The risk management process is normally a continuous process. This is necessary because the process must be effective within the environment in which the Tax Administration operates. The environment is subject to change, and these changes in the environment will have an effect on risks and risk assessment. The risk management process does not only involve operational decisions, but also high-level decisions that require the commitment of senior management.

The continuous feedback from the risk management process can help senior management to set aims and objectives for the overall tax control process, to work out control plans, to allocate budget resources, and to refine decision-making processes in these areas. Feedback can also be of great importance at the political level in formulating strategies for the future.

By using risk management techniques, human and other resources can be deployed in such a way as to achieve an optimal balance between law enforcement and support to taxpayers.

The feedback from evaluations also enables management and the operational level to be more proactive in the control field instead of taking a reactive stance. In addition, it will enable intelligence units to improve the identification of antifraud measures, and to implement them timely.

Risk analysis is the key to the risk management process. It is a proactive and dynamic process through which risks are systematically identified, analysed and assessed, so that it provides the basis for decisions on further actions. It also monitors and reviews the development of risks through measuring taxpayers' compliance.

Identification and classification of risks

The first step that needs to be made for risk management is identifying and classifying the theoretical object risk, and the related relevant facts and events. Examination activities can be carried out for research purposes. This could be research into an economic phenomenon, such as a new line of business or industry, increasing the knowledge of existing industries or of a current auditing instrument. Weighing risks is part of their classification. Elements to be considered are the extend (rate) of the risk indicating the probability that the risk indeed materializes and the amount of the risk referring to the monetary loss the Tax Administration will suffer.

A well-known proverb says, "prevention is better than cure". This saying also applies to the system of risk management. Preventing or reducing a risk is superior (both more effective and efficient) to "repairing" a risk afterwards.

Risk reduction entails decreasing or preventing a risk. It is a special form of covering risk. By using risk reduction, the probability of the taxpayer escaping his duties and liabilities is decreased. In terms of risk management, risk reduction requires that for each risk it must be established whether, and if so, in which way the risk possible can be reduced in advance.

A risk is not always a consequence of intentional behaviour of the taxpayer, but can also be the result of a lack of fiscal knowledge. It may also happen that a risk occurs specifically under certain circumstances, or in certain (groups of) taxpayers, for example in starting companies. These entrepreneurs are frequently unaware of all fiscal consequences of their activities.

A risk can many times be reduced by generic measures like:

- Legislation,
- education: both in general and for certain taxpayers,
- agreements with trade or industry, as well as with individual taxpayers to give clearance to the taxpayer about the interpretation of the law,
- increasing the perceived change of being caught.

Of course not all risks can be (entirely) prevented. This leads to risk detection, the establishing whether a risk has occurred, or will occur with a certain degree of probability.

Selection

After a risk has been detected, the question arises whether that risk should indeed be signaled to the tax officer. This depends on three factors:

- the financial importance,
- the extend of the risk involved in the object risk (the probability that the fiscal consequences will not be included in the tax return),
- the level of fiscal integrity of the taxpayer concerned, the subject risk, reflected in his fiscal behaviour.

By determining the weight of these three factors it will be possible to establish a threshold level for its category of attention intensity. With this parameter the weight of the potential risk can be determined

In each case of risk, efforts should be made to cover the risk by means of the most effective and efficient form of treatment. Preferably a treatment programme that is geared to the risk will support the tax officer.

Evaluation

Evaluation and feedback are essential elements of the risk management process. Evaluation is necessary in order to learn from the process and to increase its accuracy. Evaluation makes it possible to refine the process model, and to achieve greater efficiency. The feedback of any results and conclusions from the evaluation process provides an important input for the Tax Administration's decision making. It is therefore necessary to evaluate not only each individual step but also the process as a whole.

The feedback will have a two-fold impact:

- Firstly, it will provide information with regard to decisions on auditing strategy, and auditing policy and auditing plans, and to the overall planning of operational auditing activities. It will also be an essential tool for the allocation of human and technical resources.

- Secondly, the results will have a direct impact on the model itself. As the evaluation needs to cover all steps, as well as the process as a whole, the outcome could directly be translated into decisions, which reinforce the various steps, as well as the process as such. If tax auditing is principally based upon risk analysis, it will be of the utmost importance to regularly evaluate the model and its outcome.

Next to the information of the examination of signaled risks, information of random examinations (examinations without a special reason) can give additional feedback. The random examinations can give information of non-identified risks.

Treatment strategy translated in forms of treatment

There is an interrelationship between the risk management process and the treatment strategy. The treatment strategy reflects the degree of attention, the form and the intensity of the treatment. Such aspects as the available capacity and the level of training and development of the employees determine the degree, in which the treatment strategy, as it has established, will indeed be implemented in practice.

On the basis of the treatment strategy selected, various forms of treatment can be applied. The elaboration of the treatment strategy is based upon the enforcement pyramid, which includes all treatment forms from providing assistance to taxpayers at the bottom to detection, criminal investigation at the top. To main flows of activities can be distinguished: proactive activities/up-to-the-present activities and testing/reactive activities. Proactive treatment forms are actively providing information and proactive/up-to-the-present checks like visits to starting companies, preliminary consultation and observation on site. Testing/reactive activities are validation, verification and audit.

Why proactive testing

One of the goals emanating from the strategic objective of compliance is “optimizing the tax revenue” in terms of both the moment in time of the receipts and the completeness of liabilities and payments. Seen from the perspective of the Tax Administration, operating up to the present should result in both a faster cash flow (“pay as you earn”) and a reduced probability of collection losses. Facts are still observable, and prime documents are still available.

Operating up to the present has also benefits for the taxpayer. A company will certainly appreciate speed and knowledge ability, and by its nature a company is more focused on the present and the future than on the past.

Validation

A large number of risks can only be detected on the basis of the final return, particularly in cases where technically fiscal choices have been made after the books were closed. The selection of tax returns concentrates on these risks in particular. In principle, tax returns in the low risk categories can be processed. Tax returns in the category average risk and average importance need to be checked further, whether they need to be passed on to be dealt with by an inspector or auditor. Tax returns with high risk should always be ejected to be handled by an inspector/auditor.

Obviously, insetting the selection rules and criteria the available capacity will be taken into account. Part of the available capacity will be set aside for preliminary consultations, detection and active selection.

Verification

Verification is a form of examination, at the premises of the Tax Administration. In judging the tax return, the inspector may use data that are available at the tax office.

Examples of data are:

- data of interest received by the taxpayer,
- data on payments by insurance companies,
- data on salaries and wages,
- data on shares in companies and dividends received,
- data concerning the value of property,
- data on mortgages,
- data gathered by the Tax Administration on ad hoc basis (audits).

The most effective and efficient way is to have these data in digital form available.

In applying the risk management model the desk auditor deals with the ejection ground of any taxpayer ejected from the computerized system, the selected risk. The tax return should not be checked completely for any other adjustments to be made.

The desk auditor has to make notes of the verification systematically to guarantee that findings and conclusions are easily retrieved and clearly defined in an internal audit or during the objections and /or appeal stages.

Taxpayers have to be informed about the adjustments made through a clearly drafted announcement of adjustments.

Audit

After selection an audit assignment has to be prepared. In general, an audit assignment entails that an examination of books, records and other documents should be carried out. The first objective of an examination of books, records and other documents is to determine the acceptability of (parts of) the tax returns. To do so the tax auditor checks whether the tax returns are correct and complete. The second objective of the examination of books, records and other documents is to establish whether the taxpayer has complied with the other regulations and obligations the legislator has imposed on him.

With respect to the audit of book and records, the audit assignment stipulates which (parts of the) entity, and which (parts of the) tax returns should be audited. This is important to the tax auditor because the audit assignment indicates what is expected of him. The tax auditor must take decisions on the nature and extent of his audit that are sound from a technical point of view. Accordingly, he must have insight into the business processes of the entity, as well as into the target group which this entity is part of.

Several steps are distinguished within the auditing process of the Tax Administration:

- planning,
- execution,
- forming a judgment,
- reporting and settlement.

The organizational arrangement and the management of the auditing process must ensure the Tax Administration that the execution of the auditing process meets the quality requirements. Within each of the offices of the Tax Administration a set of measures must be operational that are aimed at assuring the quality of the auditing process.

Keeping files

At each stage of the auditing process the officers involved must keep a record of the procedures they have carried out and the related conclusions. This record is to be included in the audit file. Keeping files makes it possible to be accountable for an effective and efficient approach and execution of the tax audit.

From the audit assignment through the reporting stage the audit file must provide insight into the data used, the grounds and arguments, and the decisions taken with regard to the approach followed, the planning of the process, and the execution of the procedures of an audit.

The audit file must contain, as a minimum, the audit assignment, the audit programme (the approach), the findings and conclusions, a copy of the audit report, a time record, and a record stating that the procedures have been evaluated, and who has evaluated them.

In view of the increasing volume of information available to the Tax Authority, and the multiple possibilities for its use in audit procedures, it is recommended to develop a computerized system that captures in the various databases formed by data received from the taxpayers via returns and data collected from third parties, all the information concerning a specific taxpayer.

PLANNING AND CONTROL

Tax Administrators will want to manage their various processes, both quantitatively and qualitatively, by means of a system of planning and control. Through planning and control a Tax Administration aims to ensure the integrity of its operations, and to contribute to the equality and the security before the law, as well as to justice.

Planning

The central level determined enforcement policy is reflected in policy plans (usually covering a period of five years) and the annual plans derived from it. Directors of regional directorates or divisions are responsible for the determination of policy and annual plans of the directorate or division and for their execution. Heads of offices are responsible for the office plan and its execution; team managers for their team plan and its execution and finally, each employee is accountable for his personal contribution to the realisation of the team plan.

Any arrangement with regard to the realization of annual plans and the conditions under which they must be achieved should be laid down in management contracts.

It is important in this process of planning to communicate to the employees the objectives to be achieved by the organization as a whole, including the expected contribution of the employees.

Control

Control is the process which ascertains whether, and to which degree objectives are being achieved and which risks are being encountered. To manage the process of enforcement the control function is an important instrument. The Tax Administration has several different stakeholders with different interests. Examples are:

- politics,
- international organizations,
- judiciary,
- tax consultants and accountants,
- opinion: media and science,
- taxpayers,
- employees,
- government audit committee,
- other government agencies.

The control function must not only be aimed at the internal functioning, but also at the expectations of the external stakeholders. Figures on effectiveness and efficiency, employee satisfaction, rate of illness but also figures on the amount of taxes collected and the

actual costs are of interest. Also information about the opinion of the taxpayers and others about the performance of the organization is valuable.

A distinction can be made between the more diagnostic (mechanical) control mechanism related to critical performance variables and interactive control systems related to strategic uncertainties. The diagnostic systems result often in critical success factors and performance indicators to measure the performance. Diagnostic systems are internal oriented and make use of figures available within the organization. Interactive systems are more external oriented and comprise tools such as a customer panel or review, the use of operational audits to highlight certain aspects of the operations, benchmarks and more in general the use of reviews.

Within the control function various levels and perspectives can be distinguished:

- strategic, management and operational control; particularly aimed at outputs;
- process control, directed at the various functions, such as collection, validation, verification and auditing;
- financial control, which monitors transactions and flow of money;
- quality control which complements the quantitative control.

Another distinction is:

- hard control (statistical output) based on figures;
- soft control (attitudes, demeanour and behaviour).

An aspect that requires continuous care and attention is integrity. The nature of a tax Administration's organization causes its employees to be in immediate contact with money, goods and flows of goods, and with the large financial interest of enterprises and private persons. In these contacts tax officials must remain objective and incorruptible. The organization must provide guarantees in this respect.

Developing the control function

A certain development in the role of the control function emerges, in which a number of stages can be distinguished. It should be

pointed out, however that these stages depend upon the development state of the organization itself with regard to the processes (internal focus versus taxpayer-oriented focus), the technology (separate systems versus integrated systems) and the organization (bureaucratic or entrepreneurial).

Decisive in this respect is the role the management sees for itself.

Scorekeeper

In its most elementary form controlling involves keeping a clear tally of all transactions taking place within the organization. Examples of items determining the score are: invoicing, purchase, salaries, production records, etc.

The controller who fits to this stage is thus typified as a "scorekeeper". This name reflects his focus: recording scores. As long as these scores are properly and reliably kept, management is considered to be appropriate.

Financial controller

In a more advanced development stage the scorekeeper develops into a financial controller. In addition to his investigation into whether scores are kept properly, the financial controller also checks the efficiency: it must be proper, fast and at the lowest cost possible. Cost awareness is highly developed.

Management controller

Still a stage further in the development is the management controller. The systems, routines and procedures through which scores are kept, are at their proper place; they are reliable, and their efficiency is regularly critically reviewed. The management controller, though, brings in some new skills and perspectives. The focus of the management controller is on the manager, who he sees as a customer to be served by, first of all, listening and understanding his requirements and trying to anticipate his needs. This type of controller does not answer questions solely by producing figures, but also by providing an opinion based upon relevant information. He has the ambition to be "a partner in business".

QUALITY ASSURANCE

In addition to the role of the control function and the controller, quality can be assured by:

- assessing work done by or on behalf of the team manager
- assessing work done by technical experts
- supervision of most experienced employees (mentor)
- supervision as part of coaching
- supervision within specialist groups

Critical success factors

Critical success factors are factors that are of decisive importance to the success of the organization as a whole. The critical success factors stem from the strategy. Performance indicators are used to measure the realisation of the strategic goals. Examples are:

Critical success factor	Performance indicator
Collection maximization	Pay as you earn Cash flow pace
Productivity	The relationship between resources and production
Carefulness	Number of objections in relation to the number of tax assessments Number of objections settled in favour of the taxpayer
Completeness	Object completeness: the extent to which tax collection is covered by contra information Subject detection: number of new taxpayers detected
Satisfaction / Acceptance	Number of taxpayers that accept / appreciate the performance
Justice	Number of cases where justice is contested
Confidentiality	Number of cases where confidentiality is contested

Equity	Number of cases where equity is contested
Fraud prevention	Number of tax audits Number of proven fraud cases Number of assessments with a correction Average amount of correction
Enforceability of tax laws	Calculation gap: difference between estimated costs and real costs
Product quality	Accepted corrections Number of court decisions in favour of the tax administration
Quality of processing	Average throughput time of tax assessment and appeals Number of tax assessments to be processed
Expenditure	Relationship between resources and tax revenue
Staff proficiency	Number of staff whose performance is above average Quality: test results
Staff performance	Sickness percentage Mismatch Staff satisfaction quota

These critical success factors, represented here as performance indicators, provide insight into the development and progress of (strategic) goals.

It is not so much the actual outcome of the indicators but rather the trend that matters. The trends provide the management of the Tax Administration with strategic information for adjusting future opportunities and policies.

It is important to create a balanced set of performance indicators shortly linked to the strategy of the organization and the core tasks. Otherwise the Tax Administration could be far from achieving its mission.

The Fiscal Quality Index (FIX)

The fiscal quality index is an instrument to measure the quality of the implementation of legislation and rules. Each year, tax specialists of the tax administration determine the most important subjects of the main taxes. The subjects are specified into items. Tax specialists judge the fiscal viewpoints on the basis of a random check and indicate with a score whether the legislation and rules have been applied correctly. The different scores for each form of taxation are summarized into one index number: the fiscal quality index.

The Fiscal Monitor

The fiscal monitor is an instrument to measure the attitudes and opinions of target groups regarding the way the Tax Administration implements legislation and rules. The data for the fiscal monitor are obtained mainly through face to face interviews with standardized questions (quantitative). Some client groups (very large businesses) are interviewed in semi-structured free interviews (qualitative).

Both the fiscal quality index and the fiscal monitor help the Tax Administration improve the quality of the service and the performance of the Tax Administration. Provides the first instrument insight in the quality of the implementation, the latter provides an insight into the way customers experience this implementation.

PERFORMANCE MANAGEMENT

With a strong focus on results and a more explicit relation between organizational goals and desired effects and results the performance management will be aimed on objectives. Systems are (going to be) implemented based on the so called Business Balanced Score card. The model shows four different perspectives from which an organization can look at the outside world. For the Tax Administration the four perspectives have been translated to Tax Administration perspectives:

- Financial perspective: Results law enforcement
- Innovation perspective: Developing organization
- Process perspective: Process control
- Market perspective: Valued by stakeholders

The objectives could be the following:

Results of enforcement of the law

- Control of the cash flow
- Risk control
- Unity of policy and implementation
- Effective fraud control
- Protection of society from unwanted goods (Customs)

Developing organization

- Implementation of new technologies
- Implementation of new methods and techniques
- Raising the level of professionalism of employees
- Intensification of knowledge management

Process control

- Cost control in the logistic process
- Optimization of data management
- Realization of products and services
- Optimization of efficiency and flexibility
- Optimization of information security

Valued by stakeholders

- Integrated and current customer management
- Accessible and fast supply of information
- Decrease of costs and burden for taxpayers
- Competitive terms of employment and a challenging working environment

When these objectives are worked out into measurable goals, they will form the basis of performance management in the future.

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Case study

TOPIC 3.1.

SUPERVISION AND REVISION OF EXAMINATION ACTIONS

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CONTENTS: 1. Introduction.- 2. Examination Management Control Department.- 3. Performance Agreement.- 4. Mechanisms for the Supervision and Revision of Examination Actions.- 5. Current Situation and Future Projection of Each Examination Process.- a. Mass VAT Processes.- b. Mass Income Processes.- c. Selective Examination.- d. Examination Presence.- e. VAT Refunds.- 6. Conclusions.

1. INTRODUCTION

The supervision and revision of examination actions was until some time ago the individual task of those responsible for the different processes, which mostly favor global evaluations and follow-ups. Being issues in this manner, at the end of 2002 the Examination Management Control Department was created, its main task consists in performing the follow-up of each process that is related to examination, separately from the participating units, coordinate the efforts of the different areas with the purpose of delivering indicators that allow the performance of evaluations and management actions.

The aforementioned indicators are directed towards the follow-up of processes from three perspectives; efficiently comply with the objectives, as well as the efficiency in the use of the resources and quality in taxpayer attention.

The information generated is delivered monthly to those responsible for the processes, separated by a unit in charge of a determinate amount of taxpayers and comparative regarding previous periods. Furthermore, tables that have the information necessary to enable units perform comparisons amongst themselves are published in the Intranet.

In drafting processes, we find that sufficient information that allows its follow-up and evaluation is not always available, therefore the development of routines or procedures, which generate reliable statistics and facilitate their control, is necessary.

New applied technologies are allowing process automation, the registry of data and their on-line downloading, which will mean that more information will be available, in a timely manner and with better quality.

The generation of information shall allow in the short term, that responsible units will make their decisions on processes in a timely manner, they will be able to measure the impact of their efforts and facilitate the global evaluation thereof. In the medium term, units will be able to measure the impact of the standardization of guidelines, the establishment of objectives per unit and the verification of their compliance.

During the second half of 2003, the follow-up of the Performance Agreement began, the same established goals for certain indicators to evaluate their compliance by work teams, turning into an important supervision and control tool.

2. EXAMINATION MANAGEMENT CONTROL DEPARTMENT

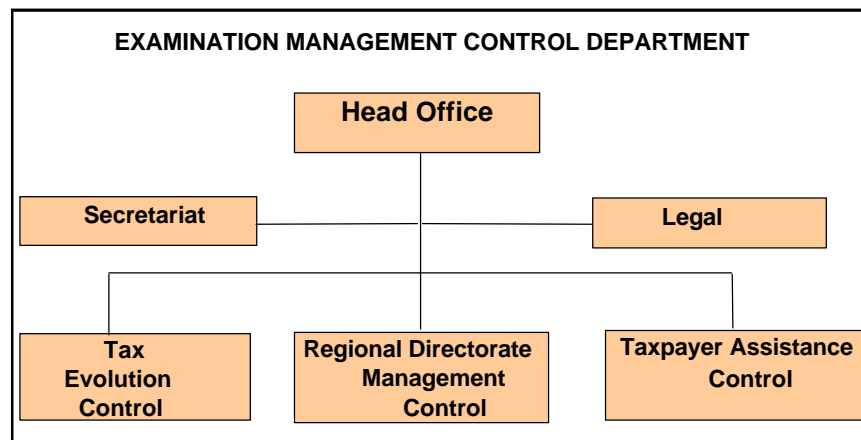
The Examination Management Control Department was created on December 31, 2002, and it is in charge of performing the follow-up on each of the processes related to examinations in a separate manner by the participating units as well as coordinating the efforts of the different areas with the purpose of delivering indicators, which allow the performance of evaluation and management.

This Department is directly subordinated to the Sub-Directorate of Examination, which is an integral part of the National Directorate. In the same the examination processes that are carried out by the different units of the Internal Revenue Service are defined, structured and planned throughout the national territory.

At the same time, the different Regional Directorates are responsible of performing taxpayer follow-up actions and in the same a large part of examination processes are developed (some processes are performed centrally through computerized systems).

Four Departments form the Examination Sub-Directorate, namely: VAT Operation and Taxpayer Cadastre, Income Operation, Selective and International Examination and Examination Management Control. There are also three Offices directed to develop examination programs regarding determinate groups of taxpayers, in addition to two Project Areas. The Offices mentioned are: The Office for the Examination of Non-Profit Organizations and Fiscal Entities, Office for the Prevention of Tax Fraud and the Office of Special Cases.

For its part, the Examination Management Control Department is organized as indicated in the following organizational chart:



There are three main tasks and its organization was based on the same. The first task, called "Tax Evolution Control", consists in developing a procedure to develop tax follow-up throughout time, with the purpose of detecting fluctuations or deviations regarding what is expected, as tool to support tax inquiries.

The second task is “Regional Directorate Management Control”, which consists of supporting Regional Directorates with the generation and delivery of indicators permit the to evaluate and perform constant follow-up on each examination process developed therein or those that affect the universe of taxpayers in their responsibility.

Finally, through the task called “Taxpayer Assistance Control” the purpose is to study and create evaluation and follow-up mechanisms regarding quality in taxpayer attention for examination processes, in the different points of interaction, those may be at the Regional Directorates or through applications that the Internal Revenue Service has put at the disposition of users via Internet.

Currently, the Department is formed by eight professionals, two of which participate in the “Tax Evolution” project, three in the “Regional Directorate Management Control” and one in the “Taxpayer Assistance Quality”.

3. PERFORMANCE AGREEMENT

During the second half of 2003, management indicators and results goals were defined regarding said indicators, to evaluate the performance of the different units. Therefore, 18 work teams were defined, based on criteria that gather the organizational and territorial structure of the institution.

Specific indicators and their goals provide information on the areas where the Tax Administration wishes to place more emphasis, and protect daily operations and the permanent standards of the Service in all its areas.

Said indicators were defined for the following fields:

- **Increase Collection:** Real percentages increase in collection that is declared in form F29 (VAT Declaration and Payment and Monthly Taxes Form) for the second half of 2003, when compared to the second half of 2002.
- **Increase the Examination Presence:** Percentage increase during the second half of 2003, when compared with the examination presence actions performed in 2002.

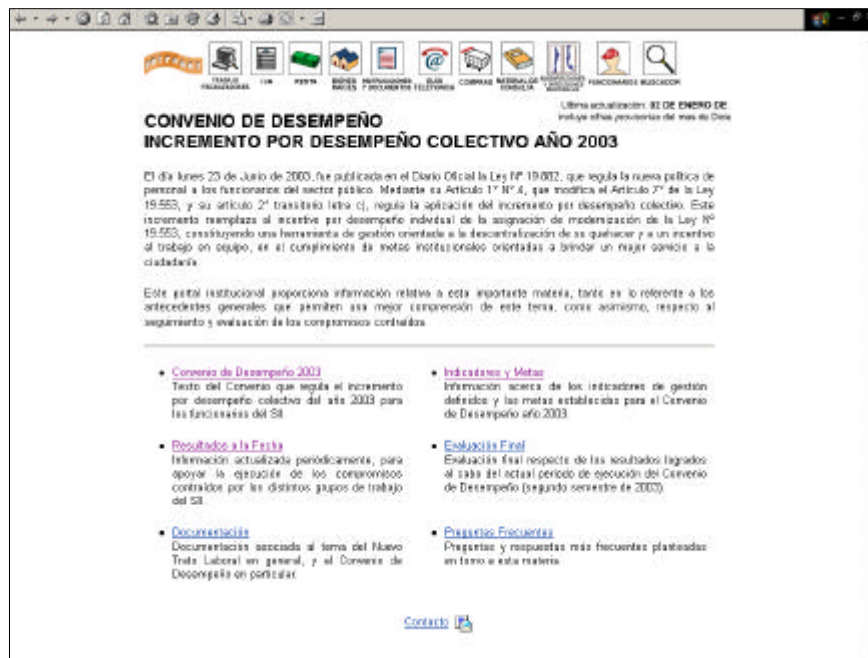
- **Increase Internet F29 Declarations:** Percentage increase of the rate of F29 declarations filed via the Internet during the second half of 2003, when compared to the second half of 2002.

To facilitate follow-up actions on behalf of work teams, information is published monthly in the Intranet, so that everyone can be thoroughly informed by monthly tracking the evolution of their indicators.

Indicators are updated monthly in regards to the immediately previous period. The verification of compliance with goals is performed during the month of January, once the definite information regarding the six-month period is obtained.

In regards to 2004 we can mention that new indicators and goals have been already established and emphasis continues to be within the scopes set forth regarding 2003, against which collective performance will be evaluated and so on so forth, therefore this constitutes a supervision and follow-up tool that involves the entire organization.

The information of the Agreement is delivered to users via the Intranet, as from a menu specially prepared for this purpose, which includes the results obtained by each work team.



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INTRODUCCION DATOS DE BASE JULIO 2002 AGOSTO 2002 SEPTIEMBRE 2002 OCTUBRE 2002 NOVIEMBRE 2002 DICIEMBRE 2002 ACUMULADO 2002

COMPROMISO 3: AUMENTO DE DECLARACIONES FORMULARIO 29 (F-29) POR INTERNET

TASA DE DECLARACIONES F-29 POR INTERNET A LA FECHA

REGIONAL	Declaraciones F-29 Internet	Declaraciones F-29 Papel	Declaraciones F-29 Unidad	Pagos de Gros Internet	Pagos de Gros Papel	TASA DE DECLARACIONES F-29 POR INTERNET	META AL 31.12.2003
I	10.569	127.918	1.610	6	1.695	12,4%	9,2%
II	19.155	112.766	2.129	2	1.695	14,1%	13,0%
III	7.109	94.507	1.267	10	536	9,7%	9,0%
IV	15.913	152.100	2.844	7	2.514	9,3%	6,9%
V	63.945	405.015	7.495	70	3.675	13,3%	10,4%
VI	35.449	193.576	2.325	17	1.905	15,2%	10,9%
VII	49.065	260.762	1.955	17	3.632	15,6%	12,1%
VIII	63.651	424.823	6.099	94	3.616	12,8%	10,4%
IX	39.631	191.253	2.074	26	2.167	16,6%	14,0%
X	55.379	244.705	4.534	64	2.426	18,1%	15,6%
XI	9.007	18.981	216	7	388	33,7%	15,2%
XII	6.910	44.222	1.012	26	622	13,1%	7,2%
RM CENTRO	91.113	290.340	5.654	96	2.751	23,4%	17,3%
RM PONIENTE	84.329	397.842	6.166	93	4.604	17,1%	14,9%
RM ORIENTE	190.801	471.434	4.912	243	7.380	26,2%	21,2%
RM SUR	66.624	367.068	5.456	33	5.785	15,2%	13,7%
GRANDES CONTRIBUYENTES	4.836	1.355	65	116	755	69,6%	22,8%
DIRECCION NACIONAL	821.186	3.758.207	55.853	809	46.679	17,6%	13,8%

4. MECHANISMS FOR THE SUPERVISION AND REVISION OF EXAMINATION ACTIONS

The generation of supervision indicators for examination process has been set forth from three perspectives, these are:

Efficacy: related to compliance with the objectives for which a determinate process is generated. Normally, we associate to collection or performance values.

Efficiency: linked to resources used in a determinate process. These are mainly human and physical, later, for the generation of efficiency indicators in the use of human resources, it will be necessary to know the amount of man-hours directed to each function and especially those considered in examination processes.

Quality in Taxpayer Assistance: through this perspective an attempt is made to observe aspects that are sensitive to taxpayers in the interaction that it maintains with the Internal Revenue Service in the different examination processes.

Information is delivered monthly to those responsible for processes, separated by units in charge of a determinate universe of taxpayers and comparative regarding previous periods. Furthermore, all necessary tables for the generation of the indicators, of all units are published in the Intranet to facilitate comparative analysis.

Examination Processes

Currently the main examination processes, are the following:

- Mass VAT Processes (Value Added Tax).
- Mass Income Processes.
- Selective Examination.
- Presence.
- VAT Refunds.

Hereinafter we shall deliver a brief description and present examples of the current supervision and revision mechanisms implemented or to be implemented at our institution.

Example of a Chart of Indicators:

4. INDICADORES PRESENCIA FISCALIZADORA									
Fuente: Datos Publicados por Presencia en Intranet									
Fecha Procesamiento de Datos: Noviembre 2003									
Código	NOMBRE INDICADOR	MODO DE CÁLCULO	UNIDADES	REGIONAL					
				ENE-OCT 2003		ENE-OCT 2002		VAR	
				Modo de Cálculo	Resultado	Modo de Cálculo	Resultado	Anual	Regional
4.1	Nº Controles Comercio Establecido	Nº Controles Inicio y Reg. Documentos + Nº Controles Puntos a Puntos + Puntos Tipo	Controles	3,248 + 82 = 3,330	+ 194	1,850 + 232 = 2,082	+ 2,278	47,23%	
4.2	Nº Empadronamiento y Tasaciones	Empadronamiento + Tasaciones	Controles	439 + 1,490 = 1,929		445 + 1,056 = 1,495	+ 1,495	20,03%	
4.3	Nº Controles Carreteras	Controles Carreteras + Controles Medios	Controles	1,044 + 402 = 1,446		775 + 81 = 856	+ 856	68,93%	
4.4	Nº Controles Terminales Faltas Mayores y Otras	Toma. Insatisfacción (Faltas y Medios) + Faltas de Grande + Medios + Medios Trigo + Exp. de Cont. + Insatisf. de Bodega + Act. Especiales	Controles	7,102	= 7,102	8,921	= 8,921	-20,39%	
4.5	Tiempo Medio Controles Comercio Establecido	III Em. y Reg. Doc. + III Pto Pto + III Pto Pto	Etapa	8,851	= 1,45	4,489	= 1,97	-26,69%	
		Nº Controles Comercio Establecido	Controles	3,351		2,276			
4.6	Tiempo Medio Empadronamiento y Tasaciones	III Empadronamiento + III Tasaciones	Etapa	971	= 0,58	1,058	= 0,69	-27,59%	
		Nº Empadronamiento y Tasaciones	Controles	1,929		1,495			
4.7	Tiempo Medio Controles Carreteras	III (Carreteras + Medios)	Etapa	978	= 0,69	990	= 1,17	-41,99%	
		Nº Controles Carreteras	Controles	1,446		856			
4.8	Tiempo Medio Controles Terminales Faltas Mayores y Otras	III Nº C. Terminales Faltas Mayores y Otras	Etapa	2,937	= 0,29	4,152	= 0,67	-38,37%	
		Nº Controles Toma Puntos Mayores y Otras	Controles	7,102		8,921			

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Example of Publications in the Intranet, to facilitate comparison among units:

Tabla General 3.1 - N° Controles de Presencia para el periodo Enero - Noviembre 2002 y 2003											
Fuente: Datos Publicados por Presidencia en Intranet											
Fecha Procesamiento de Datos: Noviembre 2003											
ENE-OCT 2002	CONTROL REALIZADOS	CONTROLES DE LA DELEGACION Y REGISTRO DE DECLARACIONES	PUNTOS PAGO	PUNTO A PUNTO	EMPRESAS MONITOREADAS	TASACIONES REVISADAS PUBLICADAS	CONTROLES CARRETEROS	CONTROLES CARRETEROS INDUSTRIALES	CONTROLES CARRETEROS MALECON	CONTROLES PRESENCIALES	FECHAS DE CANCELACION
M	N	N	N	N	N	N	N	N	N	N	N
I	8.829	0.040	0	0	439	1.493	1.896	0	0	0	402
II	8.892	4.120	29	932	1.851	401	1.238	0	0	0	388
III	8.780	3.881	36	771	838	1.711	270	0	0	0	230
IV	8.791	1.115	41	704	0	2.262	1.257	0	0	0	0
V	28.890	3.220	36	2.343	201	1.741	2.020	0	0	0	2.041
VI	19.481	8.288	46	428	287	1.261	4.428	0	0	0	1.041
VII	48.448	1.042	81	2.024	207	1.365	2.145	2.004	62.361	0	0
VIII	48.445	3.224	36	0.000	1.241	1.362	4.328	0	0	0	5.328
IX	42.468	8.022	0	0	0	0	7.822	0	0	0	2.822
X	34.268	8.000	0	1.841	0	1.290	3.041	0	0	0	2.041
XI	4.671	9.000	42	0	0	212	121	0	0	0	302
XII	8.476	2.041	76	3.041	24	336	7.022	0	0	0	0
ENE	27.888	1.838	17	888	1.871	0	28.728	382	0	0	28.728
FEB	42.811	1.000	48	0	0	0	8.888	0	0	0	8.888
MAR	28.481	9.021	88	1.441	2.381	815	26.121	608	0	0	26.121
ABR	32.888	8.101	215	301	2.881	0	1.021	4.018	0	0	4.018
MAY	34	34	34	34	34	34	34	34	34	34	34
JUN	68.421	18.718	2.021	28.221	8.848	13.888	81.324	48.812	122.421	88.221	24.821

5. CURRENT SITUATION AND FUTURE PROJECTION OF EACH EXAMINATION PROCESS

a. Mass VAT Processes

Definition

Consists in the mass administration, processing and examination of tax compliance regarding taxes subject monthly declaration and payment, the purpose is to facilitate tax compliance and perform follow-up through information cross-referencing with internal and external sources as from which, examination plans are generated regarding a large amount of taxpayers.

Dimension

Amount of Declarations: 720 million dollars monthly (8,600 annually).
 Number of Declarations: 985,000 monthly (11,800,000 annually).
 Number of Taxpayers Notified for Auditing: 30,000 monthly.

Follow-up Indicators

The VAT Operation Department and Taxpayer Cadastre, with the following types of indicators, perform the global follow-up of the process:

- Number and amount of declarations inputted monthly through different means (declarations may be filed on paper or inputted through the Internet).
- Number and amount of declarations corrected.
- Drafts issued for imbalances and returns corrected.

Information cross-referencing is performed monthly these generate the objection of taxpayers; those notified to appear before the units must file the documentation that answers for their returns or modify the same through a correction. The follow-up of these “Special Plans” is done with the following types of indicators:

- Number of taxpayers objected notified.
- Number of taxpayers notified that appear before the units.
- Number of returns corrected.
- Drafts issued for returns corrected (performance).
- Number of taxpayers notified without performance.

With this information the effectiveness of the objection process of each of the special plans is measured globally. In the short-term, this information will be delivered by unit.

For follow-up in the units, the following information is delivered monthly:

- Number of monthly returns inputted through different means (Internet, paper, etc.).
- Amount of returns in pesos and dollars.
- Average per declaration.

Comments

Follow-up information is consolidated nationally and only in some cases, and it has allowed the generation of indicators by unit, which mainly refer to efficiency of the process, measured by the largest collection and not the efficiency with which it is performed, and on guidelines associated to attention quality.

Advance in the generation of Indicators by Unit (%)

	10	20	30	40	50	60	70	80	90	100
Efficacy										
Efficiency										
Quality										

The follow-up of “Special Plans” is done globally and not by the units participating in the process. Data download routines are being generated to allow the separation of these indicators in the short-term.

Data are obtained directly from the system called IVANET, monthly, once the totality of the forms inputted in paper or through the Internet are registered. The information downloaded from the system may be qualified as very reliable.

Future Actions

To complete the generation of efficiency indicators by unit: it will be essential to separate information available, consolidated nationally, to report on the performance of taxpayers distributed nationally, to report on the performance of taxpayers distributed by units, as well as the actions that are part of the process performed by them.

The information shall be downloaded directly from the IVANET system, therefore the development of the routines and test of the results is being performed, for that reason we should begin the publication of the indicators programmed for the short-term.

Furthermore efficiency indicators in the use of resources and the quality of taxpayer attention by unit must be generated.

Examples of possible indicators are:

Efficiency:

- Number of taxpayers notified attended by examination.
- Number of taxpayers notified with performance.

Taxpayer Attention Quality:

- Average attention time per taxpayer notified.
- Number of times on average in which the taxpayer must appear before the unit until the auditing process concludes.

b. Mass Income Processes**Definition**

It consists in the massive administration, processing and examination of taxes that affect income perceived by taxpayers, declared every year during the month of April.

Voluntary compliance on behalf of taxpayers is sought through this process, by means of mechanisms that facilitate, verify or lead to the correct declaration and payment of taxes and the reduction of the corresponding credits.

Dimension

Number of Returns: 2.4 million.

Amount of Refund Requested: 1,500 million dollars.

Amount paid de the Treasury: 700 million dollars

Number of Returns Objected: 300,000 returns

Refund withheld at May: 700 million dollars

Follow-up Indicators

The global follow-up of the process has been performed by the Income Operation Department with the following type of indicators:

- Number and amount of returns inputted by different means (paper or Internet),
- Number and amount of returns corrected,
- Drafts issued by imbalances and returns corrected,
- Performance in favor and against the Treasury resulting from the correction of first returns.

After the receipt of annual returns, information cross-referencing is performed with internal and external vectors (information from internal sources and coming from third parties) that generate the objection of returns, forcing the taxpayer to deliver the background that supports what has already been declared or otherwise rectify. For the follow-up of this process the following types of indicators are used:

- Number of taxpayers objected and amounts retained.
- Number of taxpayers objected notified.
- Number of taxpayers objected notified and that they rectify via Internet.

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- Number of taxpayers objected notified and that appear before the units.
- Number and amount of corrections.
- Performance by corrections in favor and against.
- Number and amount of releases of amounts withheld.
- Number of releases performed centrally and performed at the units.

As from 2003, the monthly delivery of this information to the units responsible of the process, grouped according to the taxpayer registration of their jurisdiction.

Parallel to the income process information cross-referencing complementary to those previously mentioned, which seek specific evasion focuses and which involve a reduced number of taxpayers, to which an audit shall be practiced. The follow-up of these "Special Plans" is performed with the following type of indicators.

- Number of taxpayers summoned.
- Number of taxpayers that appear to the summons.
- Number of taxpayers with performance.
- Drafts for liquidations and returns corrected.
- Number of new returns with payment.

This information is in process of being validated to be delivered by unit.

Comments

Data downloading is performed monthly as from the system called "On-line Income", whereby the registry is performed automatically in the operation of the process. Statistics generated are reliable.

Advance in the generation of Indicators by Unit (%)

	10	20	30	40	50	60	70	80	90	100
Efficacy	■	■	■	■	■	■	■	■	■	■
Efficiency	■	■	■	■	■	■	■	■	■	■
Quality	■	■	■	■	■	■	■	■	■	■

The units have the largest amount of efficiency indicators available regarding the other perspectives. It must be equally complemented with efficiency and quality indicators.

Some examples of these indicators are the following:

Efficiency

- Number of Taxpayers attended by auditor.
- Mean performance per auditor.
- Mean attention time per taxpayer challenge attended at the units.
- Number of objected notified to correct at the units, their appearance and performance.
- Number of cases transferred to audit regarding the total notified.
- Average performances by type of note that gave place to the objection of returns.

Quality of Attention

- Mean time of releases (refund of the amount withheld without the taxpayer modifying their return).
- Mean number of times that the taxpayer appears to the unit until the end of the review.

The information already available allows the global evaluation of the Income process per unit.

The information referring to special plans shall be delivered at the units in the medium term, since data download routines are in process of validation.

Future Actions

The generation of indicators for “Special Plans” per unit.

Complement efficiency and efficacy indicators to follow-up mass process.

c. Selective Examination

Definition

It consists in the development of audit programs directed to verify tax compliance with taxpayer groups that comply with determinate selection criteria.

Dimension

Number of audit cases concluded per year: 13,000 cases
 Audit performance: 350 million dollars

Follow-up Indicators

- Number of cases inputted to be audited.
- Number of cases concluded with and without performance.
- Mean performance of cases concluded.
- Number of cases assigned by auditor.
- Number of cases concluded by auditor.
- Program profitability.
- Number of cases claimed regarding the number of cases concluded.
- Number of cases claimed with a sentence in favor of the taxpayer.

Comments

Information downloaded from the data registry system called "Examination Support System" (SAF, in Spanish). Registry is done manually, once each activity of the audit process has concluded. Information downloaded from the system has presented inconsistencies, mainly generated by the incorrect digitalization of the activities, which has limited the obtainment of reliable indicators, especially those that associate the time variable.

Advance in the generation of Indicators by Unit (%)

	10	20	30	40	50	60	70	80	90	100
Efficacy										
Efficiency										
Quality										

From the perspective of the efficacy, the current system delivers information that must complemented with the global evaluation of each audit program.

From the point of view of the efficiency, indicators that allow measuring the use of human resources associated to the different levels of complexity of the programs must be incorporated thereto. Examples of these may be.

- Number of cases concluded by auditor.
- Average performance per auditor.
- Number of cases assigned per auditor.
- Mean duration time of the audit.
- Mean time used in the development of audits, according to different levels of complexity.

From the perspective of quality, it is necessary to complement with indicators such as:

- Number of audits that surpass the maximum time determined.
- Result of claims filed by taxpayers. Number of claims accepted and which implied the reversion of the auditor's task. (The current system generates the information mentioned; its quality allows its adequate use).

In the short-term, the implementation of the application TAX SOLUTIONS will be concluded, which will substantially improve the quality of the indicators.

Future Actions

Data downloading from the Tax Solutions audit module. In this regard, it is important to mention that the registry of information in the TAX is performed whenever the auditor performs an operation, part of the audit process in the system, that is, issues a notice, liquidation, draft, etc. The same indicators already elaborated as from the SAF tool are generated, with a substantial improvement in the quality of the information.

As from the same system, statistics will be generated on taxpayers' claims to the audits performed (Review of RAF's Examination Actions and Tax Courts).

Global evaluation of each audit program. Number of Taxpayers selected, number of audits with performance, mean performance of audits, mean time until liquidation.

d. Examination Presence

Definition

Consists in the permanent procedure of on-site review, performed by the officials of this Service and which purpose is to verify compliance with taxpayers' tax obligations, especially, in the document registry and issue. Furthermore, through actions of this nature, the purpose is to encourage voluntary tax compliance.

Types of actions which require the presence of taxpayers

Controls to Established Companies: Reviews performed by auditors at the commercial taxpayer directorate (commercial establishments, offices, factories, etc.), with the purpose of verifying correct document issue and registry.

Controls at Wholesale Fairs (cattle, horticulture and fruit, wood fairs, etc.): Reviews performed by auditors at wholesale centers where input suppliers and buyers attend, with the purpose of verifying correct transaction issue and registry.

Mobile and Fixed Road Controls: Control performed by auditors to supporting documents (invoices and dispatch guides) of the cargo transported by using public roads.

Tax Lists and Appraisals: Consists in visits to taxpayers of sporadic commercial activity (craft, Christmas fairs, lease of furniture during vacation seasons, etc.), with the purpose of verifying its taxpayer registry associated to the activity developed and determines a sales estimate and profit margin for tax effects.

Dimension

Taxpayer universe: approximately 1,000,000 VAT returns
Total number of controls performed annually: 800,000 controls
Number of violations filed: 35,000
Number of man-hours used annually: 340,000 man-hours

Follow-up Indicators

- Number of controls per type of action
- Mean time used per type of control
- Amount of man-hours used per type of control

- Amount of overtime and night hours
- Number of violations filed
- Number of closings

The information is delivered monthly, separately by unit and compared with previous periods.

Comments

Information is downloaded from electronic templates where the units register the information daily. Currently the registry of actions requiring the presence of taxpayers is being established in a new on-line system, which will allow the download of information directly. Furthermore, it will be possible to download from the database taxpayers affected by type of actions requiring the presence of the taxpayer.

Advance in the generation of Indicators by Unit (%)

	10	20	30	40	50	60	70	80	90	100
Efficacy										
Efficiency										
Quality										

Unlike previous processes, in this case we mainly have information on efficiency and not efficacy. To consider the efficacy of the process, we must study the impact that each action requiring the presence of the taxpayer in taxpayers' returns and associate it to the largest collection. For this purpose, it will be possible to download from the system lists of affected taxpayers by actions requiring the presence of taxpayers to perform impact analysis.

Future Actions

Download information from the indicators as from the new on-line system.

Complement efficiency guidelines with coverage indicators.

Generate efficacy indicators, which measure the impact of collection on taxpayers affected by some type of action requiring their presence.

e. VAT Refunds

Definition

Consists in the different procedures, since money refunds are generated by virtue of payments performed as VAT payment. The taxpayer files a return request before the Service, and the latter through procedures previously established may authorize, modify or reject said request.

The refunds of taxes considered are the following:

VAT refunds to Exporters

VAT Refund due to an Investment in fixed assets (Art.27 Bis of DL N° 825, 1974)

Refund due to the Change in Subject

Dimension

VAT refunds to Exporters

Number of requests filed per year: 14,000 requests

Amount of refunds authorized annually: 2,500 million dollars

VAT Refund due to the Change in Subject

Number of requests filed per year: 8,000 requests

Amount of refunds authorized annually: 20 million dollars

VAT Refund due to an Investment in fixed assets (Art. 27 Bis).

Number of requests filed per year: 500 requests

Amount of refunds authorized annually: 70 million dollars

Indicators

- Number of refund requests received
- Amounts of refund requested
- Number of authorized refund requests
- Amount of authorized refunds

Comments

VAT Exporter refunds are managed through a workflow application called "Exporter Life Sheet" (HVE, in Spanish). The entire authorization process for the refund is carried in the same and it generates the statistical information for the global follow-up of the process. Indicators obtained as from this application do not allow the adequate evaluation and follow-up of the participating unit and the stages involved in the processes.

Unlike what has happened in other refund processes, in this case the information is available and it is necessary to generate the applications in order to download the same.

Information on VAT refunds due to the Change in the Subject and Art. 27 Bis, is registered in the SAF (Examination Support System) application, however, it is not possible to recover reliable information from the system, as a result of errors detected in the manual registry of data. Then, as from October 2003, a new manual registry on Excel spreadsheets began and we expect to download the information to perform adequate performance.

Advance in the generation of Indicators by Unit (%)

	10	20	30	40	50	60	70	80	90	100
Efficacy										
Efficiency										
Quality										

In consideration of the scarce information available on processes, we can indicate that we do not have sufficient tools to facilitate the supervision and follow-up of refund processes carried out by the units, from the three perspectives mentioned.

Some examples of the indicators necessary for adequate verification are the following:

Efficacy

- Number and amount of requests filed
- Number and amount of refunds rejected at each stage of review
- Number and amount of refunds authorized at each stage of the review

Efficiency

- Average of reviews performed per auditor
- Number and amount of refunds rejected by the auditor at each stage of the review
- Number and amount of refunds audited at each stage of the review

Quality

- Number of times that the review exceeds the terms established
- Mean time of each stage of the review

Future Actions

The generation of efficiency, efficacy and quality indicators, for each refund process indicated by responsible unit.

In the VAT Exporter refund we expect to download information directly from databases generated by the current system Exporter Life Sheet, therefore the required study began. In the short-term indicators, which will complement the current global analysis with a more detailed one by units and activities involved in the process will be generated.

In the case of refunds due to investments in fixed assets and due to changes in the subject, the download of information from the new registry templates will begin as from which the Follow-up Indicators will be generated and will be complemented with the information on refunds that are effectively performed.

6. CONCLUSIONS

Chile's Internal Revenue Service has made a decision to perform the follow-up of each examination process from the perspectives of Efficacy, Efficiency and Quality in Taxpayer Attention. Currently, partial information is being generated for most of them

Information required to generate management indicators has a significantly better quality inasmuch it is produced by the systems that rule examination processes, otherwise the manual and later registry of data in systems that consolidate and maintain historic information on processes, be them in computer applications or through other means, may create distortions which limit or invalidate their use.

The implementation of efficiency generators requires the distribution of human and physical resources used in each process. This information is not always delivered by the current systems therefore a computer application that will register the proportion of time assigned by personnel in each type of function is being developed.

The follow-up of examination processes performed as an evolution comparative measure throughout time among responsible units. To have the adequate measurement tool, which will in the short term allow the establishment of goals on determinate guidelines and evaluate their compliance, uniform the use of resources and develop global analysis of the process.

Later, units responsible for processes will be better informed and make better decisions.

During the second half of 2003, the follow-up of the Performance Agreement began, which establishes goals for certain indicators to evaluate their compliance by teams, and turning into an important supervision and control tool.

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Case study

TOPIC 3.1

THE SUPERVISION AND REVIEW OF EXAMINATION ACTIONS

Luiz Fernando Lorenzi
Operational Coordinator
Secretariat of Federal Revenues – SRF
(Brazil)

CONTENTS: 1. The Electronic Systems for Controlling the Fiscal Procedure.- 2. The Documents of the Fiscal Procedure.- 3. The Evaluation During the Procedure.- 4. The Evaluations Following Conclusion of the Procedure.- 4.1. Evaluation of procedures in relation to taxpayer selection.- 4.2. Evaluation of the procedure in relation to other similar ones.- 4.3. Evaluation of procedure with respect to compliance with the norms and procedures.- 4.4. The evaluation of the procedure with regard to the proceedings of actions under administrative law.

SUMMARY

The supervision and review of the examination procedures of the Secretariat of Federal Revenues are structured as follows:

- a) During the procedure, the head of the team follows up the execution of the work, performing a technical and administrative control, either through direct follow up of the fiscal action or through the control systems. The Head of the Team must guide the auditor in the adequate performance of the work and the correct application of the legal rules, in addition to intervening, whenever necessary and making available the adequate means for the execution of the procedure.

- b) After concluding the procedure, through the analysis of the data available in the control systems one may:
 - In relation to taxpayer selection, verify if the auditor, in carrying out the procedure, examined all items previously selected for analysis and learn the result obtained for each of them. In this way, an evaluation may be made of the execution as well as the taxpayer selection process and items to be analyzed;
 - Evaluate the procedure, comparing it to similar ones, to verify whether the procedure is within an acceptable average range of time and results;
 - Evaluate the procedure in terms of compliance with the legal and administrative norms, through auditing of the procedure;
 - Evaluate the procedure with respect to the proceedings of the writs of violation in action under administrative law, verifying the final quality of the actions originated in the fiscal procedure.

In fact, any organization, including tax organizations, must work with common administration concepts such as planning, organization and control. In this latter aspect, and with respect to Federal Revenues examination activities, there is a series of mechanisms that allow following up and evaluating the examination activity, to grade its execution, by likewise maximizing the productivity of the intervening officials.

These mechanisms are based on previous supervision and orientation and in the analysis of data related to the procedures, after the work has been concluded and beginning with the management information available in the electronic system.

1. THE ELECTRONIC SYSTEMS FOR CONTROLLING THE FISCAL PROCEDURE

The SRF has available an electronic system to support examination called Fiscal Action System, wherein, for each procedure, the following information is registered:

- a) With respect to the authorization for carrying out the procedure, the taxpayer data, taxes, periods and auditing procedures that should be carried out in the fiscal action, in

addition to the fiscal agents that must execute the procedure and the head of the team responsible for the audit.

- b) During the course of the fiscal actions, the auditor must inform the date of initiation of the fiscal action and, **monthly**, throughout the duration of the procedure, the number of hours used and the stage wherein the procedure stands. This information is provided through an electronic form.
- c) Upon concluding the fiscal procedure, the auditor will report the closing date, the auditing procedures carried out, the taxes, periods and procedures that have not been executed, the amounts of the writs of violation prepared and the corresponding number of the administrative process, in addition to other data such as the existence of criminal prosecution, inventory of properties or fiscal precautionary measures.

The auditing procedures mentioned here include the summary description of the scope of the inspections to be performed by the auditors, as long as their execution is detailed in the examination manuals. For example, see the procedure described in annex 1: said procedure determined the auditor as well as the execution of the procedure XXXXX - YYYYYYYYYYYYYY. The execution of this procedure, in turn, is regulated in the corresponding chapter of the Examination Manual.

The information mentioned in item “c” is also furnished by means of the electronic form, based on the specific system for the elaboration of the writs of violation.

In this way, the Tax Administration has available, in a permanent and updated manner, the data that allow for evaluating the examination actions as regards initiation of the procedure, number of hours used, time elapsed since initiation, the current stage of the procedure and results obtained. The system allows the evaluations to be made by an auditor, team, unit, region or the national sphere.

In sum, this system will also allow for automatically verifying if the writs of violation resulting from the fiscal procedures were maintained in the administrative judgments.

2. THE DOCUMENTS OF THE FISCAL PROCEDURE

In addition to the electronically available data, for each fiscal procedure carried out, a file is generated with the main documents of the administrative procedure, such as, for example, a copy of the writs of violation, reports on the procedure and reports on the actions without result or which may not have been executed.

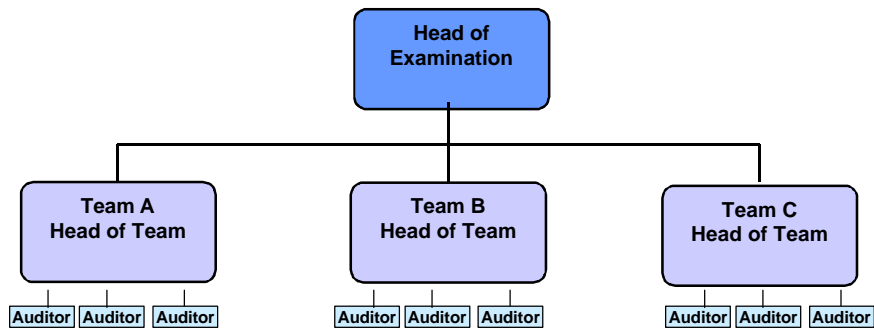
In this way, the documents are filed in the unit, to allow the analysis of the most important parts of the procedure, without having to resort to the administrative process, which many times is founded in other Public Administration entities.

3. THE EVALUATION DURING THE PROCEDURE

Within a unit of the SFR, the examination area consists of examination teams. Each team is made up of 5 to 9 auditors and a head of the team. In the large units, where there is more than one team, these are organized by specialty, according to the economic activities or sectors.

The head of the team must preferably meet the requirements established by the Secretary of Federal Revenues, who also determines his functions.

Structure of the area of examination execution of a unit:



Thus, the Head of the Team must follow up the development of the fiscal procedures assigned to his team, guiding it to ensure the adaptation of the procedure to the norms and to the best execution technique. In this case, follow-up, evaluation and control are performed through the analysis of the concrete elements of each procedure.

On the other hand, based on the data available in the control system and vis-à-vis the concrete situation of a procedure, it is possible to verify whether there were deviations according to the hours used or the time elapsed since the beginning of the procedure.

Many times, several auditors from the same team, simultaneously carry out the same auditing procedure. When following up the actions, the heads of team may identify the best practices and adopt a common line of action, thus optimizing the procedures of the team.

This standard behavior must be reported to the Head of examination of the unit, so that it may also be used by the other teams in the unit and, when appropriate, introduces improvements in the examination manuals at the national level.

Experience has shown that the efficient performance of the heads of team tend to eliminate or reduce problems in the examination procedures, with a significant increase in productivity and quality.

The control system also allows for being aware of the number of procedures being executed by the auditors, as well as their status, and thus the head of the team is able to determine each one's workload and plan the initiation of new procedures. This information may also be used by the head of the examination area to plan the workload for each team.

4. THE EVALUATIONS FOLLOWING CONCLUSION OF THE PROCEDURE

After concluding the procedures and based on the information contained in the control systems, by means of data crosschecks and their statistical organization, it is possible to evaluate the procedures under different perspectives and to adopt corrective actions.

It must be pointed out that, in view of the complexity of the national tax legislation, in principle, it is impossible to determine the cause of eventual deviations and it is barely recommended that each concrete case be examined in detail.

For instructional purposes, these evaluations may be divided into four main lines:

4.1. Evaluation of procedures in relation to taxpayer selection

Taxpayer selection should be undertaken in a technical and impersonal manner, seeking greater efficiency in the examination actions by classifying bad taxpayers according to risk and maximizing thus the resources of the examination machinery.

At the SRF, in most of its units, examination is structured in two areas: one, taxpayer selection and preparation of the procedure and the other, execution of the procedures as such.

As regards the selection and preparation of actions, the purpose is to identify taxpayers showing the greatest tax evasion potential, by even suggesting the aspects that should be examined by the auditors in the fiscal action. The evasion potential, *a priori*, is measured by the potential value of the writs of violation, although some actions may pursue other results, such as, for example, a larger scope of procedures in a specific sector, to the detriment of the direct result.

In this way, one may evaluate, with respect to the selection of the procedure:

- if the selected procedures were carried out by the auditor and if not, the reason therefore;
- if the audit procedures recommended by the selection sector produced the expected results;
- which of the selected procedures were the most effective;
- the reason for significant differences in a same type of procedure carried out by different auditors.

This evaluation serves to improve the execution procedures as well as the criteria for selecting taxpayers and procedures to be carried out, in addition to detecting eventual failures conspiring to avoid the collection of taxes owed by the taxpayer.

4.2. Evaluation of the procedure in relation to other similar ones

Although this evaluation may be made within the sphere of the examination teams by the heads of the team, the data gathered in the procedures control system, allow for making some evaluations within the sphere of a unit (comparison among teams), regionally (comparison between units of a region) or even nationally, comparing all units among themselves or specific regions

Through such comparisons one may detect deviations between fiscal actions or units, and possible failure or also procedures that may serve as paradigm.

a) Comparison of hours devoted to the procedures

As has already been said, the procedures control system records the number of hours devoted by the auditors to carry out the fiscal procedures. Based on this data, it is possible to:

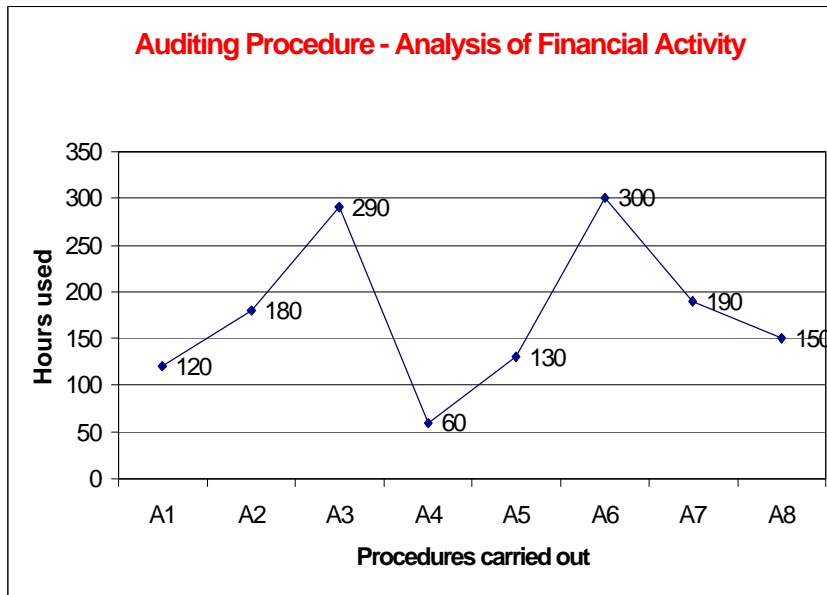
- Calculate the number of procedures that may be carried out by the unit in a given period (goal), based on historical series and labor available. For example:

Let us imagine a unit of 20 auditors, which is equivalent, in average, to 37,400 annual working hours. If, hypothetically, the unit would only perform procedure "A", whose historical analysis records for its execution an **average** of 180 hours, it is estimated that the unit may perform 207 procedures "A" during the year. Of course, there are other factors to be considered, such as the capability of the auditors involved, the size of the taxpayers, the modifications to the legislation during said period, etc., but even so, the information serves to set an average expected objective for the unit or for the team.

- Identify those procedures showing significant deviations as compared with the average (local, regional or national), by comparing the hours devoted to similar procedures during a given period. This study allows for evaluating auditors, teams, units and even, specific regions, by only adding the data obtained at those levels. Let us see, for example, the graphic demonstration of one of those analyses.

Topic 3.1

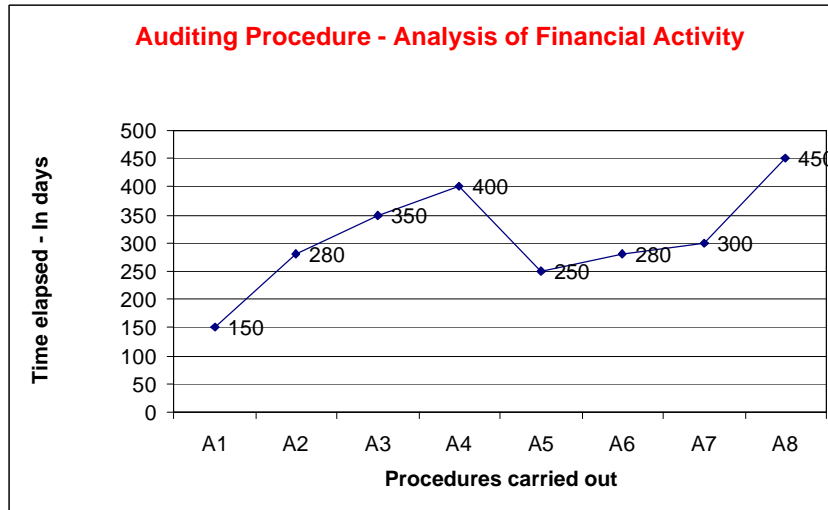
The purpose is to examine procedure “A”, performed by several auditors, comparing the number of hours used by each of them, according to the data available in the systems.



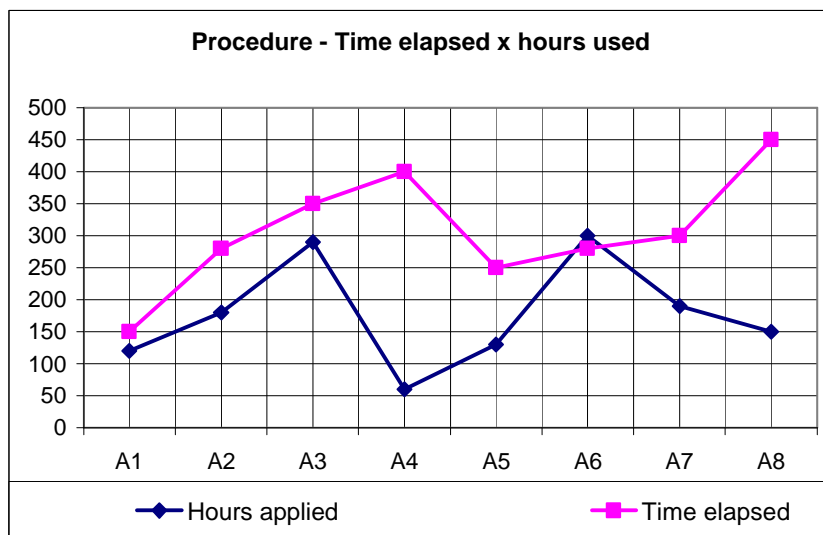
As may be seen, procedures “A3”, “A4” and “A6” show a considerable deviation in relation to the intermediate line of hours used, that is, that for the execution of the same type of procedure, different auditors used quite different amounts of time in its execution. These procedures deserve to be examined in detail to learn the reasons that led to such deviations and, if appropriate, to adopt the corresponding corrective measures.

Although the example is focused on the auditors, the data could refer to the average time in a unit or region. Thus, one could verify, for example, that in unit 4 procedure “A” is carried out, in average, in 60 hours, while in unit 6 the same procedure requires, also in average 300 working hours.

- Undertake the same comparison mentioned in the previous item, but in relation to the time elapsed in number of days, since the initiation of the procedure:



Assuming that the procedures were the same ones mentioned in the foregoing item, we may conclude that procedures “A1”, “A4” and “A8” must be examined. In addition, by combining both data, one may verify which are the procedures that, even though taking a considerable time for their conclusion, registered few working hours:



Given that the system is provided new data on a monthly basis, the number of standard hours used for determining the working goals may be revised at any time, on the basis of the updated data.

4.3. Evaluation of procedure with respect to compliance with the norms and procedures

As for the procedures discussed in items 4.1 and 4.2, the evaluations may be made by the local, regional or national head offices and their scope is eminently managerial.

Apart from those controls, the fiscal procedures are also subject to corrective auditing and a procedures auditing.

In “corrective auditing” procedures are examined on the basis of the ethical and behavioral aspects of the auditor. These audits are performed by officials unrelated to the examination area, although they directly respond to the Secretary of Federal Revenues.

The “procedures auditing” is already included in the examination structure, at the national level and is aimed at examining the procedures from the technical and administrative standpoints, aiming at the quality of the procedure.

In other words, while corrective auditing examines the procedures from the standpoint of correction of ethical conduct, procedures auditing does so under the technical aspect.

In procedures auditing, use is also made of the data available in the control system for selecting the procedures that should be examined. To support the analysis of the selected procedure, use is made of the file mentioned in item 2.

Let us consider an example:

The Brazilian legislation provides that when in a fiscal procedure one observes behaviors that may be typical of the occurrence of an offense by the taxpayer, the auditor must report the event to the head of his unit, so that the latter may, in turn, inform the public attorney’s office. Normally, offenses against the tax law imply the application of serious fines. In this way, being aware of the verified violation or the fine applied, it is possible to determine

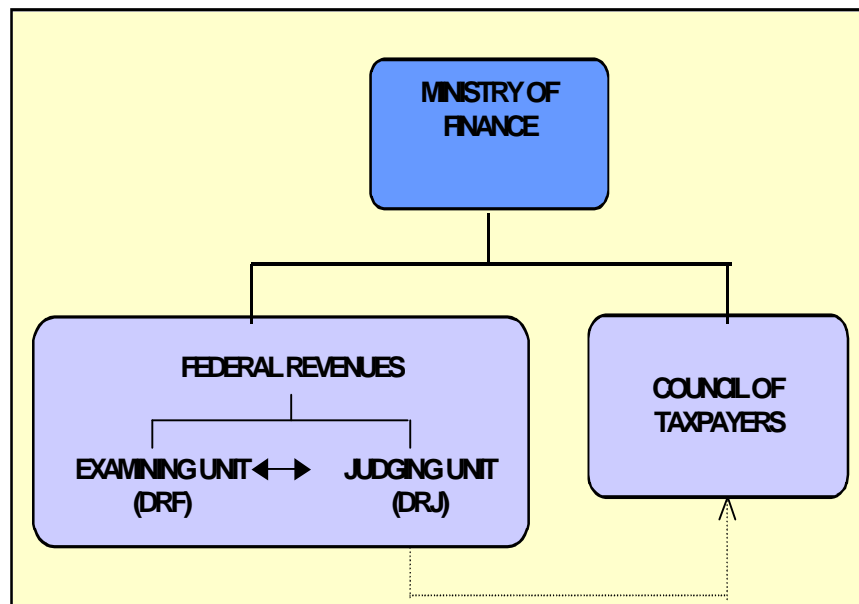
whether the auditor ceased to make the aforementioned presentation.

Based on this information, the Auditing Teams may appear before the unit to confirm, after examining the file, if there was a need to make the denunciation and in that case, to recommend to the head of the unit to do so, in addition to adopting the measures to prevent such deviations.

4.4. The evaluation of the procedure with regard to the proceedings of actions under administrative law

A way of evaluating the quality of the procedure is to verify the path followed by the writ of violation finally drawn up against the taxpayer. If it was paid, it means that the taxpayer admitted his tax debt and that the work was carried out with the necessary technical correction.

Now then, if the taxpayer disagrees with the action, he may file an administrative appeal to be judged by the Federal Revenues Trial Delegations (RTD), specific internal unit for solving taxpayer appeals.



If the judgment were unfavorable to the taxpayer, the latter may resort to the Council of Taxpayers of the Ministry of Finance, which entity is not subordinate to the Secretary of Federal Revenues, but which is equitably formed by representatives of Finance and the Taxpayers.

As may be seen, the examination action may be judged by up to two administrative instances, whose decisions must be respected and evaluated.

Based on the foregoing it is possible to identify:

- Auditors or units with a low level of maintenance of writs of violations that have been judged:
 1. In absolute terms.
 2. In comparison with other auditors or units.
- Issues that repeatedly are the subject of unfavorable sentence for the Treasury, especially within the Council of Taxpayers;
- Defects in judgment, which allows Finance to file an appeal;
- Reasons for tax exemption, in relation to the execution of the fiscal procedure, thus allowing for adopting corrective measures.

Let us see, below, an example of an analysis based on the data available in the SRF's systems, where specific procedures of a unit are verified in relation to the percentage of tax credit that was declared, on comparing it with the original amount:

Procedure	Auditor	Amount declared - R\$
A	1	100%
A	2	100%
A	3	25%
A	1	95%
B	1	100%
B	2	100%
C	2	90%
C	3	40%
D	2	100%
E	3	25%
F	1	30%
F	2	25%
F	3	20%

Average of return	
By auditor	%
1	98%
2	79%
3	46%
By procedure	%
A	80%
B	100%
C	65%
D	100%
E	25%
F	25%

Topic 3.1

As may be seen, the organization of the data available shows, in this case, that there is a significant deviation in the procedures carried out by auditor **3**. In addition, procedure “**F**” shows a low percentage of concrete results, although it is performed by auditors that normally follow up the actions. *A priori*, in this case there is a discrepancy between the Tax Administration and the appeals entity of the Ministry of Finance.

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Case study

TOPIC 3.2.

INSTRUMENTS TO SUPPORT THE FOLLOW-UP OF EXAMINATIONS

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CONTENTS: 1. Introduction.- 2. The Technological Variable in Controlling Compliance.- 3. The Effect on the Tax Audit Tasks.- 4. Basic Instruments to Support Tax Auditing.- 4.1. The organization of the auditing process.- 4.2. Tax management tools.- 4.3. The taxpayer and economic operations information base.- 4.4. Products derived from the information.- 4.5. Products derived from the process.- 4.6. Other tools.- 5. Conclusions.

1. INTRODUCTION¹

The essential mission of the Tax Administrations (TA) is to control compliance with taxpayer obligations. The control applied is directly reflected in the levels of collection² achieved. The most effective controls will be reflected in the best possible levels of tax collection, within medium as well as long term. Weak controls or the lack thereof will be reflected in poor collection.

¹ This paper is partially based on concepts expressed by CIAT in previous papers, presented at the 2002 Technical Conference and at the first seminar on Tax Administration held in San Luis de Maranhao, Brazil in 2003.

² Without considering the legal tax structure, which is determinant in the levels of collection. However, within the context of any tax structure it is the duty of the T to achieve the maximum possible levels of collection, endeavoring to ensure taxpayer adequate compliance with the norms.

Controls should be aimed at inducing voluntary compliance to the extent possible. For this purpose, the TA must consistently and permanently generate the message that any noncompliance may be detected, corrected and sanctioned. The message is generated through the application of effective controls that will dissuade the taxpayer, who will prefer to comply in view of the consequences that may result from noncompliance.

The types of control to be applied are based on the tax context, the tax culture of society, and the levels of noncompliance and evasion. Nevertheless, it has been theoretically and practically proven that the best controls are those that generate significant levels of fiscal risk among the taxpaying population. Within the tax context, fiscal risk is measured according to the joint probability of: detecting fiscal noncompliance and evasion; determining the larger amount to be paid for evasion or noncompliance; forcing and obliging compliance; and applying the corresponding sanctions.

Expansion of the risk sensation is achieved by means of objective control actions applied to taxpayers in particular, which on becoming massive and being widely known, brings about subjective results that lead to expanding the risk sensation. Each positive control action, in itself leads to one or more subjective actions; that is, expands the risk, because the affected taxpayer will inform one or more taxpayers or persons related to the tax activity about what happened.

This document will analyze the support instruments to follow-up examinations, by emphasizing the importance of information technology within the context of the previously described control of compliance with tax obligations.

2. THE TECHNOLOGICAL VARIABLE IN CONTROLLING COMPLIANCE

Greater speed in communications is ever more readily available, high speed links and communication networks continue to increase, there are new systems under the web technology, specialized software products and new elements of transaction security and authentication. The increase in systems operating in real time allows the interconnection with different data bases and the immediate crosscheck of transactions for verification loading and fiscal credit.

Systems may be accessed from any place, with only a PC and a navigator, a cellular phone or wireless public link. In this way, systems can be adjusted, formats may be changed, processes may be modified and execution times may be reduced, all of which entails increased effectiveness.

Technology, its use and increasing possibilities of obtaining structured information on economic, commercial and financial operations, allow us ever more to learn details about each taxpayer and administer this information to provide them personalized services and likewise specialized and specific controls.

The quality of the information on transactions between the taxpayers and the tax administration is improving significantly. Not only are data captured from the source generating them, but there are programs that assist in generating these data, elaborating the returns, assessing the taxes and in general, complying with all the tax obligations.

The expansion of the means for receiving massive information from the taxpayers and information agents, significantly reduces the time for processing and making that information available. Many of the controls that traditionally had been applied through subsequent massive processes, are now interactively applied on-line. It is now easier to capture more and better information from the external environment in which the administrations interact. There are also increased possibilities for capturing internal information.

The interconnection of new systems with previously existing ones, allows the on-line consultation of the former data bases to extract information that is combined with other originating from new information systems. All the information required by an official is within reach of a personal computer screen, through a local network or a wireless public network.

3. THE EFFECT ON THE TAX AUDIT TASKS³

New technologies are revolutionizing the work of tax auditors. Not only because of the access to better sources of information which permits better operational planning of their activities, but because, during the audits, specialized software products interactively guide them in

³ Considering the audit, in a broad sense, it includes all the series of actions aimed at verifying compliance with tax obligations and varied terms such as examination, information crosschecks, management auditing, in-depth auditing, integral auditing, etc.

performing their field work. Information crosschecks and “in situ” data validation contribute to making better decisions. The information they obtain and with which they feed the systems, is the best element to guarantee effective action, while in turn allowing the measurement of performance.

The global analysis of tax returns, information from third parties and relevant data on the economy may be used in establishing patterns and trends for dynamically determining auditing programs that are carried out in real time after selecting the cases to be verified, examined or audited.

Information systems also automatically assign these cases to the officials, according to their workloads and professional profiles. They also guide them in the steps that must be followed, with specific control of each assigned case, up to its conclusion.

The end results, whether the rectification of a return, compliance with the filing of an omitted return, or payment of a delinquent amount, not only feed the system for the official's individual evaluation. Rather, they also provide feedback for the global analysis, beginning with the consolidation of individual results, whereby it is possible to measure the impact of the programs carried out, determine the level of compliance with the objectives and readjust the patterns and trends to generate new auditing programs, in a permanent cycle of value aggregation.

4. BASIC INSTRUMENTS TO SUPPORT TAX AUDITING

The main instruments to support the auditing tasks are found in the adoption of good administrative practices. No technological tool may by itself exceed or replace a clear control strategy, based on systematic information analysis processes that may guide the activities to the most relevant cases of greatest relative noncompliance, and be followed up with an adequate operational planning system for prioritizing the different workloads.

Likewise, technology cannot substitute an adequately structured auditing organization, with clear procedures that may lead to operational effectiveness, that may count on appropriate planning for each audit, with sufficient information to know the taxpayer and analyze his behavior, with communication channels between the different teams to share relevant data and experiences and with an adequate information base on duly classified previous cases.

However, the adequate incorporation of information technology to the audit functions may contribute to significantly improve performance and achieve greater efficiency of the processes and effectiveness in controlling evasion.

The new challenges to be faced require that the auditing function develop and strengthen itself, by using more structured concepts of operation and more systematic processes, sustained by a series of basic instruments to support and perform the auditing tasks, among which we may consider:

- The organization of the auditing process.
- Tax management tools.
- The taxpayer and economic operations information base.
- Products derived from the information.
- Products derived from management, which provide feedback to the process, information, and the different products that are used on a routine basis.

4.1. The organization of the auditing process

This is the action framework wherein the different activities are carried out and therefore, the first instrument to be considered. It includes the organizational structure adopted and the planning, management, execution and control mechanisms, under the concepts of integrality and coherence with respect to the institutional strategy.

The organizational forms adopted are the formal vehicle for converting objectives and plans into concrete actions, through the different hierarchical or functional levels, which ultimately are the ones that materialize the display of control actions and whose performance is determinant in generating risk.

As for the role of planning as management instrument, three levels, with some variations, are identified. The strategic one, that of display and implementation and the specific one, of individual audits. All of them being of a specialized nature, they incorporate a high component of tax intelligence.

At the first level, there is the strategy for controlling tax obligations, which clearly determines the taxpayer sectors or evasion segments on which to act; the actions to be undertaken for effectively controlling the sectors with the highest level of noncompliance; how to make optimum use of resources for exercising controls; which actions to undertake to improve the risk generation capacity; and what types of taxpayer service and assistance should be provided.

The second level ensures that the strategies may result in quantifiable and attainable objectives; and in specific action plans; that these action plans be carried out through the management processes and that the processes be controlled and evaluated.

This level links the strategies and plans to the auditing programs, procedures and techniques and the subsequent selection of taxpayers. In addition, it is geared into the administrative process to establish work and information flows that operate horizontally, through the different functional areas and working groups, concluding with the specific control actions aimed at the individual taxpayers.

In this way, the operational tasks are immersed as part of the flow of a process and are also part of the strategic plans to ensure their integration and consistency with superior objectives and strategies.

At the third level, planning, although of the operational type, is determinant for the success of the control actions and combines elements of the tax, financial, economic and investigation and auditing technique type. Such planning which in the case of information crosschecks, or specific verifications is of great simplicity, becomes complex in audits of greater level and scope.

At this level, the individual planning effort for each case is the critical factor for guaranteeing adequate execution, and should be considered a direct, first order instrument for the tax auditing task.

It acts as a linking element and integrates all the other instruments that may be at the disposal of the auditors, such as internal and external information, verification procedures and techniques, information systems, software products to support the auditing task. It also acts as basic control element, for the official in charge of the case, as well as for his superiors and staff in charge of the supervisory functions.

On the other hand, the administrative process of the auditing function will determine the activities, functions and work and information flows that are necessary to execute the auditing plans and programs. At the same time, it will generate new information to provide feedback to the process, for management control and the adequate exercise of internal control.

It is usual to consider here, specific supervisory and subsequent verification procedures and particular techniques, as well as application procedures that may allow for reconstructing the work of the examiner.

Finally, the administrative schemes consider the broad participation of auditors in proposing new techniques or procedures, which after being analyzed and agreed become new standards. The permanent feedback allows adjustments based on the experience acquired, not only to the process itself, but to the auditing procedures and techniques, in such a way that the standard verification procedures originate from the very experience of the team of auditors.

4.2. Tax management tools

Technology has facilitated the development of new tools which based on some conventional concepts, substantially improve and increase their potential. Shown below are two types of high impact information systems for improving the auditing processes; that is, the work flow managers and the audit operational managers as well as two more traditional tools; namely: the program catalogues and the auditing techniques.

Work Flow Managers (WFM):

The WFM are the technological alternative for partially or totally automating the tax audit processes and responding to the very dynamics of evasion control. Through such automation, documents, information or tasks are transferred from one participant to another, for carrying out other activities or tasks according to a series of predefined rules. One of their characteristics is the ease with which they can be integrated to other information systems, whether they are specific applications, electronic mail, document administrators or any other information system.

The use of WFMs in auditing processes, calls for the identification of key factors of the process to be automated and the definition of the scope of automation, which implies determining the extent to which technology will intervene in the performance of daily auditing tasks.

In the creation of every process, all the steps to be taken up to its conclusion are determined. These involve manual or automated activities that use or generate information and which may be carried out by individuals or computers. In turn, in the execution of each activity, other systems may be used for consulting information and carrying out specific tasks, through them or in them. Also, forms are incorporated to record specific information on the cases being processed, among them working papers, audit summaries, specialized reports. In addition, applications are incorporated which contribute to carry out information analyses, such as inventory crosschecks, selection of samples for audit tests,

analyses of multiple variables applicable to particular cases, analysis of financial statements. In the same manner, options are set up to enter and analyze information obtained at the audited taxpayers' domicile or to export data to be verified during the audit.

The sequence of steps to be followed and their alternatives, the way of executing the activities and tasks related to the audits, the execution options and minimum or maximum times for performing each task are included in a compilation of rules applicable to each process.

The auditors participating in each process join the network and associate themselves to the steps and activities they may carry out. They will be assigned specific cases, on which they will execute the part of the process that corresponds to them. The WFMs control the application of predefined rules to each case going through the process.

WFMs take maximum advantage of all the means available to them. There are such aspects as the use of electronic mail to notify a participant or his supervisor, as the forthcoming expiration of a step in an important case. Or the use of mailing lists to inform groups of taxpayers about the initiation of massive verifications or information crosschecks, when their cases reach a specific step in the network. There are also functions which allow real time crosschecks with other taxpayers or informants, or to schedule verification visits to other taxpayers which may have been related to the audited taxpayer.

The WFMs may also be used to carry out information preparatory activities, as the automatic requests to the files for images of original documents, as of the assignment of new cases to the auditors, making pre-scheduled telephone calls and their connection to the network participant in charge of the case, when there is contact with the taxpayer.

Finally, to control management results, and determine the level of compliance with the objectives and strategies, the WFMs provide detailed data on each management activity carried out and its operations, allow the consolidation of these data at different levels and different stages, generating statistics that may indicate trends and guidelines on which to base the analyses, planning and decisions. It is also possible to derive relevant information for controlling the process and their results; as well as processing detailed information on the taxpayer as an individual, in order to apply him effective and personalized controls.

Audit Operational Managers (AOM):

These are computerized applications intended to support the work carried out during the execution of the audits. A first component takes care of the fundamental analyses and operational planning, orienting the auditor according to the characteristics of the selected taxpayer, the program that selected him and the information that is typical of the selection. It displays the most relevant information related to the case, indicates the most convenient tax auditing techniques to be used, establishes the minimum indicators that should be calculated as well as their variables, advises about critical factors and possible risk areas, and determines additional information which must be obtained to continue with the auditing.

Another component leads the auditor in the application of the audit techniques, supports him in carrying out the different tests, in the selection of information samples and systematically and permanently requires the recordings of the results of the process, through the standard documentation of all the audits and assisting in the automated generation of work sheets and working papers.

The AOMs afford broad possibilities, from the use of desk versions to operate and feed them directly from the auditing offices, up to mobile versions to be used in portable computers that are subsequently connected to the institutional network and in turn, feed the corporate systems, while at the same time feeding themselves with new information, including versions that may operate in real time through mobile telephones or wireless networks.

Auditing Program Catalogues (APC):

These are collections of auditing programs used for controlling evasion. Each of these programs takes care of some segment of evasion, responds to the nature of the detected deviation and determines the mechanisms for correcting it. Therefore, it defines the different actions that must be undertaken, from the specific selection of the taxpayers, up to the execution of the audits.

The audit programs include all the rules, policies, criteria and procedures that must be applied by all the participants in all cases that are selected. In that sense, they provide relevant information on the evasion situation they seek to control, the main mechanisms used, the ways of identifying it and the elements to determine, in particular cases, the most probable

evasion risks. They also indicate, in priority order, the different audit techniques that should be used, the reasons for applying them and the results to be expected, following their application.

The audit programs found in the catalogues include all the required information for determining the parameters of the processes to be executed through the WFMs.

Auditing techniques catalogues (ATC):

The auditing techniques catalogues are compilations of specific procedures to be applied during the audits and whose purpose is to perform tax, accounting or financial analyses, undertake verifications, establish inferences or determine evasion acts.

These catalogues include techniques for financial analysis, tax risk analysis and evaluation, selection of critical evasion factors, elaboration of risk maps and auditing tests.

The ATCs establish standard techniques that are of a general nature and broad coverage, usually applicable to various taxpayer segments that are not necessarily homogeneous. They are complemented with specific techniques for specialized requirements. It is also common to find verification guides, mainly for massive examination processes.

The auditing techniques constitute the arsenal of operational tools available to the auditor. Each auditing program will use one or more and will also generate new techniques that are incorporated to the catalogue.

The Auditing Program Catalogues include definitions and parameters of the different auditing processes carried out through the Work Flow Managers. They are also associated to the auditing techniques included in the Auditing Techniques Catalogues that are applied in some of the steps of the process through the audit. Operational Managers. The integration of these tools allows a complete and integral coverage of the auditing processes, from the selection of the taxpayers up to the conclusion of the case, orienting and carrying out the complete follow-up through all the pre-defined steps and providing specialized support in all the tasks that are characteristic of each audit.

4.3. The taxpayer and economic operations information base

The level of knowledge about the taxpayers depends on the quality and timeliness of the information available, the way in which it is used and, fundamentally, how it is integrated to the general control scheme, its strategies and its processes.

Having huge amounts of data does not mean having information. Therefore, great care should be taken in ensuring the effectiveness of information, to generate and obtain that which is really necessary, not redundant and avoid the risk of flooding the TA with useless data.

The information should be adapted to the needs of the control scheme, determining the most relevant aspects thereof, the timeliness and frequency with which it will be required and its reliability, guaranteeing objectivity in its provision and accuracy and ensuring that it may be combined with other information, although maintaining its importance.

Within this context, the data bases of the tax administrations are aimed at having available:

- Information provided by the taxpayers such as sworn returns, detailed information returns and financial statement returns, which is filed in keeping with the different expiration terms established by the fiscal regulations.
- Information reported by third parties (external information agents) on payments, purchases, sales, withholdings made, revenues earned, bank accounts, assets, investments, corporations and organization of the corporations, real estate properties, foreign trade, transactions subject to public registry, among others, which is filed mainly in accordance with the periodicity required by the TAs for carrying out data crosschecks and audits.
- Internal information generated by the institution itself, either through analyses of the returns, information crosschecks, auditing practices or special analyses, as in the examples shown below, with respect to the tasks carried out in this regard, by two important tax administrations:

On the one hand, a tax information system should allow the tax administration⁴ to:

- identify all its taxpayers;
- Have available a permanently updated taxpayer file;
- have sufficient procedures and means available for a broad and effective taxpayer information and assistance;
- guarantee the reliability and quality of the stored tax and accounting information;
- integrate all tax information on the taxpayers to be precisely aware of all the data affecting their tax situation, including information about foreign trade taxes;
- control taxpayer compliance with their tax obligations, that is, being aware of their tax behavior;
- detect and take prompt action in relation to nonfiling and delinquent taxpayers;
- undertake a cross verification of the data declared by the taxpayers with other data provided by third parties, to determine the reliability of the returns filed and carry out as many information crosschecks as may be necessary for performing in-depth examinations or massive controls, as required;
- detect and take action against evading taxpayers;
- Promptly notify and summon taxpayers on detecting differences that arise from their tax behavior;
- guarantee the application of sanctioning systems provided by the Law;
- introduce and formalize recovery procedures through voluntary and enforced collection;
- follow up and control each and every one of the different administrative actions;
- guarantee the control action (internal auditing of the different areas comprising the tax administration and provide information.

4.4. Products derived from the information

Much relevant information may be derived from the information available in the TAs data bases. In the past, when there were greater information and processing restrictions, crosschecks and validations were solely undertaken between boxes in the sworn returns. From algorithms of mathematical validation, up to comparisons of revenues and costs between annual income returns vis-à-vis accruals, also annual, of VAT returns, for example.

⁴ CIAT Tax Administration Manual - July 2000, numeral 5.4.2. "Consequences of the data base for the organization". The underlining is ours.

Currently, it is possible to make better use of the information available. The key to this matter is that it be done in a structured manner, by generating standard “products” derived from the information, that may allow for obtaining analyses of similar interpretation and constant and systematic application. For illustration purposes, we are differentiating only two types of products.

The individual ones by taxpayer or groups of taxpayers, among which we find:

- The tax and economic profiles of the taxpayer being individually considered.
- The tax and economic profiles of economically linked groups of taxpayers.
- The map of professional relationships which links the taxpayer to the accountants, representatives, attorneys, partners, stockholders.
- The map of commercial relationships that links the taxpayers to other economic agents from the productive, commercial or financial sector, although they may not have economic relationships between them.
- The indicators relative to taxpayer behavior and positioning with respect to comparable averages by economic activity, region, province, city which include deviation indexes with respect to their peers in different categories.
- The objective compliance indicators based on behavior with respect to their tax obligations.
- The individual risk profile, which measures the current or future probability of noncompliance with one or more tax obligations.
- The results and differences shown by the taxpayer in crosschecks of multiple variables of their own and third-party information, which usually give way to greatly effective individual control actions.

The collective or analytical aggregation ones, among which we find:

- The economic, financial, tax, by sector and economic activities analyses that show behaviors, characteristics, trends, business turnover.
- The economic and tax indicators by sectors and economic activities.
- The descriptive and characterization analyses of special businesses or special sectors of the economy.
- The specialized analyses on the operation of types of businesses that are significant in the economy.
- The analyses of potential evasion risks.
- The measurements of evasion.

4.5. Products derived from the process

While carrying out the auditing process, important information is obtained for feeding back the processes, making decisions and for the control strategy. In addition to the products derived from information, varied products may be obtained as value added from the execution of the tasks that are common to auditing, among which we may highlight:

- Average results from audits by type of taxpayer, economic activity or type of business, which allow for inferring levels of evasion, operational difficulties in the field work and estimating possible future collection goals.
- Historical trend of evasion by sectors and types of business.
- Analytical summary of cases examined by sector and by type of business
- Application of new techniques for measuring results or adjustment of the existing ones.
- Statistics on results, by program, sector and economic activity, which involve the entire process, from the selection of cases, up to the final results.
- Historical summary of audited cases with similar characteristics.
- Documentation of most typical cases, including detailed descriptions and explanations with structured data for subsequent consultations on similar cases.
- Analysis of trends in audited and solved cases.

4.6. Other tools

Complementing the previous tools, the tax administrations have legal data bases which, in addition to the legislation also include the results of tax inquiries and guidelines for interpretation or official interpretations on the application of tax rules.

5. CONCLUSIONS

To improve compliance with obligations, the TAs implement varied control strategies and simultaneously prepare and carry out plans for developing their internal capabilities and increasing the fiscal risk levels.

New technologies afford new opportunities, from the expansion of the means for receiving information from the taxpayers as well as informing

third parties, up to the execution of analyses at varying levels for determining taxpayer behaviors and setting up control measures adapted to the individual risk profiles.

The work of the auditors changes substantially. Many detailed tasks that were carried out for purposes of individual or collective analyses may now be performed by the information systems. In the same manner, varied procedural aspects that used to be executed manually, are now performed through standardized work flows. In addition, there are new tools that support the office as well as field work of the individual audits.

Nevertheless, no technology may substitute an orderly auditing work scheme. No technology may implement instruments or tools to support auditing that may turn out to be useful, unless there are control schemes, definition of strategies, activities planning, investigation techniques and qualified human resources.

What is currently happening is that technology is making available to the TAs, information systems that speed up and optimize the technical tasks, and is providing new tools which, if used correctly and framed within the context of institutional control schemes, allow for increasing operational efficiency and effectiveness for obtaining results.

In this sense, the automated work flows, release a huge operational workload at the supervisory and managerial levels, which may then devote more time to the analytical and guiding tasks of the auditing function. The automated processing of large volumes of information allows the prompt conclusion of many analytical processes, thus accelerating decision-making with respect to the control strategy and measures. The use of tools for the operational management of audits, relieves the burden of multiple costly tasks, generating in turn, greater capacity for analyzing and interpreting the results achieved.

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Case study

TOPIC 3.2

INSTRUMENTS TO SUPPORT THE FOLLOW-UP OF EXAMINATIONS

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CONTENTS: 1. Examination Instruments.- 2. The Evolution of the Working Methods.- 2.1. Selection and risk analyses.- 2.2. Working methods.- 2.3. The instruments to support examination in Spain.- 3. The Aid to Verification Method.- 3.1. Objectives of the AVM.- 3.2. The process of elaboration of the AVM.- 3.3. Main characteristics of the AVM.

The globalization of the economy and the accelerated implementation of new information technologies are substantially modifying the traditional context of the examination function.

The examination function of the Tax Administration must adapt itself to those great changes of the entrepreneurial and technological environment. It may be said that the function is subjected to the need for intensive changes oriented at a greater professionalization of its human resources and the modernization of its selection, verification and investigation methods, endeavoring to obtain the organizational structures and technical tools required for such purpose.

Approximately a decade ago, the Tax Administrations of the more developed countries were forced to begin reflecting on how the development of new telematic techniques could contribute to better tax compliance. In general, it may be said that the application of taxes requires a continuous innovative effort. This is especially relevant for an effective performance of functions, such as those that are common to the examination or inspection of taxes, where information and human resources are the main assets.

At the same time, one must bear in mind that the examination strategies should at all times make citizens aware of the fact that every possible thing will be done to ensure that noncompliant taxpayers will fulfill their tax obligations. The need for the tax examination or inspection function to become increasingly professional and effective in the use of the instruments available, derives thus, not only from the changes in the economic and technological environment, but also from the fact that a very important part of the effort for improving the relationship between citizens and the Tax Administrations and, accordingly, increasing social acceptance of taxes, is an adequate struggle for arriving at better tax compliance.

The examination function not only pursues the discovery of tax debts that have not been declared or paid by those obliged to do so, but also to convince the citizens of the need to improve their level of tax compliance. In that sense, we may consider that such actions always involve direct as well as induced effects.

1. EXAMINATION INSTRUMENTS

In Spain, the State Agency of Tax Administration (SATA) carries out the control activities through several actions assigned to different Departments:

- a) Extensive planning:
 - Controls carried out by tax management entities that allow for undertaking massive control of the returns filed by the taxpayers. The Tax Management Department performs these extensive controls that are essentially aimed at taxpayers without business or professional activities.

b) Intensive planning:

- Controls carried out by examination entities, that allow for exhaustive controls of accounting documents and, if necessary, non-accounting documents of the taxpayers, as well as investigating the most serious cases of fraud which may involve penal implications. The Financial and Tax Examination Department undertakes the tax verifications of business and professional activities of all cases where there may be possible elements of fraud.

c) Specialized planning by types of taxes:

- Controls regarding the IIEE and Customs tariffs assigned to the Customs and IIEE Department.

Focusing on the examination entities of the Financial and Tax Examination Department, it must be noted that the effectiveness of intensive examination actions is significantly influenced by the following factors:

- Integral planning of actions with the support of historical experiences as well as specific fraud investigation teams.
- Having available an efficient organizational structure that may allow the adequate specialization of teams and units.
- Appropriate Planning and Selection which implies that human and material resources will be devoted to those activities that will result in a greater direct and indirect effect of the actions undertaken.
- Normative capability for investigating and being able to adequately react to frauds discovered, so as to promptly modify the inappropriate behavior.
- The use of adequate professional working methods, including the use of appropriate computerized tools for carrying out the examination activity.

2. THE EVOLUTION OF THE WORKING METHODS

The future of tax examination requires a significant renewal of working methods in a manner consistent and coordinated with the incorporation of new technologies and promotion of better management of knowledge. This affects the selection and risk analysis methods, but also the way of directing undertaking the examination task. In addition, within medium and long term we are progressing toward a very significant transformation of the examination work, which involves training for directly analyzing and working on the business management and information systems.

2.1. Selection and risk analyses

Improvement of the examination function has to do with improvement of selection, in order that actions may be aimed at the most significant noncompliances and whose correction may influence the improved behavior of the rest of the taxpayers.

The SATA is responding to those needs of application of information technologies to selection and risk analysis through the development of a series of computerized applications:

- a) The *ZUJAR* system, a system of data storage and mining specifically adapted to the needs of innovating the taxpayer selection systems.
- b) Development of initiatives for risk analysis that may allow for locating human resources according to the ABSTRACTO risk, thus constituting *Homogenous Spheres of Action* (HSA). In these HSA, with “concrete” risk selection techniques, we would complement the previous determination of diffuse risk environments made by the HSAs.

Related to these risk analysis techniques is the Tax Information Analysis System (T.I.A.S.) intended to allow a system for selecting large businesses according to the analysis of economic, commercial, financial and international ratios obtained based on the information available in the data bases.

- c) Experimentation of the possibilities of neuronal networks to generate taxpayer behavior profiles.

2.2. Working methods

Improvement of selection techniques must be accompanied by a very significant innovation in the working methods used in the examination function, so that they may be capable of responding effectively and at the same time, homogeneously, to the noncompliant behaviors one intends to eliminate.

A first decisive factor one must take into account in that reflection is the increasing use by businesses, not only of computerized systems, but also, of some ever more advanced accounting and business management instruments. It would be incongruent, within said context, for the tax control and investigation bodies to maintain working methods that would disregard said reality, endeavoring to apply the accounting examination and tax auditing mechanisms designed when the maintenance of computerized accounting records has not even been generalized.

Therefore, the first challenge of Tax Examination is to develop its capacity for using the businesses' own systems for undertaking those systematic and critical verifications and tests, which were impossible prior to the development of the current systems. In sum, there should be a correlation between the accounting and business management systems and the methods used by those undertaking verifications of those accounts and activities.

A second factor to be taken into consideration is the ever greater need for a speedy response from the examination services, which can no longer wait for the expiration of the legal terms of the statutes of limitations for carrying out their actions. The international interconnection of activities and the speediness of fraudulent behaviors call for being capable of responding within ever more tremendously reduced terms than in the past, since otherwise the extension of fraudulent behaviors will be facilitated.

Therefore, the evolution of working methods will depend on the capability of making the new technological instruments respond adequately to the new needs regarding the use of information, management of knowledge, definitions of quality and new work evaluation systems. We will briefly discuss each of these variables.

2.2.1. The use of information

The examination entities are, to a great extent, devices for capturing and using information. Thus, the adequate use of information is the crucial aspect of an organization capable of effectively fighting for better compliance with tax regulations.

The needs for previous use of the information available are common to all tax information systems and are also among the most important variables for evaluating the administrative organization's effective compliance with its mission.

The Spanish Tax Agency has available extensive individualized information relative to each taxpayer, facilitated by the latter as well as obtained by those who maintain or act as intermediaries in their economic and financial activities. This system, which is one of the most developed of the European Administrations, requires the incorporation of the most advanced analysis instruments which, at any time, may allow the technological possibilities for obtaining the maximum yield from the information, with a view to making an adequate selection of taxpayers to be examined, and also, so that once selected, optimum use may be made in the verification actions of the information previously available.

The examination function or tax inspection should ensure intensive use of the information available in the tax data bases as well as in the company's accounting records. Ultimately, it is a matter of adapting the examination to the means already normally used by the companies, to thus achieve the productivity gains implicit in the systematization of the information and to handle the company's information with the same tools used by the latter. Within medium and long term we are headed toward a radical transformation of the culture of the examination work, by providing training to directly analyze and work on the business information and management systems.

In addition to the information which is systematically entered in the SATA's data bases (obligation to periodically PROVIDE which affects a numerous group of taxpayers), there is another type of "final" information that is obtained through CAPTURING and which normally is aimed at complementing that which is provided. Lastly, worth mentioning is the existence of an ONIF with the exclusive task of detecting emerging fraud (investigation) and thus serving to prepare the planning of specific control actions.

2.2.2. The management of knowledge

The need for exchange of experiences and common implementation of knowledge generated by the persons carrying out their examination functions are widely shared by the Tax Administrations of different countries.

To improve the organization of knowledge is an essential requirement for promoting more intelligent organizational networks. The documents and tools generated by a working team must contribute to the work of others. Therefore, it is essential that experience be at the service of the entire organization, thus overcoming excessively individualistic working styles.

The need to use flexible and enriching working techniques in Examination is not, nevertheless, only the result of said conviction regarding the need to create more intelligent organizations. It is rather a question of significantly renewing the working instruments and incorporating new technologies and very specially, considering their implications in the organization of knowledge.

Such concern has become evident in the design of what is commonly known as expert systems. Expert telesystems are computerized programs prepared to solve problems in concrete working areas, attempting to simulate the ways of acting of human experts through artificial intelligence techniques. It is believed that by means of simple, interactive, very informative applications, one may achieve greater standard controls, for the benefit of juridical security and to the detriment of the necessary investigating initiative of the examiner as well as a significant increase in productivity and quality of the actions.

A first decisive factor to be taken into account in this reflection, as we have previously indicated, is the increasing use by businesses not only of computerized systems but, also, some ever more advanced accounting and business management systems. It would be incongruent, in that context, that the tax control and investigation entities would maintain working methods that would disregard said reality.

A second factor to be taken into consideration is the ever greater need for a speedier response from the examination services. The international interconnection of activities and the speediness of fraudulent behaviors call for being capable of responding within ever more tremendously reduced time frames than in the past.

2.2.3. The quality of the work

The professionalization objectives of the examination function should be based on an increasing effort to consolidate a paradigm of quality of work. On the one hand, the need for neutral treatment of individuals verified renders it very important to establish a basic standard in relation to the verifications made. Such basic standard should not be a reference established without regard to the professionals themselves, but precisely a definition developed by them from the series of *good practices* that are considered adequate for a specific type of action.

In this sense, it is considered essential that the examiners participate and perform an active role in the establishment of that standard of quality or good practices.

The organization of the examination function should promote a level we should call *normal quality* of the work, and at the same time, one should promote and reward those creative behaviors that afford the entire organization effectiveness and quality gains. Among those excellence criteria we may mention: innovation in working methods, the discovery of new types of fraud unknown to the administration, obtaining information to be used by other teams, detection of tax technique problems, etc.

2.2.4. The evaluation instruments

The dissatisfaction and obvious deficiencies produced by exclusively quantitative control systems (especially, results in tax debt discovered) of the activity carried out by the examination entities, make it advisable to count on instruments for the professional evaluation of the work performed, which may allow those responsible for performing a qualitative evaluation of the work carried out and thus avoid the mistakes caused by the merely quantitative techniques that are too prone to achieve only that which is measured, to the detriment of the quality objectives. Therefore, the new working methods should be capable of contributing to achieve indicators of the quality of individual work.

2.3. The instruments to support examination in Spain

The development of instruments to support examination, aimed at the modernization of the working methods, is being carried out in Spain, fundamentally through the following means:

On the one hand, one should point out the juridical support instruments in the examination task. In this sense, in addition to contributing all the existing legislative, legal material and administrative criteria one should mention the elaboration of an **Examination Procedure Manual** which allows the examiners, following their incorporation to a computerized environment, to have an updated text covering in detail the different aspects of the procedure for processing the examination files. Likewise, the **Documentary Data Base** systematically compiles the most significant juridical criteria that have been produced in the examination offices so as to allow an exchange of experiences in the juridical field.

Lastly, the necessary homogenization of juridical answers is achieved through the **national coordination of Technical Offices that** provide the administrative criteria to be applied in cases where the norms may offer different interpretative solutions to similar situations of tax regularization.

On the other hand, the technical aspect of the instruments to support examination should be pointed out. Some of the most outstanding ones are:

- a) The elaboration of **sectorial and thematic verification guides**. By means of these guides, the examiners specialized in a specific fraud sector or mechanism, develop basic information to help the non-specialized examiners. The elaboration of these guides enjoys a long tradition in Spain, although at present the intention is to better diffuse, homogenize, update and systematize these works by taking advantage of the new technologies for this purpose. In this respect, through a computerized application available to the examiners and managed at the central level, the different guides are being published, following a task of homogenization, while the development of new guides is being ordered, so that this will result in a series covering the main topics or sectors

of the work of the examiners. Their incorporation to a data base will likewise allow for the constant updating of the contents.

- b) Investigation actions carried out by entities specialized in such actions, through the National Fraud Investigation Office. After orienting the selection criteria, following the investigation made, a speedier action of the non-specialized control services is also possible.
- c) The development of the Aid to Verification Method (AVM) as instrument for systematizing the working methods of the examination entities and making available to the examiners the computerized instruments and tools that may be useful for carrying out their actions.

3. THE AID TO VERIFICATION METHOD

The concern of the Spanish Tax Agency for modernizing the working methods of the tax examination or inspection entities, has given way during the past years, to reflect towards the future, as to the best mechanisms that are capable of providing the examination entities with the support instruments that may facilitate adaptation to the technological, cultural and professional challenges that have been diagnosed.

In late 2000, the Tax and Financial Examination Department decided to promote, through the National Fraud Investigation Office, a project aimed at elaborating a basic verification method of general application to enterprises.

Upon the implementation of this project, one has taken into account, together with the general analysis reflected in the previous section, the differential characteristics of the Spanish Tax Examination. First of all, we have available a very powerful and advanced tax information system, from the technological standpoint. This implies a significant comparative advantage, with respect to other countries that are initially obliged to make up for the limitations of their information systems. Such comparative advantage calls for making available to the Examination function, tools that may allow a much more effective and efficient use of that important information device, in order that the examination may have instruments that may operate with the information existing in the data bases.

A second differential element is the specialized training of the examination entities' human resources. It is now a matter of overcoming the exclusive individualistic use of those capabilities and being able to extract from experience and knowledge the organic feedback that may allow the development of greatly improved working methods.

The Aid to Verification Method, endeavors to qualitatively improve operations for examining the information available and organizing it by means of an instrument capable of systematizing tests and tasks and allowing feedback processes; and, also allowing current computerized tools (spreadsheets, treatment of data bases, text processors) to be applied to the data.

3.1. Objectives of the AVM

The project developed endeavors to generate instruments capable of promoting a standard with respect to the working methods used and the documentation thereof. It was considered that said standard should involve the in-depth use of the computerized tools and a better use of the information existing in the data bases.

The project was aimed at elaborating a basic verification method intended for general actions undertaken in companies with a sufficiently developed accounting, based on criteria of normalization, professionalization and search for quality objectives. The Method should be based on auditing techniques and the use of working technologies and instruments that may facilitate the daily examination work and a better use of the information and applications of the Data Bases.

Therefore, in sum, the main objectives are the following:

- Facilitate the use of the tax information system.*
- Generate instruments for team work.*
- Improve the documentation of the actions.*
- Progressive incorporation of computerized tools.*

3.2. The process of elaboration of the AVM

The AVM was elaborated on the basis of the experiences of a group of very qualified professionals with vast experience. Based on the previously described diagnosis and the objective determined by the Tax and Financial Examination Department, the project was entrusted to a Working Group formed by examiners with vast experience who worked in different territorial services. This Working Group carried out its activity as of October 2000 through late June of 2001.

The group made a selection of possible tests and instruments that could be adequate for the elaboration of an examination working method. The methodology adopted was that of the discussion group with respect to the proposals of the same members of the group.

The activity of the Working Group led to the elaboration of a prototype that was called Basic Verification Method (BVM) which resulted in the operational development of the corresponding software by the Tax Computerization Department.

The prototype developed was made available to approximately 40 examination teams or units for several months. Those pilot-tests of the Method involved their experimentation, by specific units or teams that had not participated in its design, in order to contrast and verify whether the quality of the product developed was sufficient for achieving the objectives pursued. The results of the experimental test were determined through responses by the participants to a questionnaire elaborated for such purpose and the personal conversations maintained with them.

Through the pilot test it was possible to determine the deficiencies or weaknesses of the prototype. With the suggestions and reports prepared by all those teams or units, a plan for improving the application is developed, which in addition comes to be called AVM (Aid to Verification Method), to highlight its nature as instrument to support the examiners services.

Since the use of the application was of a voluntary nature, it was considered essential to progressively diffuse its characteristics in order to facilitate, along with systematic training an informal process for communicating the advantages of swing the application.

In spite of its voluntary nature, the experience with the AVM (from July 2002 through December 2003), discloses an increasing use thereof, regardless of the indicator used (number of users, number of files created and number of information indexes requested).

On the other hand, it must be taken into account that it is a dynamic application, which continuously incorporates new uses; it is the subject of permanent updating and is subjected to the systematic integration of the users' recommendations or suggestions.

3.3. Main characteristics of the AVM

The Aid to Verification Method (AVM) is being used since July 2002, and may be found at the Tax Agency's intranet. It is a computerized application of a systematic and intuitive structure, whose use does not require advance knowledge of computerization. The application allows for unloading information from the data bases that may generate working sheets and is at the disposal of the user.

The starting point of the AVM are the characteristics that are common to an examination file for promoting the most efficient use of the information existing in the data bases, through automated working sheets and by distributing the tasks among the teams or units. In addition to the innovative aspects of the working methods and instruments the purpose of the system is to be able to work directly on the computerized accounting records of the companies and to introduce instruments for evaluating the quality of the work.

The use of the AVM is recommended to all officials that are part of examination teams or units, that is, examiners, as well as sub-examiners and agents that undertake the verification of companies with developed accounting.

The main characteristics of the AVM are the following:

3.3.1. Systematization

The AVM is an instrument for systematizing the tests, tasks and work sheets that are common to the verification of businesses with sufficiently developed accounting records. For each activity determined, there is a detailed description of its objective, way of carrying it out and the support instruments available.

The AVM affords a broad catalogue of tests and tasks to be carried out in an examination. In this sense, it must be understood as a framework wherein the inspector makes selections and decisions, anticipated as well as those selected by the adviser.

The basic operational concepts are the following:

- Tests. *All verifications with a specific objective.*
- Tasks. *Concrete actions for carrying out a test.*
- Work sheets. *These are the documents that serve as proof of the actions carried out. On occasions, those work sheets are automatically generated by the system on the basis of information available. In other cases, they must be prepared by the users, on the basis of proposed models.*
- Aids. *These represent the series of support elements, explanations, suggestions, recommendations on tests or tasks, sources of information available or applicable basic norms.*

3.3.2. Structure

The Aid to Verification Method is adapted to the nature of examination actions. Three basic levels of development of the actions have been established:

- *Preliminary actions.* These involve all actions that may be carried out prior to the direct actions with the taxpayer. Their purpose is to previously analyze the information available in the data bases and they have been structured as follows: *Tax documentation or file, Analysis of data declared by the taxpayer and Analysis of data declared by third parties.*
- *Initial actions.* These are all the actions to be carried out in the first visit(s) to the taxpayer, which are aimed at preparing the diagnosis and selecting the risk areas. They have been structured under *Appearance, Accounting and Structure and organization of the company.*

- *Examination by areas.* Implies the systematic development of tests and tasks corresponding to the selected risk areas. In the AVM ten specific areas have been anticipated.

3.3.3. Flexibility

The AVM is a flexible instrument that may be adapted to the information that is available at any time, as well as to the different circumstances that may arise during the examination procedure. The AVM is an instrument permanently open to improvement derived from experience and accumulated knowledge from the examination units and teams.

Each AVM screen includes a link to SUGGESTIONS that allows the on-line communication with the promoters of the application.

The AVM continues to be an experimental project, an application subjected to real testing, it being essential to derive from its use, the precise teachings, in order to search for complete and ambitious alternatives at the service of Examination. Currently the process is underway for elaborating sectorial developments of the AVM by types of activity or specialized verifications.

3.3.4. Use of the tax information system.

The AVM users may obtain information files from the Consolidated Data Bases which are the subject of specific automated routines, and allow the application to tax data in spread sheets and data bases.

These basic sheets are pre-elaborated and allow for obtaining basic contrasts and specific data crosschecks, without the need for the user to have special computer knowledge. Currently there are available to the users, automatic basic sheets, as well as tens of forms and non-automated work sheets.

3.3.5. Incorporation of computerized tools.

The AVM incorporates computerized tools of voluntary use that may facilitate the execution of the work through computerized auditing instruments, as a result of the generalized use of such instruments

by the companies and the advantages of the resulting systematization and functional security. The AVM's flexibility allows a progressive integration of said computerized auditing tools, facilitating the transition toward such ways of working. The tools incorporated have been elaborated by different territorial or central services.

The main computerized auditing tools available to the users are:

- The PROMETEO application as a tool for working with the accounting of businesses.
- The ALIA application, specific tool to work with the Value Added Tax records of the companies.
- The NORMA 43 application, specific tool to work with the files of bank account transactions facilitated by the financial entities.

3.3.6. *Documentation of the actions.*

The AVM allows for improving documentation of examination actions. Execution of the Method favors the adequate documentation of actions in the working papers which may reflect the tests undertaken, regardless of the fact that specific actions, because of their importance in the procedure, be documented in proceedings. In addition to work sheets, models of every type of examination documents have been incorporated (requests, reports, proceedings, files, etc.).

3.3.7. *Team work*

The AVM provides instruments to favor team work in the examination units. The Method allows the assignment of tests, concrete tasks or working papers to the different members of the examination unit or team, that is, to the head of the unit as well as to tax sub-examiners or agents.

3.3.8. Formative and informative willingness

As previously indicated the AVM counts on aids of a systematic nature, in order to make known the possibilities of the proposed working system for such verifications as well as the most important pertinent norms.

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Case study

TOPIC 3.3

INTEGRAL EVALUATION OF THE RESULTS OF EXAMINATION ACTIVITIES

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CONTENTS: Summary.- 1. Introduction. - 2. Evaluating the Results of Activities.- 2.1. Planning examination activities.- 2.2. Computerized inspection and follow up instruments.- 2.3. Evaluation of activities.- 2.4. The cost of examination activities.- 2.5. The “SISEPRO” evaluation and productivity control system.- 3. Evaluating the Impact on Taxpayers Behavior.- 3.1. The impact of examination activities.- 3.2. Evaluation of Bolivian Taxation Administration.- 4. Conclusions.

SUMMARY

As the practice of auditing gets modernized, new challenges are faced in Tax Administration. Among these are the processes used to evaluate performance. This is very interesting in terms of reorienting how audits are carried out.

Integrated evaluation of the results of auditing activities should not limit itself to verifying fulfillment of the goals and objectives set as set by administration commitments. It must also include the bigger picture of identifying how well the taxpayer responds in terms of voluntary fulfillment of their responsibilities.

Applying these criteria to the process of auditing activities carried out by the Service of National Taxes in Bolivia includes, from the first point of view: evaluating the results of auditing activities starting from the process of planning, following up on performance, and evaluating the direct effects both in terms of tax collection and levels of individual productivity. From the second perspective, what are the resulting benefits in terms of voluntary compliance as a bi-product of auditing activities?

Under results, we can see that as a result of activities in 2002, there has been growth in terms of the number of audits carried out, in terms of collections, verification and control resulting from audits.

Activities in 2003 have resulted in 11,763 audits, resulting in collection of 62.4 million Bolivianos. Compared to 2002, these results represent an 85% increase in terms of the number of audits and 43% increase in the taxes collected due to auditing.

The main objective of the majority of audits has been the Value Added Tax VAT which is the main tax collected by the Tax Authority. The impact on this tax was an increase of 6% in cash collections during 2001, 13% increase during 2002 and 21% during 2003. These growth rates have been the most significant ones within the Bolivian Tax System.

Furthermore, the taxpayers who were audited improved their performance in terms of their sworn tax declarations regarding the Value Added Tax. Growth in that tax rose to 47%, which was the largest one, registered among the entire group of all taxpayers.

Moreover, taxpayers who were audited showed changes with regard to their declared debits and credits, declaring a lower percentage of purchases for each unit sold. This change permitted the taxpayers to not increase their VAT tax credit by 345 million Bolivianos and thus to not reduce the VAT on the amount indicated that represented about 19% of the cash VAT collected.

1. INTRODUCTION

An integral evaluation of the impact of examination activities focuses on two perspectives: the first, evaluating the direct results of examination activities with regard to the goals set by the Tax Authorities. A second perspective is with regard to changes in taxpayer behavior among the taxpayers audited.

2. EVALUATING THE RESULTS OF ACTIVITIES

This consists of analyzing and following up on the results of examination activities, starting with the process of planning activities, follow up of activities, results in terms of interventions carried out, direct collections and individual productivity of the auditors. This evaluating in the case of the Bolivian Tax Authority is done based on the following framework:

2.1. Planning examination activities

National Law N° 1178, establishes Governmental Administration and Control Systems (SAFCO)¹, regarding the planning instruments using the Annual Operations Programming System which has the purpose of establishing a uniform methodology and systematic procedures for making homogeneous plans and programs that reflect strategic planning criteria.

In the Service of National Taxes, planning examination activities is carried out within a strategic framework², according to the methodology indicated in the paper on examination strategies.

Strategic objectives are determined through this process, as well as activities, tasks and goals in terms of the number of activities to be carried out and the amount of tax to be collected by each one of the Auditing Departments in the District Manager's Offices.

2.2. Computerized inspection and follow up instruments

The Service of National Taxes has a computer system used in operations, which is called the Integrated Tax Collection System of the Tax Administration (SIRAT), the applications portion of which is used in examination activities and which has the following subsystems:

¹ Published June 23rd, 1990, Governmental Administration and Control Systems are: the Operations Programming System, the Administrative Organizational System, the Budget System, the Personnel Administration System, the Administration of Goods and Services System, the Treasury and Public Credit System, the Integrated Accounting and Governmental Control System.

² The Strategic Framework is composed of a Vision that establishes the direction the Administration is moving in and represents the challenges that it is aiming to address. The Mission, which is the reason for the entity's existence also establishes the objectives our efforts will be directed toward achieving as well as the Values and Principles that the human resources and institutional activities must internalize.

- a) Activities Control System.
- b) Taxpayer Selection System.
- c) Third Party Information System.
- d) Auditing Procedures and Technical System.

The results of evaluations and follow up regarding examination activities have been implemented by the Activities Control System COG which is defined as a computerized tool that permits orderly control and inspection of auditing processes, permitting follow up of examination activities at different user levels³, through chronological registration of the following general processes:

- Request for an Order to Audit.
- Authorization and issuance of the Order to Audit.
- Taxes and periods audited.
- Responsible auditors and their Supervisors.
- Register of notifications made to the taxpayer.
- Charges for Specific Taxes.

The COG system is implemented on line in the Managers Offices for the Largest Taxpayers and due to hardware limitations for the rest of taxpayers the information is updated through a BATCH process. The data is centralized in a SIRAT Data Base, the Department for Quality Control and Evaluations being the main user. It is an agency under the Manager's Office for Auditing Nationwide. Every 15 days, this Department issues reports on the activities that have been carried out. It presents general information and by category, calculating indicators for evaluation and control of activities, allowing for feedback. In addition, this information is the main source of data for the Productivity Evaluation System. Without this software it would be impossible to carry out the follow up and control of examination necessary for the purposes of evaluating activities.

2.3. Evaluation of activities

Examination activities can be quantified based on two parameters:

³ National and District Managers, Heads, Supervisors and Auditors in the Auditing Department.

a) The Number of Examination Cases

The number of interventions or examination cases carried out is related to the total number of control activities and the “sense of risk” felt by taxpayers. When a larger number of taxpayers are audited, a higher “sense of risk” result, which causes an improvement in voluntary compliance in terms of tax payment of their tax obligations.

b) Tax Collections

This variable permits measuring the effectiveness of examination activities, since once taxpayers accept and pay the amount of tax calculated, they must change their behavior with respect to their future tax payment obligations.

A comparison of examination activities is provided in the following table:

Table N° 1

COMPARISON OF EXAMINATION RESULTS

EXAMINATION PROCESSES	During 2001		During 2002		During 2003	
	Actions	Collections	Actions	Collections	Actions	Collections
External Audits	362	7,805,886	174	24,734,597	182	22,139,336
External Verification	9,502	19,088,292	3,275	9,460,300	5,830	24,656,260
Internal Verification (*)	0	0	2,891	9,290,022	5,751	14,571,965
Preventive Educational Control	n.d.	0	51,913	129,136	46,786	1,100,005
TOTAL	9,864	26,894,178	58,253	43,614,055	58,549	62,467,566

Source: Service of National Taxes, National Auditing Managers Office, Department of Quality Control and Operations Evaluation

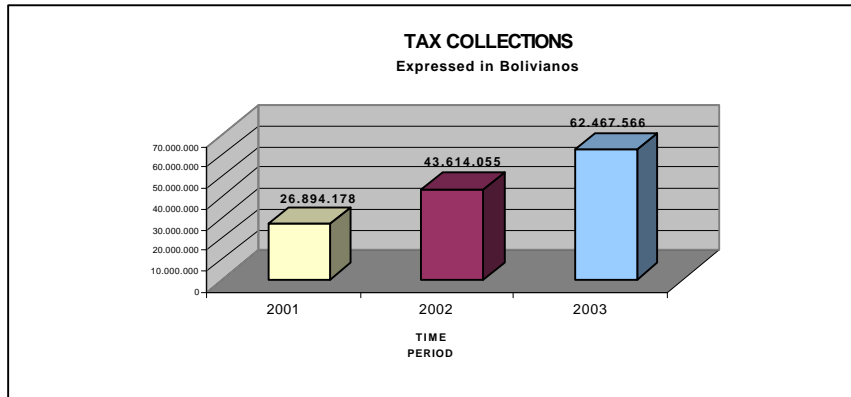
(*) Internal verification activities were recently implemented, starting with 2002

Regarding cash tax collections, there was an increase from 26.8 million Bs⁴ during 2001 to 43.6 MM⁵ during 2002, which represents a 62% increase. During 2003, there was an increase of 44%, reaching an amount of 62.4 MM.

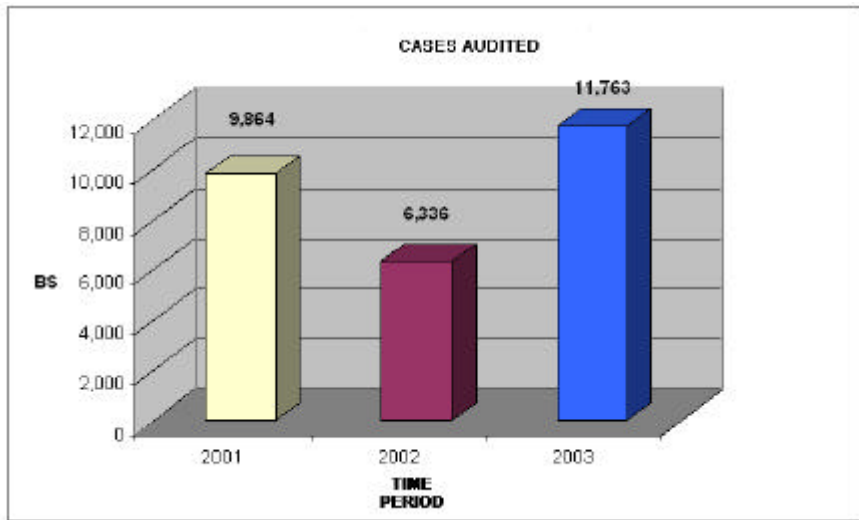
⁴ All amounts are expressed in Bolivianos. For the purposes of comparison, the Average Exchange Rate during 2003 was 7.67 Bolivianos per US Dollar.

⁵ For the purposes of simplifying communication MM will be used to abbreviate the word “million.” In addition, from here on all amounts refer to Bolivianos.

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Regarding the number of examination interventions, during 2002 there was a 35% decrease due to examination activity being temporarily suspended for three months, as will be explained later on. However, during 2003, there was an 86% increase in the number of examination interventions, with 11,763 cases being carried out.



In terms of taxes determined as a result of examination activities, beginning in 2002 a significant increase was observed from 120.2 MM during 2001 to 451.8 MM by the end of 2002 and 440.4 MM by the end of 2003. This represented a 266% increase between the period of 2001 and that of 2003.

One of the objectives of the examination strategy was to reduce discretion in selecting taxpayers to be audited. During the 2001 period, 75% of the cases audited were selected at the discretion of district and national authorities. Beginning in 2002, an automated selection system was implemented for selecting taxpayers by applying fiscal intelligence criteria.

During 2002 and 2003, 6,423 and 7,611 taxpayers respectively were selected, using automated processes to select those targeted for examination. This represented an increase of 25% and 70% participation in the total universe or number of examination interventions.

By increasing the percentage of taxpayers selected automatically, the susceptibility of taxpayers to be selected for examination based on personal or interested attitudes was reduced, thus fortifying transparency and fairness in SIN's examination unit.

Table N° 2

SELECTION METHODOLOGY

SELECTION METHODS	YEARS							
	2001	2002			2003			
Discretionary	75%	30%			30%			
Automatic	25%	70%			70%			
TYPE OF OPERATION	CASES AND COLLECTIONS	CASES	COLLECTIONS	%	CASES	COLLECTIONS	%	
Pchses. Vs. Sales	None exist	2,513	5,802,176	27%	4,033	9,300,822	36%	
Cards		1,457	2,910,674	16%	930	2,802,425	9%	
Double Invoicing		995	68,725	10%	1,267	490,699	12%	
Omissions		1,458	467,765	16%	286	1,756,771	3%	
Permanent balance in favor		20	40,682	1%	37	220,995	1%	
Invoices Reviewed					924	In Process	8%	
Agents					134	In Process	1%	
TOTAL			6,443	9,290,022	70%	7,611	14,571,712	70%

At the same time, tax collections resulting from examination of taxpayers selected by automated systems increased from 9.3 million during 2002 to 14.6 million during 2003, about a 56% increase.

Regarding the Hydrocarbons Sector, during 2002 additional taxes assessed and due from the petroleum sector were Bs156 million, which was a 526% increase over 2001, which were Bs25 million. In the same way, during 2003, Bs484 million were assessed, representing an increase of 210% over 2002. Since this is a

Strategic Sector for tax collecting, a National Manager's Office for Hydrocarbons has been created so that it is not included in the general reports on supervision of auditing activities.

2.4. The cost of examination activities

To evaluate the cost of examination activities, the direct costs are considered, expressed in the salaries of the officials working in the auditing area, since there is no breakdown of the indirect costs and they are not significant. The information is expressed in the following table:

TABLE N° 3
PERSONNEL COSTS

AUDITING PROCESSES	2002 PERIOD				2003 PERIOD			
	No. of Auditor s	Costs	Collections	Surplus / Deficit	No. Auditor s	Costs	Collections	Surplus / Deficit
External Examination	50	4,369,840	24,734,597	20,364,757	56	5,227,469	22,139,336	16,911,867
External Verification	49	4,459,991	9,460,300	5,000,309	73	6,366,854	24,656,260	18,289,406
Internal Verification	38	3,513,058	9,290,022	5,776,964	68	5,735,535	14,571,965	8,836,430
Voluntary Preventive Education	25	2,033,876	129	-1,904,740	28	1,861,197	1,100,005	-761,192
TOTAL	162	14,376,765	43,614,055	29,237,290	225	19,191,055	62,467,566	43,276,511

In the table we can see an increase in surplus (Collections – Costs) going from the amount of 29.2 MM during 2002 to 43.3 MM during 2003, representing an increase of 48% in production.

Regarding the cost/benefit relationship, we can see that for every Boliviano invested in examination activities, 3.3 Bolivianos came back. Even more important, however, are the indirect effects produced as a result of examination activities, as shall be explained below.

2.5. The “SISEPRO” evaluation and productivity control system.

Carrying out an analysis of the examination results from 2002, it was learned that the District Manager's Offices for the Auditing Departments did not show uniform productivity in their examination processes. Furthermore, there were delays in recording activities in the Annual Control system and the auditors were not interested in resolving these problems.

Faced with this situation, the Productivity Evaluation System (SISEPRO) was created as an instrument to correct these defects and to increase productivity levels, motivating and empowering the personal capabilities of auditing personnel.

The system allowed for auditors, supervisors and department heads to be categorized based on individual and group results for each one of the auditing operations. The best performances from personnel will be considered under the motivational policies called SIN (salary increases, training courses, scholarships, official letters of commendation and others). In order to evaluate the reliability of the information system, cases are selected to be reviewed based on quality control procedures.

In the same way, SISEPRO helps in evaluating the level of fulfillment of the goals stated in the POA for each District Manager's Office and afterwards to carry out a periodic evaluation of the auditing departments, in order to increase productivity.

The names of the best auditors, supervisors and department heads are published on the Service of National Taxes's Intranet.

The Productivity Evaluation System is structured around the following components:

2.5.1. Ranking the Auditors

The Ranking of Auditors is a report of position of the results of auditing obtained by each auditor and they have been calculated based on the following variables:

a) Number of Audits Concluded

Is the sum of the audits concluded by an auditor for each one of the auditing processes.

b) Assessments Paid

The total of the amount of Tax Obligations Paid as a result of the auditing processes which includes; payments in cash, payments on account, corrections, payments with securities, purging of amounts of taxes requested to be reimbursed and others that represent an increase in balances in favor of the tax department or decreases in balances in favor of taxpayers.

To determine the indicator of the Ranking of Auditors, in the first case one must obtain indicators for audits concluded and taxes collected, as a result of the calculation of these indicators the ranking of the auditors is obtained. This calculation is determined by assigning a percentage to each indicator based on the auditing process that is being evaluated.

The indicator for audits concluded $IC_{(D)}$ is calculated in the following manner:

Interventions Concluded by the Auditor
Average Number of Interventions Concluded on the National Level

The indicator $IC_{(F)}$ allows one to compare the results of interventions concluded by the auditor based on the average, according to the following criteria.

- If $IC_{(F)} = 1$, the auditor concluded a number of interventions equal to the average.
- If $IC_{(F)} > 1$, the auditor concluded a number of interventions greater than the average.
- If $IC_{(F)} < 1$, the auditor concluded a number of interventions below the average.

Evaluating productivity in tax collection is more complex than in the above case, since one cannot compare tax collection in a District composed of taxpayers of lesser importance to one composed of taxpayers of greater importance. For example, it would not be correct to compare tax collection in the Potosi District Manager's Office with

that of the Large Taxpayers in the Santa Cruz General Manager's Office. For this problem it is necessary to carry out adjustments that reduce these distortions.

In this way, the best correction parameter must be relative to cash collections by agency, as follows:

$$\text{Adjusted Tax Collections} = b \frac{\text{Actual Collections}}{\text{Theoretical Collections}} + (1 - b)$$

The adjustment is carried out by calculating the tax collection obtained by auditing with the theoretical tax collection that should have been obtained if one considers the same proportion as in general tax collections.

Finally, $IR_{(F)}$ is calculated

$$IR_{(F)} = \frac{\text{Tax Collection Obtained by the Auditor}}{\text{Adjusted Tax Collection by the Examination Process}}$$

The indicator $IR_{(F)}$ allows one to compare the results from interventions concluded, by auditor regarding the average according to the following criteria.

- If $IR_{(F)} = 1$ the auditor collected the same as the average.
- If $IR_{(F)} > 1$ the auditor collected an above average amount.
- If $IR_{(F)} < 1$ the auditor collected less than the average amount.

2.5.2. Plan for Rotating Personnel

Consists in the rotation of auditing personnel from one District Manager's Office to another in order to improve auditing performance and to train personnel. For these purposes, the dimension of the Auditing Departments and the results achieved by the intervening agents are considered.

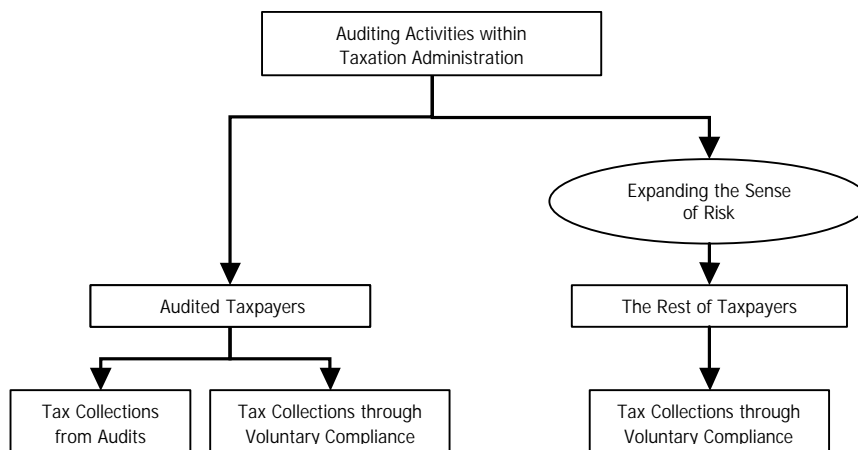
2.5.3. Plan for Temporary Substitution

The National Auditing Manager's Office intervenes when it has been determined that there are defects in the results of examination processes. The Head of the Department is temporarily replaced, along with the necessary professionals and technicians and all of their responsibilities in order to carry out an examination and to redefine the direction of the Auditing Department.

3. EVALUATING THE IMPACT ON THE TAXPAYERS TAX PAYING BEHAVIOR

3.1. The impact of examination activities

In order to explain the impact of examination activities, we present the following diagram, which outlines how examination activities have direct and indirect effects.



3.1.1. Direct effects

The direct effects are those that are manifested directly by audited taxpayers and can be distinguished by the tax collections that examination activities generate as well as new tax paying behavior on the part of those audited. If the taxpayer agrees with the auditors' observations, then he also must decide what his tax paying behavior will be in the future regarding the items audited.

3.1.2. Indirect effects

Indirect effects of examination activities are those manifested among the rest of taxpayers. When examination activities increase, the "sense of risk"⁶ expands and that modifies taxpayer's behavior, since they must make a decision regarding how they will pay their taxes when confronting the changes in the "sense of risk."

3.2. Evaluation of Bolivian Taxation Administration

The process of institutionalization was begun by appointing a Governing Board for the Service of National Taxes on 14/9/2001. One of its first decisions was to temporarily suspend examination activities due to indications of corruption in some examination processes and the uncertainty that it caused among old employees. Examination activities were begun once again in February, 2002, implementing internal verification processes for large taxpayers.

3.2.1. General development of the VAT

Examination activities have been directed towards the Value Added Tax VAT due to the importance described above. For this reason they will be analyzed in terms of their impact on tax collections.

In table No. 4 we can see that tax collections in cash for the VAT showed positive growth of 6% in 2001, 13% in 2002 and 21% in 2003.

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Table N° 4

TAX COLLECTIONS IN CASH FOR THE VAT – INTERNAL MARKET

VAT Internal Market	2000	2001	Growth Rate	2002	Growth	2003	Growth Rate
January	116,921,103	112,829,412	-3.5%	124,989,205	10.8%	153,474,904	22.8%
February	92,036,745	101,411,116	10.2%	97,500,572	-3.9%	149,324,458	53.2%
March	74,779,973	92,985,962	24.3%	104,695,672	12.6%	128,696,383	22.9%
April	92,378,740	119,833,741	29.7%	124,688,758	4.1%	130,464,897	4.6%
May	100,627,663	108,851,443	8.2%	125,421,776	15.2%	135,118,774	7.7%
June	93,783,264	115,190,376	22.8%	129,065,429	12.0%	145,307,652	12.6%
July	95,785,311	105,374,142	10.0%	120,340,538	14.2%	145,413,460	20.8%
August	97,023,985	110,947,544	14.4%	98,913,363	-10.8%	168,775,490	70.6%
September	96,752,595	116,378,709	20.3%	111,225,712	-4.4%	135,968,425	22.2%
October	126,999,508	106,441,611	-16.2%	124,797,570	17.2%	147,147,570	17.9%
November	128,514,796	96,393,329	-25.0%	138,312,846	43.5%	152,319,326	10.1%
December	88,617,428	88,127,727	-0.6%	142,285,070	61.5%	153,087,268	7.6%
TOTAL	1,204,221,111	1,274,765,112	5.9%	1,442,236,511	13.1%	1,745,098,607	21.0%

Source: Service of National Taxes

3.2.2. Impact of examination activities on taxpayers

In Table N° 1, during 2003 11,763 examination cases were processed (182+5,830+5,751), resulting in tax collections of 62.4 MM Bolivianos. During 2002, results showed growth of 85% in terms of the number of audits performed with a 44% increase in taxes collected as a result of examination activities. In order to determine what has been the impact of examination activities in terms of voluntary compliance by taxpayers audited, data has been gathered from the sworn VAT tax declarations, which is presented in the following table:

Table N° 5

VAT DECLARED BY TAXPAYERS AUDITED

VAT Internal Market	Debits Audited 2002	Debits Audited 2003	Credits Audited 2002	Credits Audited 2003	VAT 2002	VAT 2003	Growth Rate
January	479,371,460	552,585,608	395,768,864	452,924,007	83,602,596	99,661,601	19.2%
February	433,961,028	558,334,104	364,265,204	406,618,927	69,695,824	151,715,177	117.7%
March	503,146,365	501,175,235	420,076,642	394,518,151	83,069,723	106,657,084	28.4%
April	516,902,986	524,749,043	439,171,700	432,304,805	77,731,286	92,444,238	18.9%
May	537,469,417	581,097,110	472,100,375	489,445,802	65,369,042	91,651,308	40.2%
June	539,280,949	564,054,434	470,217,534	446,923,522	69,063,415	117,130,912	69.6%
July	544,586,136	569,154,381	465,803,016	460,481,292	78,783,120	108,673,089	37.9%
August	601,678,524	569,516,511	533,654,828	459,407,643	68,023,696	110,108,868	61.9%
September	545,335,252	608,322,319	465,018,185	501,461,219	80,317,067	106,861,100	33.0%
October	582,397,101	588,101,602	505,787,197	463,777,439	76,609,904	124,324,163	62.3%
November	578,286,793	605,616,960	492,849,928	480,013,210	85,436,865	125,603,750	47.0%
TOTAL	5,862,416,011	6,222,707,307	5,024,713,473	4,987,876,017	837,702,538	1,234,831,290	47.4%

Source: Service of National Taxes, National Managers office for Computer Information and Telecommunications

As we can see in table N° 5, every month there has been an increase in VAT. At the end of the period analyzed, it was 47%, far above that determined by the normal growth rate of the VAT, which was found to be 21%

In addition, the behavior of taxpayer's debits audited and credits audited has been quite favorable for the Auditor's Office: sales declared have increased from 5,862 MM in 2002 to 6,222 MM in 2003, representing a 6% increase. On the other hand, credits audited have declined from 5,024 MM during 2002 to 4,987 MM during 2003, representing a 0.7% reduction.

Behavior regarding credits/debits is shown in the following table:

Table N° 6

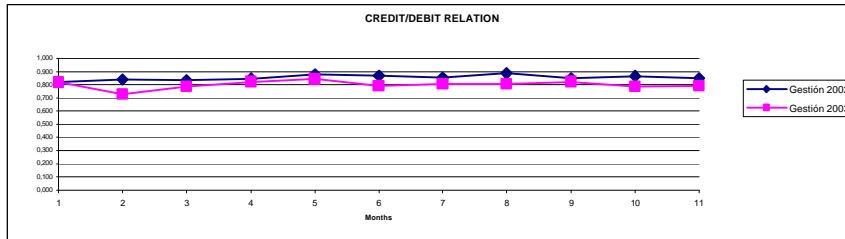
THE CREDIT/DEBIT RELATION OF AUDITED TAXPAYERS

VAT Internal Market	Credits Audited 2002	Debits Audited 2002	Cre/Deb 2002	Credits Audited 2003	Debits Audited 2003	Cre/Deb 2003
January	395,768,864	479,371,460	0.826	452,924,007	552,585,608	0.820
February	364,265,204	433,961,028	0.839	406,618,927	558,334,104	0.728
March	420,076,642	503,146,365	0.835	394,518,151	501,175,235	0.787
April	439,171,700	516,902,986	0.850	432,304,805	524,749,043	0.824
May	472,100,375	537,469,417	0.878	489,445,802	581,097,110	0.842
June	470,217,534	539,280,949	0.872	446,923,522	564,054,434	0.792
July	465,803,016	544,586,136	0.855	460,481,292	569,154,381	0.809
August	533,654,828	601,678,524	0.887	459,407,643	569,516,511	0.807
September	465,018,185	545,335,252	0.853	501,461,219	608,322,319	0.824
October	505,787,197	582,397,101	0.868	463,777,439	588,101,602	0.789
November	492,849,928	578,286,793	0.852	480,013,210	605,616,960	0.793
TOTAL	5,024,713,473	5,862,416,011	0.857	4,987,876,017	6,222,707,307	0.802

Source: Service of National Taxes, National Auditing Manager's Office

In Table N° 6 we can see that during 2002, audited taxpayers declared on average that their purchases represented 85% of their sales. During 2003, this relation declined and purchases only represented 80% of sales. In general, during 2003 the credit/debit relation declined by 6% and in every month has been less, as can be seen in the following table:

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Finally, if the same credit/debit relation of 2002 had been maintained in 2003, the proportion of which was 85.7%, the audited credit would have been 5,333 MM resulting in taxes of 889.8 MM.

However, the results in 2003 were 1,234 MM⁶, which leads us to conclude that the improvement in examination activities resulted in 344.9 MM generated due to modification of behavior among audited taxpayers.

4. CONCLUSIONS

- 4.1. Integral evaluation of examination activities must be carried out from two perspectives; the results of the activities and the impact on voluntary tax paying by taxpayers.
- 4.2. Strategic plans and programs also must be considered in the evaluation process, because through a permanent realignment, strategic objectives can be adjusted to optimize use of resources in the area of examination.
- 4.3. Given the volume of examination information, to carry out adequate follow-up of examination activities, it is vitally important to use information support software to have timely and reliable information at hand.
- 4.4. Follow-up and control of examination activities shows the great importance of management's decisions in strengthening auditing departments showing the greatest weakness in their results in terms of numbers of cases and tax collections.

⁶ Amount extracted from table N° 5

- 4.5.** The cost of examination must be kept within reasonable parameters, although, objectives of activities are not only the ones established in terms of amount of taxes collected as a result of audits, but are oriented towards expanding the “sense of risk.” But these costs must be less than the amount of taxes collected through examination.
- 4.6.** To the extent that examination is modernized in the Tax Administration, new problems must be resolved such as a lack of uniformity in auditor’s productivity and how to obtain an increase in it.
- 4.7.** The experience of the Tax Administration of Bolivia shows how the indirect impact of examination activities is manifested in voluntary compliance by taxpayers, which results in a greater benefit than just the taxes collected directly through the examination processes.

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Case Study

TOPIC 3.3

INTEGRAL EVALUATION OF THE RESULTS OF EXAMINATION ACTIONS

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*CONTENTS: Case Study: The Oriental Restaurants.- Case Study: Foreign Bank
Accounts.- Repentance, the Effect of Publicity on Fiscal Behavior.*

There are two ways of dealing with fiscal risks¹ :

- The standard organizational structure, capable of managing large flows of tax returns, information, risks and examination activities. This is the main 'production machine' of the Tax administration, the process of 'mass production'. The management tasks are to create a working risk-based organization and, mostly annual, the choice of risks.
- Project management, suitable to deal with special operations and campaigns. Some risks need a 'tailor made' approach, but are placed within the structure of the mass production process. Experience learns that management wants to be informed frequently and wants to decide at every mayor step of these operations. There will be publicity and often political attention.

¹ As explained in Chapter 2.2 of the CIAT Examination Handbook.

First, let me emphasize that the examination function (validation, verification and tax audits) is only a part of the enforcement strategy. Every risk and every group of tax payers can be seen as a pyramid of individual cases: all companies in one city, all restaurants in a state, all income tax payers with a company car, etc. It is impossible to examine them all, choices have to be made and a large part of the defined group will stay without attention. Therefore, preventive activities, like eliminating opportunities, eliminating reasons, enticing cooperation, advertising, providing information, etc. are of the same importance as the examination of part of each group. Also the chance of being caught, or better, the perception of the chance being caught, has a great influence on the behavior. This perception can be manipulated.

A second remark: Management is responsible for the choices made during the process of enforcement. To make these choices possible there has to be a system of planning risk treatment on an aggregated level. From a risk base, with all the defined tax risks, through the phases of preliminary research on risk treatment, making standard treatment instructions, gathering information on costs and benefits of treatment, to parametering the risks, there has to be a (annual) mix of risks, parameters and ways of enforcement. This risk mix is the proposed use of the available men and means. The choices within the consistence of this risk mix have to be clarified, so decisions can be made at the right level.

CASE STUDY: THE ORIENTAL RESTAURANTS

Knowing to run a business is knowing how to audit a business. This rule should be hanging on the wall of every tax auditing office. Whether it is a large bank or assurance company, or a small restaurant, the only way to audit effectively is knowing how this type of business is run, what is important, what are main risks, which correlations exist and are used by the management as steering tools. Therefore, gathering information, doing research en studying developments in important types of industry, will be a good investment for the benefit of all tax examiners.

It can be wise to concentrate the knowledge and treatment of certain businesses on one place in the country: e.g. banking, assurance companies and oil companies. In Holland also all professional sports are treated and audited nationwide by one group.

Besides this concentration, it will be wise to form 'risk groups' of auditors and specialists to do research and study developments in certain types of businesses.

Their products will be: descriptions and auditing manuals for this type of businesses, new risks with the proper treatment, and parameters for dividing the high-risk cases from the low risk. This risk group can be on one place or can be spread out through the country, communicating with e-mail and other modern ways of exchange of information. Which specialized groups to start will depend on the typical situation in each country: agriculture, heavy industry, construction work, bars and restaurants, etc.

In this Dutch case study, one risk group is responsible for bars and restaurants. In the past they have produced descriptions of types of businesses, the gross margins, correlations between costs of purchase of goods and costs of labor, the correlation between drinks, type of food and ingredients, etc. There are several risks developed with indicators, selection methods, and ways of treatment, all part of the standard risk treatment plan. This information is digitally available for all tax auditors. The use of the standard risk treatment plan is obliged when auditing selected businesses.

The risk group was getting more and more signals that the oriental restaurants were becoming a high fiscal risk. Often these restaurants are family-businesses, with unclear costs of personnel. Cooks and kitchen-helpers are often Chinese, working illegally and being paid with black money. Chinese owners like to gamble with unknown money. As source of all these hidden expenses, part of the turnover is left out of the books. To cover up this lack of turnover, also purchases of ingredients are hidden, with the cooperation of suppliers, as they deliver goods without proper invoicing.

There are about 5000 oriental restaurants in Holland, with a total turnover above \$ 1 billion, so the risk is worthwhile investigating. First, the risk group did preliminary research: special audits to get confirmation on these signals and to develop detection methods. Several suppliers of ingredients were audited for their ways of invoicing. Several restaurants were audited, trying out different methods: taking stocks and comparing these with recent invoices, making analysis of cashbooks, comparing gross margin with prices, looking for correlations between ingredients, visiting restaurants unexpected and counting the number of personnel, comparing this with the planning of hours, asking for ID's, comparing these with the wage tax administration, etc.

Some approaches turned out to be effective, some not. It also had to be clear that every method was within the rights and obligations of the tax enforcement regulations.

The products of this research were:

- A detailed description of this type of business, the usable ways of auditing, the correlations, the methods to provide proof for undeclared income.
- A method of selecting the most risk-full cases, with usable parameters.
- Estimates of the effects and amount of adjustments, plus the average number of hours to be spent on each audit.

The first product is of great importance for the auditors, after it is decided that oriental restaurants will be part of the risk mix. The second and third products are needed for decision-making.

There are 5000 oriental restaurants. Each audit will take about 80 hours. When only the cases with the highest risks are done (about 100) the audit will lead to an expected amount of adjustments of \$ 100.000. This will decline to \$ 50.000 per audit when also the medium risk cases are audited (about 500). There is also a severe effect of improved behavior to be expected on the oriental restaurants that are not audited and even on all restaurants.

For the selection there appear to be several indicators:

- Gross margin. The average is 200%. Selecting all restaurants below 200% would mean auditing 2500 restaurants. Selecting those with a gross margin below 180% would reduce the number to about 1000 audits. This information is based on the VAT-files.
- Correlation between costs of purchases and costs of personnel. Average was about 1:1. Selecting to 100:80 and less would reduce the number of cases. This correlation could also be based on digitally available information from VAT- and wage tax files.
- From the classification of companies, part of the restaurants was known to be with a higher risk than average. This classification is done twice a year on all companies and is based on indicators like late payments, late tax returns, adjustments made in the past, etc.

- Special attention was needed for about 200 restaurants, which stopped buying ingredients from certain suppliers, after the invoicing by these suppliers was changed according to regulations. These restaurants are suspected to use a 50/50 system: half of the purchases are invoiced, half not. Apparently, they went to other suppliers who still were willing to deliver goods without proper invoicing. The audits on invoicing of suppliers did not provide specific proof, as the invoices were nameless and payments were cash. The suppliers that changed their behavior on invoicing complained to the tax administration that they were losing many sales because of unfair competition. They demanded that the tax administration should audit proper invoicing by all suppliers. The audits on invoicing were extended. In addition, the proposition was made that these 200 restaurants will get high priority in the selection. Although a changing of supplier is no proof in itself, in this special situation it is a useful indicator.

With the aforementioned information, a decision could be made by the management, as part of the decision on the risk mix:

- Should we include oriental restaurants in our next risk mix? Yes.
- How many audits will be done, 100, 200, 500, 1000 or 5000? It was decided that there will be 500 audits, taking about 40,000 hours during the coming year and providing an estimated gain of \$ 25 million. This decision was influenced by the wish to give a message to all restaurants that extensive attention will be given to widely spread unacceptable practices.
- Which restaurants will be audited? The selected 200 that apparently were manipulating with invoices, plus 300 others with a gross margin below 180% and a low rate of known costs of personnel (below 100:80) and a risk indicator higher than average.
- What to do with the suppliers? The audits on proper invoicing were extended. On complaints of unfair competition by other suppliers, there will be a direct response.

After these decisions, the audits could be planned by the risk group, the descriptions and treatment instructions could be spread and the audits could be included in the local auditing plans. Each audit will produce a standard list of results that will be sent automatically by the intranet to the risk group. This group is monitoring the results per tax office and will react on unexplained deviations. Every four months results are reported, as part of the report on the approved risk mix.

How are the results? The project is still running, so I cannot give you final figures.

- More than 200 suppliers had to be visited. The problem of improper invoicing became larger than estimated. After most of the large suppliers of ingredients adjusted their invoicing according to law, the restaurants searched new suppliers, willing to cooperate in nameless invoicing. These new suppliers had to be tracked and visited too: often smaller trade companies and retailers.
- The legal possibilities of fining improper invoicing are limited. The maximum amount is about \$ 3000. This penalty did not impress some suppliers. The Ministry is working on new legislation on penal sums, but this is a time-consuming process.
- The many hours spent on visiting the suppliers and enforcing proper invoicing had no direct financial revenue. To be effective a supplier had to be visited several times: first to audit the system of invoicing, then to judge the change of the system according to law. So many hours are spent without any measurable financial benefit.
- The results of the audits of restaurants are ok, about as planned.
- There are great differences between tax offices: some score very high, others far below average. These differences are related with the level and skills of the auditors that local management had assigned. Apparently only good auditors will make this audit to a success, and good auditors are scarce.
- In the preparation much effort was put in detailed descriptions of this type of business, the usable ways of auditing, the correlations, the methods to provide proof, etc. A 'risk treatment plan' contained this information. Also there were kick-off days and newsletters. Should not even an average auditor be able to do a good job with all this help?
- We concluded that here the limit was reached of what can be done with descriptions, instructions and other supporting instruments.

Consider the type of auditing: searching for unknown turnover, comparing stocks with the last invoices, comparing identified personnel with registrations, making correlations and calculations, being critical about the quality of the bookkeeping, and above that, combining all different information into one provable conclusion. This is a difficult type of auditing. It not only demands skills and techniques, but also insight, creativity, experience and perseverance.

- But still our conclusion is that the treatment of this risk is a success: the estimated gain will be reached, the number of hours will be higher than planned, but it will end a widely spread bad practice, the approach gave a strong impulse on more effective legislation and many auditors claim that they have learned much from these audits.

CASE STUDY: FOREIGN BANK ACCOUNTS

As explained earlier, sometimes a tailor made approach is needed. Then parametering, making treatment instructions, and waiting for the results are not sufficient. The risk will cause many publicity, is political sensitive, equality of treatment needs special care, etc. Project management within the existing structure is necessary. In the late 90's a standard system of management of special operations and large campaigns was initialized in the Netherlands. Though the system is improved during the years, the main way of operating has been the same:

- Every project starts with an initiative. This can be a signal within the tax administration or from outside. Most important is to be aware of useful signals at a central level at an early stage. All directories are represented in a coordinating group, and the obligation to bring possible initiatives to this board was spread to all higher and lower management.
In the first years local management occasionally tried to do special operations without informing the coordinating group. In two cases these operations suddenly became headline news, and the local management had to explain to the Ministry why they were not informed about the operation. Some hard words were spoken, and the effect was that no local manager nowadays will start an operation on his own.
- Next phase is preliminary research. Is the risk worth while investigating? Are there special problems to be expected? Is there a usable method of detection?
- A steering committee decides after the preliminary research phase and after the next phases. This committee also gets four-monthly reports and monitors developments.
- The next phase usually will be the start of some pilots, to try out the developed way of treatment. In some situations the pilots are just a number of cases done first, learning as they progress. In other situations pilots can take a year or more.

- The piloting phase will lead to an advice to the steering committee: extend the treatment to all cases, or to a selection of cases, or stop further action.
- After this decision the real project starts: A project group is formed. The management of involved tax offices is officially assigned to cooperate and make the necessary men and means available. For each project there will be a coordinator in each involved tax office. Projects usually start with a kick-off day for the coordinators, presenting the detailed instructions and the Access application, build for the project.
- The highest management is informed every four months and at critical stages of mayor projects. When publicity is expected, the reaction will be in close cooperation with the Ministry. In many cases there are questions in parliament, which also are answered in close cooperation with the Ministry.

For each project an Access application is build, with relevant taxpayer data, standard letters, reminders, and other documents, registering each step in the treatment process for each individual case. The building of this application is done by a few people, who can produce a working program in a few weeks. During the pilot phase often changes and additions are made on these applications. These changes take only days. All used applications are placed nationwide on one directory in the intranet (the closed network of the tax administration). A competence matrix determines what each user can do: which information is visible, which is changeable. The great benefit for the users is the easy to use way of producing all standard letters and registering and controlling the situation of every case. The advantages for the project management are: equal treatment of all cases, and a direct monitoring of the situation of each tax office. Management information can simply be produced and is always up to date. When tax offices are behind schedule the management will be asked for explanation. Also results below average are noticed and will lead to action.

The foreign bank account case is a good example, with all the elements, and with a remarkable conclusion. Although the following description is quite detailed I want to emphasize that the whole story has been in the Dutch newspapers, so no secrets are revealed.

Years ago, some employees of the KB Lux bank in Luxembourg stole microfiches with the bank numbers and names of owners of about 35.000 bank accounts, concerning a total amount of \$ 2 billion. First, they tried to resell the microfiches to the bank. After this failed, they went to the

Belgium tax department. Even now, several years later, it is still unclear how the Belgium tax administration got possession of these microfiches. There are several court cases about the question whether the information was obtained legally. However, one thing is sure: the Belgium tax administration got the information. After some study they concluded that part of the bank accounts was owned by Dutch citizens, and on the end of 2000 the information on more than 10.000 bank accounts was provided to the Dutch tax administration, according to the international rules of spontaneous information.

At the same time the Dutch tax administration got information about bank accounts of Dutch citizens in Germany, Spain and Italy, in total a few hundred bank accounts.

So in the beginning of 2001 in the Dutch tax administration a small group was formed to plan further action.

A study was done on the received information. From each bank account was known: balance at one day (February 17, 1994) and the full name of the owner and a second authorized person. So: no address, no date of birth, no signature. It was clear that identification would be difficult and in many cases impossible. For each bank account we would have to prove that only one combination of two individuals was fitting.

A file was needed of all Dutch citizens, with full names, the relations with other individuals, and their fiscal numbers and tax information. Our tax file 'bvr' was capable of providing this information. Then for each bank account all possible full names had to be mapped. In about 1000 cases there was only one possible full name. In the other cases there were more than one citizens with the same full name. Combining the name of the owner and the second authorized should give extra clues: man and wife, father and son, partners in business, etc. The search for unique combinations gave about 2000 more identifiable bank accounts. The rest of the cases would take more research. Also the identification of each case had to be clearly documented, so it would stand in court. This quest for identification went on during the next years. In the end about 5700 bank accounts were identified. The other cases could not be brought to a unique combination of two names, there are hundreds 'Jan de Vries' or 'Marie Jansen'. The group of people who did this research has done a remarkable job: until now this identification method was never questioned in any court case.

Question 1: Is the money on this bank account declared in tax returns? This was an easy one: in almost all cases the bank account and the interest were not declared.

Question 2: Is the information of 1994 still usable in 2001? Yes: Dutch law has a rule that foreign income, like interest on a foreign bank account, can be corrected up to 12 years later.

Question 3: Which cases should be prosecuted in a public criminal court? This was discussed with the central office of public prosecution. Tax administration and public prosecutor agreed that about one hundred cases should be prosecuted: owners of bank accounts with high balances and owners with an example or trustworthy function in society: judges, policemen, employees of the tax administration, etc. This group was small, maybe 25, but it existed. As the research on identification went on the number of prosecuted cases rose to about 150. A working group of tax officers and public prosecutors was formed to coordinate all selected cases.

Question 4: Is the information, received from Belgium, lawful and usable as proof in court? This could be a problem as the microfiches were originally stolen from the bank by some employees, and it was unclear how the information had reached the Belgium tax administration. The use in fiscal law would not be a problem as Dutch jurisprudence even allows unlawfully gathered information, unless the tax administration itself violated the law. The use in criminal law could be a problem, and will be questioned. The public prosecutor stated the information was lawfully received; the use was quite defensible in criminal court.

Question 5: Should there be created a special relief of penalty? This would be a political decision. The preparing group thought it would be very unfair to all citizens that did declare their interest income. Also the Minister of Finance did not see any reason for a relief of penalty. Dutch tax law has the possibility of repentance. If undeclared income is spontaneously declared to the tax administration afterwards, before the tax payer could know that this income was already tracked by the tax administration, taxes will not be fined. This repentance rule could be used in publicity: Reveal hidden bank accounts and interest now, and you will not be fined, you just pay taxes and interest for overdue payment.

Question 6: Should there be a special task force to carry out this project, or should the work be done by the tax offices throughout the country? The preparing group proposed to work with a special task force, as this would be easy to manage, equal treatment will be guaranteed and the operation will be flexible and of high quality. This task force was rejected by the highest management. Although the coordination would be more complex, the work had to be done by all tax offices, as this project, with its potential big successes, could be an impulse for moral and pugnacity of a large group of tax officers.

In the summer of 2001, a general plan was made, as a proposal for the highest management. At the end of August the proposed approach was accepted and the real operation could start. In the autumn detailed instructions were made, the Access application was designed, with standard letters, reminders, registration of each step, etc.

On the first day of November, two pilots started: 50 criminal cases and 100 cases that would not be prosecuted. The criminal cases were visited by the fiscal police, the civil cases received a standard question letter. On November 6 the operation was in all newspapers, on November 10 questions were asked in parliament, on November 13 some big lawyer firms stated they will combat the legality of the used information. As expected it was good business for lawyer firms and tax consultants.

Two months later the first evaluation was made: 75% of the criminal suspects and 95% of the civil cases confessed. They gave full disclosure of their foreign bank accounts. The first calculations of adjustments and payments of tax, interest and fines were made and accepted. Also the first cases of repentance appeared. To stimulate this 'spontaneous' repentance a special form was designed and put on the Internet-site of the Dutch tax administration: the 'declaration foreign bank account'.

In December 2001, the treatment of the rest of the cases started. All tax offices had assigned local coordinators. They were instructed during kick-off days, received admittance to the supporting computer application, and sent out the first question letters.

In the year 2002 and the first half of 2003, the operation progressed. The identification led to a constant flow of new cases. The supporting application made it possible to monitor the process, the local coordinators were frequently informed about new developments and results, all formal and fiscal questions were answered by a group of specialists. There was a high rate of confessions in the civil cases, leading to standard

calculations of payable taxes, interest and fines. Many people signed a standard form to accept and pay the calculated amounts and to renounce the right of appeal.

The group of criminal cases took more time, as expected. One court case should work as an example for coming cases. This court sentenced that the Belgium state should give disclosure about the way the information was obtained. After a delay of months this court case stranded, as the suspect died. New court cases came in 2003, some were won, and some were lost. Appeal was necessary. Because of communication problems within the department of public prosecution the time limit for appeal in the first lost cases was exceeded. New appeals will come, but it can take years before there is final certainty about the legality of the use in criminal cases. Almost all publicity goes to these criminal court cases, but one has to realize that all criminal court cases together only represent 1% of the usable bank accounts.

In June 2003, the 'massive' part of the project was ended. Total benefits for the Dutch state was about \$ 200 million. Half of it was cashed, the rest was in progress. Almost 90% had confessed the possession of the foreign bank account. The rest was in some state of denial. These cases were the start of the 'intensive' part of the project, in which each individual case was supported or executed by a group of legal specialists.

REPENTANCE, THE EFFECT OF PUBLICITY ON FISCAL BEHAVIOR

As mentioned before, there was a group of 'spontaneous' repentance. It started with a few cases, but then, as publicity progressed, the group was growing: hundreds, exceeding 1000 in the middle of 2003. Remarkable was the fact that most of this group mentioned bank accounts that were not in our KB Lux file. The extra benefit on taxes and interest was \$ 30 million.

When the flow of repentance cases started, a small group of psychologists and sociologists, working within the tax administration, were assigned to study this phenomenon. Was there a correlation between publicity and repentance? Could publicity influence behavior? Which kind of publicity was the most effective? Several studies have been done in the past two years, and more studies are to be expected. The conclusions are remarkable.

There is a direct correlation between publicity and repentance, with a two weeks delay.

Obviously people consider their own situation after reading or seeing the news. Some get doubts and get sleepless nights. They contact their consultant, or someone they trust. The matter will be discussed within their family. A decision is made, and the repentance form is sent. The cases of repentance could be directly related to specific news items in newspapers and on TV.

Which kind of publicity was the most effective? All publicity was divided in: threatening messages (you will be punished), rational arguments (it is wise to use the possibility of repentance) and news, relating behavior with social standards (it is unfair to evade taxes). One should expect that the threatening news of being caught and fined, the fear of discovery and punishment was the most effective. But it was not. Fear will paralyze. People tend to stay quiet and do nothing when the message is threatening. So the effect will be the opposite. On the other hand, relating to rational arguments, and even more, to social standards, can be very effective. This project turned out to be a unique possibility to compare different sorts of publicity with actual numbers of responding cases of repentance.

The effect was so obvious that since the middle of 2003 a new approach has started: 'enforcement communication', influencing fiscal behavior by the right kind of active publicity. The effect turns out to be very worthwhile.

As a follow-up of the foreign bank account project the project 'foreign possessions' started. Because of the closer cooperation between states in Western Europe, more and more information is received from other countries: German and Italian bank accounts, information on unknown 'stiftungen' in Liechtenstein, Spanish and French real estate, unknown trusts on the Antilles, all owned by Dutch citizens. The news was spread that Dutch taxes had received this information. In these messages the possibility of repentance was mentioned, as being a wise solution for worrying owners. The news and the message was headline news for weeks. Last autumn there was a meeting of tax officers of several Western European states. France brought a little present: documents of 5000 French real estate properties, own by Dutch citizens. The meeting and the French present was mentioned in a press release by the tax administration. Again it was headline news within a day. Now every week there are dozens of news articles, opinion items, professors explaining the consequences of tax fraud, etc. The project 'foreign possessions' now has two parts: The first is to coordinate the correction on taxation from all incoming foreign information, organized in the same

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way as the bank account project. Again millions are harvested and some criminal cases are prepared. The second part is the treatment of incoming repentance forms: about 1500 new cases until now. Public is getting convinced that they are not safe from taxation, wherever they go.

The same approach is now part of several other fiscal risks. It may well become a standard part of every organized operation.

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CLOSING SESSION

GENERAL RAPPORTEUR

Claudino Pita

Advisor to the Federal Administrator
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Claudino Pita

First of all, I would like to thank CIAT for inviting and giving me the honor to participate as general rapporteur of this Assembly.

I would also like to sincerely congratulate all officials of the Service of National Taxes of Bolivia, who upon being lead by the President of this Service, Mr. Eduardo Zegada, have magnificently organized this event and gained the recognition of all participants thanks to their kindness as manifested during these days.

In this regard, I would like to begin this report as of the moment we arrived at Cochabamba. We were men and women, alone or in small groups, speaking different languages: Spanish, English, Portuguese, French, Japanese and many others, all with concerns and expectations regarding this General Assembly.

On the inauguration day Mr. Eduardo Zegada during his welcome speech informed us that we were in a country that is located in the heart of America and that Cochabamba, in turn, is the heart of Bolivia.

Some of us thought that this was a simple geographical reference, however, during the course of the week, we understood it was more than that, we were inside a heart bursting of friendship and hospitality, and this gave those individuals or groups that arrived at Cochabamba the opportunity to turn into one big family by overcoming all language barriers and in this manner recreate, once more, CIAT's traditional family, which is distinguished by the mutual respect, solidarity and friendship among its members.

In this regard, regarding the environment of professionalism, cordiality and fraternity present during CIAT meetings, I would like to point out the decisive influence of one person, Mr. Jorge Cosulich, CIAT's Executive Secretary, whose individual qualities may be mentioned as the most important person behind that atmosphere, whose preservation should be a priority in the future development of the activities of.

Before I start with the report on the papers presented during this Assembly, I would like to quickly reflect on the scope of its central theme: "The examination function of the tax administration."

The purpose of the examination function, in a broad sense, is to control full and timely compliance with taxpayer obligations, material as well as formal.

It has an important role in the efficacy of the administration, and, this is the fundamental instrument to fight evasion, allowing in this manner equal tax enforcement and an adequate level of tax revenue.

At the same time, nowadays the examination action should be understood not only as a group of inspection or repressive activities, but it should be seen that it is at the service of taxpayers and society at large.

The modern concept of examination comprises proactive and educational actions, whose purpose is to avoid non-compliance, through preventive warning and orientation actions to taxpayers.

Furthermore, it must and should be understood as a service to taxpayers that correctly comply, maybe this is the service of greatest impact to promote spontaneous compliance with tax obligations, upon proving to those taxpayers that their effort to comply with their obligations has not been in vain, and that they are recognized and at the margin of the repressive actions applied to individuals who did not comply.

In very simple terms, the fundamental service that the tax administration should not cease to provide, is the service of preventing a good taxpayer from feeling or being pointed out as the "fool" and evidently this would be achieved as the tax administration takes actions to prevent this from turning into a generalized environment where non-compliance goes unpunished, therefore the examination functions has an essential role.

Regarding the works presented, which have supplied the foundations for a highly beneficial exchange of experiences that has enriched us all professionally and which undoubtedly will have a positive effect in our administrations, I would like to highlight some topics developed therein and formulate some quick comments and observations on each topic.

Mr. Rolando Lopez Lopez from the Service of National Taxes (SIN, in Spanish) of Bolivia developed the Topic 1 – EXAMINATION STRATEGIES. After formulating a series of conceptual considerations on Institutional Strategic Planning and the General Examination Process, regarding its need and importance, he highlighted how the purpose of this process is the expansion of the risk regarding non-compliance, since this could expand voluntary compliance with positive effects on the amount collected.

As from the development of those conceptual considerations, he also mentioned that the initial step to establish the adequate examination strategy is the analysis of the internal and external environment.

The speaker considered that as from the preliminary analysis of the environment, the design of examination strategies, requires the presence of three components:

- Taxpayer, Which taxpayers are to be examined?
- Processes, What kind of examination processes will be applied? and
- Resources, What minimum resources are required?

The answer to the question on which taxpayers should be examined, is answered through the production of the “risk sensation” coming from the examination, direct (objective risk), indirect (subjective risk), both subject to the effectiveness of the detection, execution and the sanction imposed for non-compliance, constant and sustainable throughout time and the use of fiscal intelligence, this being understood as the procedure whereby information is processed to identify taxpayers presenting most indications of tax non-compliance, in function of previously defined fiscal risk “criteria” or “guidelines”.

Regarding the types of processes that would be convenient to adopt, he mentioned three modalities that should vary in function of the level of fiscal fraud of the taxpayers or the “risk sensation” sought to be established and that differentiate from each other in depth and scope. These three modalities would be the massive control of formal obligations, facts or economic transaction verifications and tax audits.

Regarding the minimum resources required, he mentioned sufficient budget, simple and practical standards and procedures regarding their interpretation, management control systems that allow the measurement of productivity and facilitate internal control and support campaigns in the media.

Finally, the speaker talked about the experience and strategies on examination of the Bolivian Tax Administration; he mentioned that given the high level of non-compliance in his country, the control action of the administration is directed towards achieving the expansion of risk in the group of taxpayers as a support for voluntary compliance, with positive effects on collection.

Regarding the general examination scheme, he mentioned that starting from internal and external information on taxpayers and the processing of that information is supported on different types of examinations: preventive controls, of educational or coercive nature, internal verifications, external verifications and external examinations.

Considering the points set forth by the speaker and the deliberations during an open discussion on examination strategies, it would be proper to conclude that these strategies depend on three elements: the characteristics of the context, the resources available and, of course, of the general strategy of the tax administration, having to establish as from these the parameters for the selection of taxpayers to examine and determination of the types of examination processes to develop, all this by having as general objective the expansion of the objective and subjective risk in regards to compliance with tax obligations.

The next topic covered was Topic 1.1 – PROCESSES FOR THE DESIGN OF EXAMINATION PROGRAMS, through the presentation of two practical cases.

Mr. José Luis Martínez Serrano from the State Agency of Tax Administration of Spain (AEAT in Spanish) presented this first topic and he essentially made reference to taxpayer selection processes and began his presentation by expressing that there are two trends, that of the countries that usually prepare plans and the countries that prefer the risk analysis concept, stating that these two approaches may be seen as complementary and not antagonistic.

He also affirmed that a fiscal control system is worth the value of the following two factors: Human and material means (the possibility to detect a concrete case of fraud) and a Sanctioning Legal System (sanctions that await the apprehended defrauder), where information is the basic part.

Regarding the process of designing examination programs, he mentioned that in the determination of the sectors, fraud topics, taxpayer profiles and types of operations must be controlled throughout a determinate period, all agencies of the tax administration which calling is to control must participate jointly.

He also stated that the aspects to consider when elaborating an examination plan, in a system shared by central and peripheral areas, as the Spanish system, would be: the analysis of the results of the Plan from the previous Year, as a starting point; the results of the Information Plan, in the sense of which is the new information incorporated or how the alter has been organized into the system; sector analysis to determine economic activities or homogeneous taxpayer groups; the gathering of new proposals from personnel dedicated to auditing and, in general, to fiscal control, and what the speaker mentioned to be a field that is still unexplored in most tax administrations, such as the idea contributed by Society; the exam of means available, human resources available and the equal distribution of efforts; the decision of separate action programs, which facilitate their follow-up allowing the analysis and control of the execution of the Plan; the distribution of a number of actions for each Geographic Area; the selection, centralized, decentralized or mixed and computerized, supported on computer tools, individualized analysis of information or random systems; compliance control and results evaluation which closes the planning cycle, causing in this manner the beginning of a new planning process.

Immediately after, the speaker referred to the computerized selection system that applies the risk analysis method implemented at AEAT, which is part of the proposal of the European Union to member countries as a means to fight fraud and which purpose is to assign a global risk ratio to each taxpayer in function of compliance with previously defined parameters, which may be used for: taxpayer identification and may be consulted by selection units; complement other selection tools; order lists obtained in function of the level of risk and this constitutes a direct selection tool.

The presentation covered another tool developed and used by AEAT for the selection of taxpayers called ZUJAR, which provides online analysis of the data that is evident in the database with the use of “data warehousing” technologies. Finally, starting from a theoretical approach, an explanation was given on a new project in the neural networks of the AEAT, which is also directed to serve as an examination selection tool.

Immediately subsequent to, and continuing with the development of Topic 1.1 – PROCESSES FOR THE DESIGN OF EXAMINATION PROGRAMS, Mr. Marcelo Costa from the Federal Administration of Public Revenues of Argentina, presented the second practical case.

Mr. Costa began his presentation by mentioning that the basic difficulty inherent to the examination function is how to improve the fiscal compliance of the group of taxpayers regarding the material impossibility of individually controlling each and every one of them, and that the challenge is to determine who to examine, how to use the human resources available and what audit methods are to be used so as to impact with direct actions on non-complying taxpayers and/or actions inducing towards compliance and/or which increase the perception of risk. For this purpose he expressed, planning and programming are common, permanent and indispensable instruments.

He immediately gave an interesting presentation on the evolution of planning examinations in Argentina, expressing that as from 2002, a new methodology was implemented, and not only did they return to the elaboration of an Annual Examination Plan (PAF, in Spanish) with centralized features, but the same ceased to contain quantitative aspects only and turned into a comprehensive planning tool, incorporating customs’ control and examination.

He also mentioned the elements that are considered in the operational formulation of the PAF, which are: the definition of basic strategies and action lines related to examination, the analysis of the relative importance of the sectors regionally; the evolution of the different sectors of the economy and the operational capacity available in function of the information prepared by the operational areas every year at December 31st.

Regarding the examination aspects considered in the PAF 2004, he highlighted the following: the investigation and selection process of taxpayers to be examined; examination procedures in tax issues; examination procedures in customs’ affairs; the examination of large

national taxpayers and feedback and management control, he also expressively mentioned the goals and parameters to be complied with.

The conclusions that may be extracted from the practical cases presented on this topic, as well as from the open discussion on the same are that risk analysis constitutes one of the modern methods to support the selection of taxpayers and it should be widely used by tax administrations; it is necessary to have accurate, streamlined and varied information regarding its sources, because it is important in planning the examination process of the central and peripheral agencies; technological support to process information is necessary; that in-depth audit processes should be preferably reserved for taxpayers of greater relative importance; that programmed control actions should take into consideration the convenience of establishing fiscal presence as ample as possible and that the incorporation of preventive actions into examination programs is advisable.

The following TOPIC 1.2 – FINANCIAL AND HUMAN RESOURCES ASSIGNMENT POLICIES FOR THE EXAMINATION AREA, was described by the presentation of two cases as well.

The first case was presented by Mr. François Guimont from Canada Revenue Agency, who, after making an illustrative general presentation on the Canadian Tax Administration, expressed that the assignment of financial and human resources for the examination area is based on three main principles: strategic objectives and priorities; risk management and assessment; and the need to strengthen and maintain the efficacy of the audit capacity.

On the strategic objectives and priorities he mentioned that these consist of assuring, by using a limited amount of resources, tax compliance and that compliance burden be minimum for taxpayers that comply with their fiscal obligations. He also mentioned that based on the analysis of the fiscal context and its risk assessment, five priority areas have been defined: large company audits; International transactions; Sophisticated fiscal planning and tax evasion; Goods and Services Tax fraud; and the maintenance of an adequate examination presence.

Regarding risk management and assessment, he expressed that the Agency has examination programs that are based on evaluation systems allowing focus on areas of greater risk and direct its activities to force compliance specifically on these areas. He mentioned that all tax returns are assessed to determine their risk level by using the background of

each taxpayer, information from third parties and criteria established on the basis of an analysis of non-compliance and high-risk returns are audited.

Finally, he mentioned that the general criteria guiding the assignment of resources, is the need to strengthen and maintain the audit capacity. The strategy followed for this would be to promote an environment based on advanced communication, training, technology and analysis capacities, in addition to having work tools such as laptop computers and related computer programs.

He concluded by stating that personnel is the most important asset, therefore, a comprehensive national strategy is being prepared to assure that the capacity to attract, perfect and retain dedicated and capable personnel that can respond to the future needs of the fiscal examination area remains in force.

Continuing with the development of Topic 1.2 - FINANCIAL AND HUMAN RESOURCES ASSIGNMENT POLICIES FOR THE EXAMINATION AREA, Mr. Armindo de Sousa Ribeiro, from the General Tax Directorate of Portugal, formulated an ample description of the objectives, organizational, and planning and control aspects of the examination function in Portugal.

Regarding the assignment of human resources for the examination function the speaker stated that two types of problems arise: the first type is of quantitative nature and is related to the rigidity of the structure of personnel assigned to tax examination and the reduced number of officials; the second type, of qualitative nature, refers to the growing need for quantification and experience in the exercise of examination functions, the need to redefine careers and categories as well as the profile of personnel to be recruited and to educate them on present challenges, and for this it is necessary to invest in the support and execution of specific professional training actions for the tax examination area.

Among the factors that condition the policy of assigning human resources to tax examination as listed by speaker, it is important to mention the following: technical qualifications; the policy for committing material resources; the competition with other functions and agencies and the legal and ethical rules required to perform the function; the adequate remuneration level and the motivation awakened by the career.

It may be concluded, that according to the practical cases presented on the assignment of resources for the examination area, as well as according to the considerations stated during the open discussion, that for the adequate performance of the functions of this area, it will be necessary to supply it with the adequate material resources, among others, mobile computer equipment which facilitate information gathering and access to information during field work and, even more importantly with human resources to exercise the examination activity in full compliance with the profile required for that activity, in regards to their technical-professional knowledge and their ethical behavior.

Immediately after Topic 1.3 – THE LEGISLATIVE SUPPORT NECESSARY FOR EXAMINATION ACTIONS was developed through the presentation of two practical cases.

The presentation of the first of the practical cases was in charge of Mr. Alberto Real Benítez from the Tax Administration Service of Mexico, who referred to the juridical framework for examination actions in his country, which is formed by the Political Constitution of the United Mexican States, that grants the authority to perform home visits, the Fiscal Code of the Federation (C.F.F. in Spanish) which rules the procedures that the fiscal authority must apply when exercising their powers; Tax Laws and their Regulations that establish the obligations that must be complied by taxpayers and Internal Regulations.

He highlighted the following examination powers provided for in the law: domicile visits; the possibility of determining taxable income, as well as the assessment of the actions or activities through presumptions regarding certain causes provided for in the Fiscal Code; obtain financial information on individuals, by means of a request to the financial entities to provide a copy of bank account statements, filed through the entity that rules those entities.

Mr. Ricardo Toma Oyama from the National Superintendency of Tax Administration of Peru presented the second practical case.

First he referred to the legal framework formed by the constitutional norms, among which he drew our attention to those referring to personal guarantees such as those that establish bank secrecy, tax reserve, non-violation of domicile, secrecy and non-violation of communications and private documents of individuals and professional secrecy, and he made comments to the fact that these standards may be deemed as restrictive towards the examination action of the tax administration and that on certain occasions constitute insurmountable obstacles regarding the advance of that action.

The emerging legal framework of the Peruvian Tax Code establishes the following powers: inspection, investigation and compliance control of tax obligations and assessment on a presumed basis.

If you take into consideration that the administration activity in general and the examination activity in particular, both constitute a regulated activity, that is, that they must strictly be framed within the powers conferred by Law, the powers conferred by the Law are crucial for the efficient development of examination actions.

The practical cases as well as the open discussion lead us to conclude that in terms of the laws ruling examination actions, powers to access information and apply presumptions are a key aspect.

On the other hand, the permanent evaluation of these norms is important in order to identify elements that may represent barriers to the adequate exercise of examination actions and subsequently promote the corresponding initiatives to achieve relevant and possible changes.

Mrs. Deborah Nolan from the Internal Revenue Service of the United States of America presented Topic 2 – VERIFICATION AND AUDITING OF LARGE TAXPAYERS. First, Mrs. Nolan made a presentation on the reorganization process of the Internal Revenue Service of her country, which as from decisions adopted in 1998, was restructured by taking into consideration service units to taxpayers with similar needs, making special reference to structure, performance measurement and competencies of the Large and Mid-Size Business Division.

Mrs. Nolan, also mentioned the peculiar characteristics of large corporations, which bring in greater difficulties to examination tasks, since they usually have worldwide operations, they introduce complex and sophisticated tax transactions.

Regarding the control exercised by that Unit, she highlighted the performance of examination actions directed to increase auditing coverage in high-risk areas, for example, intervening agencies and the responsible use of tools to force compliance, i.e., the application of sanctions.

On the other hand, she also referred to the tools used to make possible quick settlement of disputes, which is very important to facilitate compliance by taxpayers and control on behalf of the tax administration. Among these tools she mentioned: agreements prior to the presentation

of returns between the administration and the taxpayer; resolutions that provide guides to clarify controversial aspects in tax issues, which are common to a significant number of taxpayers; mediation for fast settlement of appeals in auditing issues; and the promotion of examination focused on limited aspects.

She made special reference to the “Sarbanes-Oxley Act” which, was originated by the scandals that involved some of the most prominent corporations in her country and which purpose is to reestablish public trust and improve the use and access to financial information for shareholders and other users of this information.

Finally, regarding the future challenges of the Large and Mid-Size Business Division, she mentioned that the efforts to improve and modernize this division are directed towards: process reengineering; reinforce the balance between services offered to taxpayers and control and enforcement actions to assure compliance with tax obligations; identification of new emerging risks; change in corporate practices; and specifically, attention to challenges inherent to the human capital of the division.

Beyond the importance of the topic, clearly manifested during the presentation and the open discussion on the same, most control efforts applied to large companies are directly justified on the fiscal importance thereof and their indirect justification is in the ample source of information to control compliance in the remaining universe of taxpayers. On the other hand, it is important to mention regarding large businesses, their lack of timely control, could result in the accrual of important tax debts, which recovery by the Treasury could turn into a political problem, and these companies could possibly allege the preservation of productive investment and jobs.

Topic 2.1. SECTOR SPECIALIZATION continued with the presentation of two practical cases.

Mr. Flávio Araujo from the Federal Revenue Secretariat of Brazil presented the first practical case and he mentioned that in the authority of that Secretariat special units were created in 1998, with the purpose of providing specialized coverage to certain taxpayer areas.

The speaker stated that the criteria taken into consideration to form these areas were: one, the economic sector, creating two Special Delegations for the attention of financial entities and two, certain specific

activities whose characteristics also advised to submit them specialized controls, therefore the Special Delegation of International Affairs was created.

Mr. Araujo also mentioned that the requirements for highly specialized officials to work at the Delegations created, were fulfilled by means of the following training actions: specific training promoted by the Secretariat of Federal Revenue; external training performed by public or private institutions; post-graduate courses – extension, masters and doctorate studies – carried out in institutions located in the country or abroad.

Mr. Elvin Hedgpeth from the Internal Revenue Service of the United States was in charge of Topic 2.1 - SECTOR SPECIALIZATION, and presented the second practical case. He mentioned that personnel specialization in the large and mid-size business division is done pursuant to the following criteria: by industry, issue or controversy and by fiscal auditor.

He stated that specialization by industry is organized around five main sectors; retail, food, pharmaceutical and healthcare; financial services; heavy manufacturing; natural resources, and communications, technology and media.

Regarding specialization by issue or subject matter refers to technical advisors that are responsible for a series of aspects, such as emerging issues, laws, accounting, training, etc.

The speaker mentioned that the examiners comprise important specialization criteria, and, they are grouped into the following: computer audit specialists; economist; Employment Tax specialists; engineers; financial products specialists and international examiners.

Undoubtedly, the current context due to the variety and complexity of economic relations underlying tax obligations, increasingly require the specialization of examiners so that beyond accounting and financial formalities, they can construe the economic reality of different businesses. As it happens in the practical cases presented and from the open discussion on the same, tax administrations have begun to respond to requirements of this nature. In issues pertaining to the specialization of examiners to first of all consider the context in which the respective administration acts and the needs arising from the same, at the same time, to establish priorities in function of the relative importance of the different branches of the activity, since resources are

generally scarce. On the other hand, this specialization may be gradually achieved through training and recruiting policies and, whenever necessary, through the temporary contracting of professionals, all which will allow the formation of multi-disciplinary teams which may allow the same to delve deeply into auditing tasks.

Topic 2.2 – SPECIALIZATION IN COMPUTERIZED AUDITS, continued with the presentation of two practical cases.

Mrs. Sylvie Perroudon-Ragot, from the General Directorate of Taxes of France presented the first case, and she made a detailed and very illustrative lecture of France's fiscal control on the subject of computerized accounting.

She mentioned that the strategy for controls of this nature started from the premise that not all inspectors can turn into information technologies' specialists, therefore, since 1982 consulting teams in information technologies were created and the specific legal framework was adopted in 1990 and 300 general inspectors were equipped with "accounting auditing software in 2000".

She also added that in the juridical framework adopted for computerized control defines the nature and scope of information subject to control; the obligation to conserve data in computerized support imposed on companies; the control modalities of bookkeeping carried through computerized systems and sanctions established in the event of not complying with obligations.

On the topic of the competence of information technology inspectors, she stated that the same is twofold: tax and information technologies. They intervene by supporting general inspectors to: audit computerized systems and perform mass information treatment.

Mr. Flávio Araujo from the Federal Revenue Secretariat of Brazil immediately presented the second practical case on the Topic 2.2 SPECIALIZATION IN COMPUTERIZED AUDITS, and his presentation was mainly centered on the efforts developed by the Secretariat to train auditors, in general, to perform their work in a computer environment and develop in the same an information technologies' culture which allows them to adequately use information technologies' tools at their disposition.

The speaker highlighted as results obtained with these actions the following: better access by the auditor of auditing techniques in magnetic media; the implementation of an information technologies' culture; training of auditors for information cross-referencing; the establishment of ample and advantageous international relations and, specifically on the topic of large taxpayers, to shorten duration times and delve deeply into the same with the best results.

From the presentation of the cases and the open discussion, it is advisable that whenever possible, auditors should be specialized in information technologies when performing computerized accounting audits, and true specialists should support it, without detriment to the fact that simultaneously, auditors in general should have knowledge in this area, allowing them the maximum use of the resources offered by IT for the development of auditing tasks.

Topic 2.3 – SPECIFIC INFORMATION REQUIREMENTS, was covered by means of the presentation of two practical cases.

Mr. José Luis Zegarra from the Service of National Taxes of Bolivia presented the first practical case, and, he explained that the Fiscal Intelligence Department is in charge of determining which information is relevant for control processes; define procedures, methods and/or tools to obtain information and define the processes whereby information will be submitted to detect possible fraudulent actions.

At the same time, the speaker stated that the main inputs for Fiscal Intelligence are the internal and external information that the tax administration has and has access to, stressing that large taxpayers are the main suppliers of external information.

Immediately, and continuing with the development of Topic 2.3 SPECIFIC INFORMATION REQUIREMENTS, Mr. Mario Aranguren, from the Tax and Customs' Directorate of Colombia presented the second practical case.

Mr. Aranguren listed in detail the different persons, entities and situations where the laws require from taxpayers the supply of specific information.

He also spoke about the use of that administration to support examination activities and concluded with a very important reflection on the reach and form of information requirements from the tax administration, as well as its use.

In this regard, the speaker mentioned that tax administrations often have large amounts of information for taxpayer control, and it is unfortunate that this information is not used appropriately.

The speaker affirmed that tax administrations are usually the experts in storing information, data, however, in general, they have proven to be not very efficient in its use.

He concluded his presentation by stating that to support examination tasks of any tax administration, it is not enough to request a lot of information if the same is not used properly and it is very important to always bear in mind that all data requested must have a determinate purpose and use, which justifies its requirement.

The presentation of the practical cases and the open discussion that followed, gave way to important reflections, such as specific information requirements must be determined based on methods and technical criteria, i.e., through some type of reverse engineering, that allows the identification of the data and information necessary to be known and the level of truthfulness of what has been filed or registered by the taxpayer must be understood, i.e., how a loss or benefit was generated. Also with the same purpose, it is important to consider the feedback that may result from previously processed examinations. Furthermore, when requesting information, so that it is not in vane, the real possibility of processing that information, and the cost imposed on the taxpayer as well as up to what point is this justified.

Mr. Matthijs Alink, from the General Directorate of Taxes and Customs Administration of The Netherlands, presented Topic 3. THE EVALUATION AND CONTROL OF EXAMINATION ACTIVITIES.

After a detailed presentation on the purpose and forms of action of the tax administration, Mr. Alink stated that the tax administration also requires of a managerial information system for adequate decision making and performance evaluation as well as for the adaptation of programs and processes, not only in examination activities but for organization as a whole.

He added that said system must provide sufficient information so it satisfactorily responds to the needs of internal units in charge of the review and evaluation of the procedures, processes and practices of the tax administration and a key element for this, consists in determining the critical factors to be measured in order to estimate the effectiveness of the operations and the performance of the tax administration.

Specifically on the topic of control, the speaker stated that that function not only must be directed towards internal operations but to the expectations of the external parties interested in the daily tasks of the administration as well.

On the subject of what to measure and evaluate, he concluded that figures on employee effectiveness and efficiency and satisfaction are important, but the figures on the amount of taxes collected and real cost are similarly interesting as well as the information regarding taxpayers and third parties' opinion on the organization performance is highly valuable.

Of what was stated during the presentation of the topic and the ensuing open discussion, it would seem advisable that beyond controls and general evaluation of the tax administration it is important to have specific systems and mechanisms for the control and evaluation of examination activities, specifically considering the nature of critique regarding the effectiveness of those activities which mean, for the one part, the generation of a risk perception which leads towards voluntary compliance, and furthermore, the first step preventing non-compliance from being benefited from impunity.

Therefore, it is particularly desirable, for the tax administration's control and performance evaluation systems to be as ample as necessary to cover the entire range of their functions and activities, that those systems, mechanisms and indicators allow the performance of examination activities that are closely followed, allowing the timely and authentic control and evaluation thereof.

Two practical cases on Topic 3.1 – SUPERVISION AND REVIEW OF EXAMINATION ACTIVITIES followed.

Mr. Mauricio Sanhueza from the Internal Revenue Service of Chile presented the first case.

The speaker stated that the supervision and review of examination activities was until recently a task performed by those responsible of the different processes, mainly through global evaluations and follow-up and that towards the end of 2002 the Examination Management Control Department was created, which purpose was to perform the follow-up of each examination process performed separately by participating units, coordinating the efforts that allow the establishment of indicators to evaluate the management.

He added that indicators are directed towards process follow-up from three different perspectives: efficiency in compliance with objectives; efficiency in the use of resources; and the quality of taxpayer attention, since the information generated is delivered monthly to those responsible of processes and furthermore, all tables reporting on information are published in the Intranet so that units may make comparisons.

Mr. Sanhueza also stated that new technologies are allowing process automation, data registry and online downloading, which bring the benefit of having better quality information in a timely manner.

He concluded by saying that it is important to have the adequate follow-up tools for the examination process, to allow the measurement of their evolution throughout time and perform comparisons between the units executing the same, and this permits the establishment of goals on predetermined parameters to evaluate their compliance, uniform the use of resources and develop global analysis of processes.

Mr. Luiz Fernando Lorenzi from the Federal Revenue Secretariat of Brazil presented the second practical case on Topic 3.1 - SUPERVISION AND REVIEW OF EXAMINATION ACTIVITIES.

The speaker mentioned that any organization must develop their activities by observing common administration concepts such as planning, organization and control and that in regards to this last aspect a series of mechanisms have been installed at the Federal Revenue Secretariat which allow the follow-up and evaluation of examination activities, in order to qualify its execution and maximize productivity.

He added that the supervision and revision of examination procedures is carried out during their execution once these have concluded.

During the examination procedure, he stated, the head of the team is in charge of the follow-up of the work, by executing technical and administrative controls, verifying the adequate execution and the correct application of the legal provisions and that once concluded, starting from the management of the information available in the electronic control system, a verification is performed to see whether if the auditor examined all predetermined points to be analyzed and the results obtained in regards to each of them, verification is also made on whether if the procedure fit into the average time, and the results were acceptable, if legal and administrative provisions were complied with and finally, evaluate the final quality of the actions.

Furthermore, Mr. Lorenzi detailed the form and mechanisms used to document fiscal procedure, and he explained the forms used and their application.

Of the practical cases and open discussion that complemented the development of the topic, it is possible to conclude that to assure the correction of the examination procedures and obtain feedback that will improve the programming and execution of these processes, the implementation and/or perfection of examination, supervision and revision systems and mechanisms must constitute a priority for tax administration, therefore the experiences presented may constitute a valid reference.

Immediately after, two practical cases on Topic 3.2 - INSTRUMENTS TO SUPPORT THE FOLLOW-UP OF EXAMINATIONS, were presented and Mr. Miguel Cremades from the State Agency of Tax Administration of Spain presented the first case.

In developing the topic the speaker emphasized that the development of examination support instruments, is mainly being done through the elaboration of a Inspector's Procedure Manual which provides in an information technologies environment, an updated text on the different aspects of the procedural steps; the Documents Database which systematically gathers the principles of the most significant juridical criteria that has been produced and guarantees that the necessary homogenization of juridical responses is obtained through the national coordination of Technical Offices, where the criteria to be applied in the cases where norms may offer different interpretation solution is disclosed.

On the other hand, he stressed that examination support instruments in their technical aspect, consist of: sector and verification thematic guides developed by specialists in a determinate sector or defraud mechanism; specific investigation actions developed by specialized agencies, through the National Fraud Investigation Office, this allows to orient selection criteria and more responsive actions from non-specialized control services and finally, the development of the Verification Help Method (MAC, in Spanish) as a work method systematization instrument and put at the disposition of information technologies' tools and utilities, may result to be useful.

Mr. Miguel Cremades expressed that the main objectives of the Verification Help Method are: to facilitate the exploitation of the tax information system; to generate teamwork instruments; to improve the documentation of actions and progressively incorporate information technologies' tools.

Immediately Mr. Nelson Gutiérrez, from the Executive Secretariat of the Inter-American Center of Tax Administrations, presented the second practical case on Topic 3.2 - INSTRUMENTS TO SUPPORT THE FOLLOW-UP EXAMINATIONS.

The speaker, after an ample presentation on the aspects pertaining to the technological variable in compliance control and its effects on examination, stressed that no technological tool surpasses or may replace a clear control strategy based on systematic processes and information analysis, followed by a good operational planning system.

However, the speaker also mentioned, that the adequate incorporation of information technologies into examination functions could help to significantly improve performance and achieve greater efficiency in evasion control.

Within the group of basic instruments to support and perform examination tasks he emphasized and explained in detail those pertaining to: the organization of the examination process; tax management tools; taxpayer information base and economic operations; products resulting from information and products resulting from management that feed the process, information and different products that are routinely used.

The speaker concluded by stressing that automated work flows free an enormous operation burden at supervision and direction levels, which frees up time to dedicate it to analytical and direction tasks and the automated processing of large information volumes, allows many analytical processes to be performed quickly, accelerating decision making; the use of information technologies' tools for operational management lessen many costly tasks, generating greater capacity to analyze and construe results obtained.

The presentation of both practical cases and the open discussion thereon, provided valuable theoretical and practical arguments which evidence the advantages of the development and use of tools, particularly, information technologies' tools, to support examination activities, which may translate into expressive profits in terms of speed, objectiveness, opportunity and in general, the perfection of examination activities, in what pertains to the strategic aspects as well as their programming, management and execution.

Topic 3.3 – THE INTEGRAL EVALUATION OF THE RESULTS OF EXAMINATION ACTIONS, was developed by means of the presentation of two practical cases. The first presentation was made by Mr. Mario Arduz Campero from the Service of National Taxes of Bolivia, who

expressed that the integral evaluation of the results of examination actions must not be limited to verify compliance with the goals and targets, but must also identify how this has had an impact on taxpayer's voluntary compliance.

After a detailed presentation of the mechanisms used in their country for the evaluation of management results and taxpayer's behavior, the speaker expressed a series of conclusions among which it is important to point out: that the integral evaluation of examination activities must consider both types of results; that though permanent feedback strategic objectives are adjusted to optimize the use of the resources in the management of the examination area; that it is extremely important to have the support of IT applications allowing the timely and reliable use of information; that management costs must maintain reasonable parameters and the objectives of the actions must not only be established in regards to collection goals per examination, but also in the expansion of the "risk sensation", which represents a greater benefit than the collection that is directly obtained from those actions.

Mr. Frans Besselink, from the General Directorate of the Tax and Customs Administration of the Netherlands presented the second practical case on Topic 3.3 - THE INTEGRAL EVALUATION OF THE RESULTS OF EXAMINATION ACTIONS.

The speaker commented in detail two specific practical examination cases, one pertaining to restaurants and the other to offshore accounts, and he referred to the results obtained and the use of information collected during those actions to improve processes and support tools, especially for risk analysis.

It is important to emphasize a general comment made by Mr. Besselink regarding preventive actions in examination, such as eliminating opportunities and reasons for non-compliance, procure cooperation and advertise examination actions, provide information, etc., which he mentioned to be equally important as the examination of each taxpayer group, increasing in them the perception of the possibility of being detected, which will have an enormous influence on their behavior.

Through the practical cases presented and the open discussion that followed the presentation, it may be concluded that the integral evaluation of the results of the examination actions,

should comprise not only compliance with the quantitative goal proposed, such as the number of activities or amounts of tax adjusted, but their impact on the attitude of the taxpayers as well as in regards to compliance with their tax obligations and, furthermore, the quality and precise documentation on the experience gathered during the execution of these actions, in the sense that it may become useful to be inputted in order to perfect the processes, procedures and tools used by examination actions.

To conclude this rapporteur I would like to make some general reflections on the presentations and the exchange of experiences carried out during this Assembly.

Firstly, it seems that it is unanimous that all recognize that the strategic objective of the tax administration is the promotion of spontaneous compliance of tax obligations, by establishing a balance between the efforts made to facilitate compliance, on the one hand and the detection and sanction of non-compliance on the other, it would be important to understand that the modern conception of examination, considers the examination function to be in charge of participating in both types of efforts.

Similarly, the collective reflection on the examination topics covered, means the papers and debates discussed here, constitute an excellent reference for the perfection of all tax administrations, but we must caution that the best solutions from the theoretical point of view, cannot be the most adequate ones for a determinate administration when they are considered in their context of action and the availability of the resources. Therefore, without undermining the merits of the different experiences that we have had the privilege to know, it is essential to avoid the risk, and many years ago this had been the warning of one of the most illustrious tax experts Gerson Augusto da Silva, who stated that certain “mimetic exacerbation” must be overcome, in the sense that it is not about copying good foreign experiences, but reflecting on them as useful alternatives and if after the first analysis, they seem applicable to our reality, adapt it to the same.

As my last reflection, I would like to express that I also consider essential to have present that all functions and purposes of the modern tax administration, in regards to its possibilities of success,

are supported on a tripod formed by information, technology and the human resources that it has available. However, if we turn this into a mathematical formula, we would have to say that while information and technology have the nature of being the addends, human resources have the nature of multiplying the results of that addition.

RESOLUTION OF THE 38TH CIAT GENERAL ASSEMBLY

Tribute
38th CIAT General Assembly
Cochabamba, Bolivia

Continuing with the long tradition at CIAT we take advantage of the realization of an important event such as this General Assembly, to pay proper tribute to the people that with their support have contributed to the strengthening and consolidation of our tax administrations and our Center.

The individuals we pay homage to in this session where we close CIAT's 38th General Assembly, are renowned professionals that have dedicated great part of their lives to tax issues. Today we want to pay tribute to the dedication, professionalism and delivery of Ramiro Cabezas Masses, Bill McCloskey, Claudino Pita and Jorge Eduardo Corradine. Similarly, we wish to pay posthumously homage to Edmond Lacroix, Chief of the French Mission at CIAT, who past away this past November 2003.

Ramiro Masses Cabezas, Bolivian, is an accountant, alumni of the University of Chile. He has taken Master level courses at Harvard University in taxation, economics and administration of financial institutions. He has held senior level positions in the public administration of his country; currently he is the General Taxation Superintendent. He has been Director of the Central Bank of Bolivia, consultant and Head of the Mission of the Institute of Public Administration of New York to advise Latin American governments such as Peru and Venezuela. He was member of the working group of the Bolivian Tax Reform (1985), in charge of implementing the Bolivian Tax Reform in 1986. In addition, Mr. Cabezas published important papers on tax topics and has been invited as a lecturer to internationally renowned forums on this subject.

Bill McCloskey obtained his Masters in History at the University of Western Ontario. He has been linked to the Canadian public administration for over 30 years. Currently, he is special adviser to the Commissioner of the Canadian Revenue Agency being responsible of preparing the five-year review that the Parliament makes to the Revenue Agency and its Legislation. Until 2003, he was assistant Commissioner of the Policy and Legislation Division. He has also been General Director of the area of Regulations of the Goods and Services Tax, and Director of the Sales Tax Division, Department of Finances where he was in charge of the development of the Policy and the Legislation to implement pertaining to goods and services tax. In addition, he headed the Canadian delegation in the first round of negotiations on tariff acceleration with the United States.

Claudino Ramon Antonio Pita, a lawyer alumni of the National University of Buenos Aires and *Magister* in Social and Corporate Law from the Federal University of Rio de Janeiro. Currently, he is Adviser of the General Administrator of Public Revenue of Argentina. Until December of the last year, he was our Director of Strategic Planning and Studies. Claudino is considered one of the people with the greatest knowledge and management of tax subjects in Latin America. This is reaffirmed by the important positions that he has held throughout his prolific career. He has been adviser to General Directorate of Tax Policy of Argentina, Specialist of the Tax Program of the OAS, Head of the Fiscal Studies Center of the Inter-American School of Public Administration, Economic Analyst At-large for the Economic and Government Studies Center of the Brazilian Institute of Economy, Visiting Researcher of the IADB, Consultant for different governments and agencies on tax matters, professor for several European and Latin-American Universities and the author of several studies specialized publications on tax subjects. In addition to his ample and complete professional career, those of us here present know and distinguish Claudino for his extraordinary personal qualities. Claudino has gained the affection and admiration of all of us after the many years that he has shared with us at the work and activities of the center.

JORGE EDUARDO CORRADINE is Civil Engineer from the University of Los Andes in Colombia. He has a Masters degree in Information Technologies as well as a Master's in Administration. He worked during 20 years at CIAT and worked as Adjunct Secretary for our Agency until Amyotrophic Lateral Sclerosis (ALS) kept him from continuing to develop the extraordinary work that he was doing.

To Jorge Eduardo we owe much of the success of the events organized by CIAT nowadays. Through his dedication, perfectionism and devotion, he laid the foundations that constitute the pillars of the organization and the excellence that today distinguish our Assemblies and Conferences. Claudino is an untiring worker, always attentive towards improving and modernizing CIAT's management. Unequal friend that many of us still miss, specially on these occasions that represented for him the culmination of many months of work where the main objective was the success of the event.

POSTHUMOUS TRIBUTE

We today want to pay a Posthumous tribute to a great French gentleman who always will be in our memories, Edmond Lacroix, who was not only the Chief of French Mission at CIAT, but a friend, a person with unequal personal qualities and conditions that makes him special turning him into part of us and of CIAT, always.

Jorge Eduardo Corradine Garavito*

ACKNOWLEDGEMENT TO CIAT

Allow me some brief words on this rare disease that ails me, it's called ALS Amyotrophic Lateral Sclerosis, it kills motor neurons and produces paralysis in the muscles of the motor system, which are controlled by will. It is a degenerative process of the Central Nervous System, it is self-immune, what produces it is unknown, and much less, what stops it. I am completely immobilized, except for some facial muscles and the fact that I am alive, thanks to the mechanical assistance of a respirator and to a tube, that allows my nourishment.

Of the 20 years that I have worked with CIAT, I feel great satisfaction of having formed part of a team that has been characterized by its dynamism in handling challenges and professional achievements. We worked laboriously but we obtained tangible results. In what pertains to me, the organization of International Meetings allowed me to develop all the technology that still is used today at CIAT, the Information and Inquiry System proved to be a very effective solution for member countries and finally I participated in some Technical Assistance Missions, also characterized by improvements for the Tax Administrations Systems of the member countries. Nevertheless, most important of all was to be able to know the members that participated, throughout all those years, at the different activities of CIAT and the friendship that I was able to make with many of them.

This distinction that is granted to me today means very much to me, it is like the culmination of my services at CIAT, for which I am very thankful. In addition, I want to take advantage of this occasion to make my recognition to the different Executive Councils of CIAT, its Executive Secretaries and very specially to Jorge Cosulich, who has supported me unconditionally, not only during my active years at CIAT, but specially during the course of my disease. To conclude, I would like say that thanks to all that support, the last project of my life has been possible, which is to be alive in spite of ALS.

Jorge Eduardo Corradine Garavito

* This letter has a very special meaning to all of us, since it was dictated, word-by-word, and sentence by sentence, which entailed great effort, and mostly a will of iron and limitless imagination.

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Cochabamba, Bolivia
March 8 – 11, 2004**

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TECHNICAL PROGRAM

**38th CIAT General Assembly
Cochabamba, Bolivia
March 8 - 11, 2004**

DAILY SCHEDULE OF ACTIVITIES

Monday, March 8

**MAIN THEME: THE EXAMINATION FUNCTION OF THE
TAX ADMINISTRATION**

09:00-09:30 Inaugural ceremony.

09:30-11:00 Official photograph and recess.

Moderator: Rubén Aguirre, CIAT Executive Council
President.

11:00-11:45 **Topic 1. The examination strategies.**

Speaker: Rolando López López, Service of
National Taxes of Bolivia.

11:45-12:15 Open discussion

Afternoon

Moderator: Matthijs Alink, Directorate General for
Tax and Customs Administration, The
Netherlands.

14:00-14:40 **Topic 1.1. Processes for the design of
examination programs.**

Speakers: José Luis Martínez Serrano, State
Agency of Tax Administration of Spain.
Marcelo Pablo Costa, Federal
Administration of Public Revenues of
Argentina.

14:40-15:00 Open discussion

Technical Program

Moderator: Carlos Silvani, International Monetary Fund (IMF).

15:00-15:40 **Topic 1.2. Policies for the allocation of financial and human resources for the examination area.**

Speakers: François Guimont, Canada Revenue Agency.
Armindo Jesús de Sousa Ribeiro, General Directorate of Contributions and Taxes of Portugal.

15:40-16:00 Open discussion

Moderator: Karl Christmann, Federal Ministry of Finance, Germany.

16:00-16:40 **Topic 1.3. The necessary normative support for the examination actions.**

Speakers: Alberto Real Benítez, Tax Administration Service of Mexico.
Ricardo Arturo Toma Oyama, National Superintendence of Tax Administration of Peru

16:40-17:00 Open discussion

Tuesday, March 9

Morning:

Moderator: Robert Szurman, Central Financial & Tax Directorate, Czech Republic.

09:00-09:45 **Topic 2. Verification and auditing of large taxpayers.**

Speaker: Deborah Nolan, Internal Revenue Service, United States of America.

09:45-10:15 Open discussion

10:15-10:35 Recess

Moderator: Vinette Keene, Ministry of Finance and Planning, Jamaica.

10:35-11:15 **Topic 2.1. Sectorial specialization.**

Speakers: Flavio Antonio Araújo, Secretariat of Federal Revenues of Brazil.
Elvin Hedgpeth, Internal Revenue Service, United States of America.

11:15-11:45 Open discussion

Moderator: Denis Graham, Revenue Service, Ireland.

11:45-12:25 **Topic 2.2. Specialization in computerized auditing.**

Speakers: Sylvie Perroudon-Ragot, General Directorate of Taxes of France.
Flávio Antonio Araújo, Secretariat of Federal Revenues, Brazil.

12:25-13:00 Open discussion.

Afternoon

Moderator: Horacio Castagnola, Federal Administration of Public Revenues of Argentina.

14:30- 15:10 **Topic 2.3. Specific information requirements.**

Speakers: José Luis Zegarra, Service of National Taxes of Bolivia.
Mario Aranguren, Directorate of National Taxes and Customs, Colombia.

15:10-15:40 Open discussion

Wednesday, March 10

FREE DAY

Thursday, March 11

Morning

Moderator: Eduardo Zegada Claure, Service of National Taxes of Bolivia.

09:00- 09:45 **Topic 3. Evaluation and control of examination activities.**

Speaker: Matthijs Alink, Directorate General for Tax and Customs Administration, The Netherlands.

09:45-10:15 Open discussion

10:15-10:35 Recess

Moderator: Armindo Jesús de Sousa Ribeiro, General Directorate of Contributions and Taxes of Portugal.

10:35-11:15 **Topic 3.1. The supervision and review of examination actions.**

Speakers: Mauricio Sanhueza Berríos, Internal Revenue Service of Chile.
Luiz Fernando Lorenzi, Secretariat of Federal Revenues of Brazil.

11:15-11:45 Open discussion

Moderator: José Cedillo, National Integrated Customs and Tax Administration Service of Venezuela.

11:45-12:25 **Topic 3.2. Instruments to support the follow-up of examinations.**

Speakers: Nelson Gutiérrez, CIAT Executive Secretariat.
Miguel Cremades Schulz, State Agency of Tax Administration of Spain.

12:25-13:00 Open discussion

Afternoon:

Moderator: Mario Duarte Caballero, Executive Directorate of Revenues of Honduras.

14:30-15:10 **Topic 3.3. Integral evaluation of the results of examination actions.**

Speakers: Mario Arduz Campero, Service of National Taxes of Bolivia.
Frans Besselink, Directorate General for Tax and Customs Administration, The Netherlands.

15:10-15:40 Open discussion

15:40-16:10 **General Report** - Claudino Pita, AFIP, Argentina.

16:10-16:40 Closing ceremony

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