



Superintendency  
of Tax Administration

# 42nd CIAT General Assembly

## Strategies for the Promotion of Voluntary Compliance



Antigua Guatemala, Guatemala  
April 21 to 24 , 2008



Inter-American Center of Tax Administrations – CIAT  
Superintendencia de Tax Administration of Guatemala – SAT



## 42nd. GENERAL ASSEMBLY



## STRATEGIES FOR THE PROMOTION OF VOLUNTARY COMPLIANCE

Antigua Guatemala, Guatemala  
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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 37 countries: 29 countries from the Americas and 5 European countries as full members, and 3 countries as Associate Members: Czech Republic, Kenya and South Africa. 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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## **INAUGURAL CEREMONY**



## **WELCOME STATEMENT BY THE SUPERINTENDENCE OF TAX ADMINISTRATION OF GUATEMALA**

**Mrs. Carolina Roca Ruano**  
Superintendent of Tax Administration



*Mrs. Carolina Roca Ruano*  
*Superintendent of Tax*  
*Administration*

The Tax Administration Superintendence of Guatemala welcomes you to the 42nd Assembly of the Inter-American Center of Tax Administrations - CIAT.

CIAT Assemblies are among the most important tax events of the world. They are recognized for their contribution to disseminate knowledge and practical experiences among member countries and observers to give administrations access to first-hand information, contacts and the possibility of exchanges with innovators and leaders, and to identify trends, approaches or successful practices to address their needs and help them meet their objectives.

The networking opportunities created by participating in the CIAT Assembly include contacts with high level tax authorities as well as technicians. This enriches exchanges and the possibility to monitor relationships among administrations both for the purpose of exchanging mutual technical assistance as well as to obtain information.

The main item in the agenda of the 42nd Assembly will be "Strategies for the Promotion of Voluntary Compliance". This topic will be addressed through presentations by different administrations. These presentations have been read and approved by the Technical Council of the Assembly.



## Inaugural Statement

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Guatemala and its Government are pleased to have the opportunity to be your hosts and are certain that your coming to our country will allow you to enjoy the professional environment of the Assembly and at the same time enjoy the unique experience of a country with millenary history, cultural diversity, natural beauty and many activities that will heighten your senses and warm your spirit.

**Mrs. Carolina Roca Ruano**  
Superintendent of Tax Administration

**STATEMENT BY THE CIAT EXECUTIVE SECRETARY  
DR. CLAUDINO PITA**

Ladies and gentleman:



*Dr. Claudino Pita*

It is an honor and a pleasure for us to count in the inauguration of this General Assembly with the participation of the Minister of Public Finances of Guatemala, Mr. Juan Alberto Fuentes Knight, and through him we wish to thank the Government for the generous hospitality afforded us.

We likewise wish to express our recognition to the Superintendent of Tax Administration, Mrs. Carolina Roca, as well as to all the officials that assist her for all the efforts devoted to this meeting, which gathers us today in this beautiful and historic city of Antigua.

On the other hand, we must point out the notorious progress achieved by SAT in these past years, which set it as an example to be followed by those of us who are aware of the importance of making our tax administrations modern, professional, transparent organizations at the service of our citizens.

We also wish to thank the presence of delegations accompanying us from 33 CIAT member countries, from the Americas, Europe and Africa, 7 countries from Europe, Africa, Asia and Oceania and 5 international organizations with whom we share common concerns and initiatives and welcome all of them most cordially.

The main theme of the Assembly we are initiating is: **“STRATEGIES FOR THE PROMOTION OF VOLUNTARY COMPLIANCE”**. This is a

topic which, only by mentioning it, leads us to forms of action of the tax administration, which endeavor to achieve in society the generalized perception that compliance with the tax obligations is correct, fair and convenient.

According to our program, the main theme will be analyzed under three main axes, each of them grouping topics that will be presented as case studies prepared on the basis of concrete country experiences:

**Topic 1: Strategies for the development of the tax culture**

Case studies:

- 1.1: Social legitimization of the tax culture and policy
- 1.2: Policies for communicating with society and new methods for rendering them more efficient.
- 1.3: Ethics and Corporate Responsibility in the tax administrations

**Topic 2: Strategies for facilitating Tax Compliance.**

Case studies:

- 2.1 The electronic invoice
- 2.2 The efficiency of the tax administrations and the reduction of compliance costs.

**Topic 3: Strategies for the control of tax compliance**

Case studies:

- 3.1 Examination of economic groups
- 3.2 The control of financial transactions
- 3.3 The control of electronic commerce

As anticipated, these are forms of action of the administration intended to:

- ⇒ show and persuade society in the sense that the payment of taxes is based on a social duty;
- ⇒ smooth down to the extent possible, the path toward compliance, in terms of simplification of standards and procedures, as well as costs, and
- ⇒ eliminate as much as possible any assumption of impunity in case of noncompliance.

The purpose of the CIAT meetings is to share the diversity that characterizes us and of which we feel proud. Such diversity allows us to present different viewpoints on similar subjects, and show that there is no predetermined solution to every problem, but rather that such solution may be identified and further enriched with the knowledge acquired from other experiences.

I would like to reflect on the main theme which may also serve as basis for ensuring better compliance.

It is worthwhile to recall the Millennium Declaration approved through Resolution of the United Nations Organization's General Assembly in September 2000 and the eight objectives stated therein, of which the first one is worth highlighting: 1: eradicate extreme poverty and hunger.

Progress toward the goals determined for each of almost the totality of those objectives impose on governments policies and actions that call for sufficient financial resources, either of local origin or from international cooperation.

On the other hand, in order for many countries to overcome their current situation and advance with fairness toward a necessary greater progress and welfare, it is necessary, among other measures, to implement more powerful and effective social policies, which also requires the necessary financial resources.

From this perspective, taxation may be seen as an essential instrument to move toward more progressive and equitable societies and, accordingly, tax administration in the modern democracies may also be seen as the promoter of rules originating from self-taxation; that is, laws discussed and approved by the legitimate representatives of society, whose execution pursues and will allow for obtaining genuine resources for the development of public policies, in particular the social ones.

What we have been calling for a long time the far-reaching objective of taxation, is not exhausted through its dissemination in society, but rather, must fundamentally be instilled and internalized in each official and in the tax administration as a whole, as well as reflected in its attributes: ethics, equity, transparency and permanent search for excellence in its services.

Currently and in the field of tax administration, almost all the countries have been devoting sustained efforts aimed at determining adequate strategies, setting up modern organizational structures, rationalizing their primary processes by making them more efficient, taking advantage of the benefits of information and communications technology and, in particular, having become aware of the fundamental role of human capital for achieving and rendering any progress sustainable, creating conditions for the ethical and technical development of their officials.

However, in addition to the need to persevere in those efforts of modernization of the tax administrations, it would also seem advisable that other concerns, besides the almost exclusive attention to economic efficiency and competitiveness aspects be included in the tax system reforms. The forthcoming tax reforms should be aimed at mainly achieving two classic objectives of taxation: sufficiency and equity.

The **sufficiency** of the tax system is linked to its capacity for collecting sufficient resources for financing the State's actions. To fulfill such requisites, taxes should bear generality characteristics as regards the nature and scope of the tax bases. Nevertheless, although there may be broad based taxes, generality is affected by tax exemptions and evasion.

**Equity** deals with the convenience of distributing the tax burden according to the taxpaying capacity, thereby benefiting progressivity. This does not disregard the redistributive effect that may be achieved through social expenditure. However, given the results of recent studies on the impact of such expense in Latin American countries, the recurrent and excluding mention of the greater redistributive potentiality of public expenditure vis-a-vis taxes would seem exaggerated and unrealistic, especially when the purpose is to justify the indifference toward equity of taxes or, what is worst, its regressiveness.

There is no doubt that these brief reflections will be considered in greater depth and enriched with the excellent lectures and case studies to be presented and, also, through the exchange of ideas and experiences in the fruitful comments and debates that will follow these presentations.

To conclude, we wish to reiterate our gratitude to the Vice-President of the Republic for his distinguished presence and to SAT, through Mrs. Roca, for its very cordial hospitality and outstanding organization. We would also like to thank the CIAT Executive Secretariat officials who, with their high professionalism and institutional commitment allow

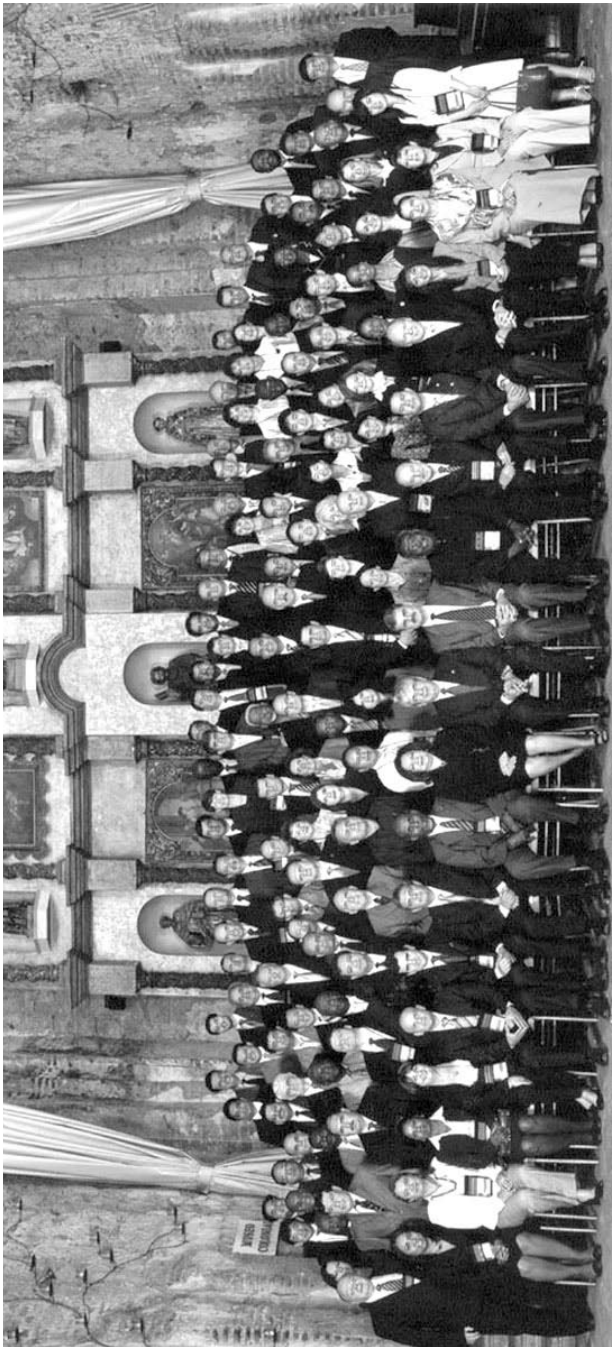
us to advance toward complying with the objectives of our Center, which objectives must always urgently respond to what our member countries may deem convenient and likewise, we thank the latter for their constant and resolute support.

Finally, we wish you all a pleasant stay in Antigua and hope that your expectations may be fully satisfied through the useful ideas on the topics we will be discussing, and the opportunity to make new friends and ultimately that all will be to the advantage of your institutions and, what is most important, of the societies to which they belong, as has always been CIAT's purpose in its international meetings.

Thank you very much and I wish you all a very fruitful and happy Assembly.

**Dr. Claudino Pita**  
Executive Secretary

**OFFICIAL PHOTOGRAPH OF THE  
42<sup>ND</sup> CIAT GENERAL ASSEMBLY**



Antigua Guatemala, Guatemala  
April 21 to 24, 2008

## **TOPIC 1**

# **STRATEGIES FOR THE DEVELOPMENT OF THE TAX CULTURE**





## STRATEGIES TO DEVELOP A TAX CULTURE

**Carolina Roca Ruano**  
Superintendent of Tax Administration  
(Guatemala)

*CONTENTS: Summary. -1. Context.-2. Approach and scopes. -3.Reasons for compliance. -4. Why promote a tax culture? -5. Law, morality and culture. -6. Perceptions and attitudes. -7. Adoption of strategies. -7.1 Objective and scope. -7.2 Stakeholders. -7.3 Beneficiaries. -7.4 Scopes and messages. -7.5 Education as the pillar. -7.6 Conditions of the strategy and its complementarity. -8. About the experience of Guatemala. -8.1 Actions of the permanent Tax Culture program. -8.2 Inter-relations. -8.3 Strategy principles and features. -8.4 The local environment and reciprocity. -8.5 Insight and exploring. -9. Conclusions.*

### SUMMARY

In the last three years, the Superintendency of Tax Administration (SAT) of Guatemala has been conducting an integral program to develop the tax culture; the experiences and lessons learned are mentioned at the end of this document and have served as its basis.

The implementation of said program has also lead SAT to reflect upon the topic of the tax culture and establish contacts with entities that shall work in this area, as well as with other Tax Administrations of Ibero-America that undertake similar initiatives, which has contributed to enhance their knowledge on the issue and has been also fundamental to adequately support a significant part of the methodological criteria, notions and aspects set forth herein.

Based on the analysis of the context, the document approaches the focus and scopes of the strategies geared at the development of the tax culture, considering four essential themes for the purposes of this presentation: i) the reasons for tax compliance; ii) the importance of promoting the tax culture; iii) the relevance of the law, ethics and culture

in this issue as the three main controllers of human behavior; and iv) the reason why the actions to promote cultural changes are ultimately aimed at the modification of perceptions, attitudes, behaviors and, chiefly, values.

The adoption of any strategy implies answering the basic questions of what, who, what for, where, how and when; thus, we shall analyze hereunder the features of the strategies to promote the tax culture in aspects such as: objectives and scopes, key players, beneficiaries, contents and tools.

Nevertheless, there is consensus on the fact that “there are no recipes” for the adoption of this type of strategies, since, ultimately, the specificities of each country and the tools of each Tax Administration determine the class and magnitude of its intervention on the matter.

Lastly, for illustration purposes, we address the case of Guatemala, describing its main features and prevailing conditions, as well as the options chosen, the lessons learned and the directions followed.

Overall, we wish to share with the participants of the 42<sup>nd</sup> CIAT General Assembly, the standpoint of a Tax Administration that considers the promotion of the tax culture as part of its core functions and a relevant component of the taxation, citizen development and legality culture areas.

## **1. CONTEXT**

There is an increasing interest in the Tax Administrations over the development of the tax culture, that is, over the adoption of strategies that enable to create awareness in their countries on the relevance of meeting obligations as regards internal and customs revenue, but from an educational approach that is not exclusively centered on the taxpaying population, but rather on non-taxpayers, from children to youths to adults excluded from the effective taxpayers' base, whether because they have no direct legal tax obligations or because they conduct their activities in the informal market.

If we conceive the culture as a set of knowledge, lifestyles and habits of a given society, or else, as the set of expressions of the traditional form of life of a people,<sup>1</sup> we would understand by tax culture the set

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<sup>1</sup> *Dictionary of the Royal Academy of Spanish, Twenty-second Edition, 2001.*

of information and the degree of tax knowledge in a given country, but moreover, the set of perceptions, criteria, habits, and attitudes of society with regards to taxation.

Thus, in the case of the majority of Latin American countries – Guatemala among them- we could assert that the social behavior prevailing has been against the payment of taxes, which is evidenced in rejection, reluctance and evasion, that is to say, different forms of noncompliance.

Frequently, such behaviors seek to justify themselves by disqualifying the performance of the public administration, whether on the basis of corruption, inefficiency or lack of transparency in the management of resources, or ideological arguments on the economy, society and the role of the State.

In general terms, such is the context in which the Tax Administrations of a majority of Latin American countries have to undertake their tax education functions. Nevertheless and from a positive standpoint, we find fertile ground to sow and reap the ethical and citizen coexistence values that provide the groundwork and social legitimacy to taxation and compliance with tax obligations as a country's need in order for the State to promote economic, social and political development, as part of its mission.

This outlook enables to view the broadness of the social and cultural sphere open to the initiatives to promote the tax culture and sets forth, from its origin, the need to establish priorities, select target groups, define goals and approach modes consistent with the Tax Administration's institutional strategy and the available resources to such end.

Thus, it refers to the adoption of a strategy that may not be partial or temporal, but substantial, permanent and incorporated in the inherent forms of *being* and *doing* in the institution, that is to say, integrated to the daily activities of its basic functions, but with a long-term vision that shall be applied within as well as outside the Tax Administration (TA).

The coverage and scope of the strategy may be as broad or narrow as the institution decides. In any case, it requires depth of actions, no matter how limited, since the changes in structures and behaviors are not produced overnight: they entail deep transformations in the ideas of individuals and groups, which leads them to act differently, or as in

the case of children and youths, assume a mature and responsible civic identity, fully aware of their rights and obligations in the society were they live.

## 2. APPROACH AND SCOPES

How can the tax culture be promoted in a country that lacks it? What are the steps to follow? Who shall assume responsibility? What actions should be undertaken to change the values and attitudes that have opposed taxation in the course of history? How may rejection and resistance be overcome?

Answering such questions is no easy task, but it is worth the effort of shedding light on such topic based on the specific experience in the field of development of the tax culture in a country that features one of the lowest tax burdens in Latin America and whose social indicators are also featured among the less favorable in the continent: Guatemala. We shall address it at the end of this document.

In order to strengthen the tax culture (understood as the set of values, beliefs and attitudes shared by a society regarding taxation and tax laws), it is necessary for individuals to be informed and duly aware of the issue, but above all, that they understand the relevance of their tax responsibilities. Since the development of the tax culture goes beyond the mere sphere of the taxpayer population for its essential relation to the promotion of responsible citizens that exercise their rights and meet their obligations, two reciprocally legitimating dimensions.<sup>2</sup>

Thus, the development of the tax culture shall be deemed a systematic and permanent effort based on principles, focused on the promotion of civic values and, therefore, aimed at current taxpayers as well as the citizens of the future –children and youths–, whose culture and vision of the world are under development, and makes them more susceptible of internalizing and adopting the values that shall determine their social behavior in the future. As asserted by Eurosocial, only the free, informed and self-governed citizens, aware of their rights and obligations, shall be honest taxpayers.<sup>3</sup>

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<sup>2</sup> *Rufail, Sergio (Deputy Director General of Taxpayer Service of the Federal Revenue Administration of Argentina, AFIP): Conclusions of the International Civic-Tax Education Seminar. Buenos Aires, Argentina, October 6-10 of 2007.*

<sup>3</sup> *Eurosocial, Taxation Sector: Virtual Civic-Tax Education Forum, November 28<sup>th</sup> – December 11<sup>th</sup> of 2007 (www.eurosocialfiscal.org).*

One of the main conclusions of the International Civic-Tax Education Seminar held in Buenos Aires in October 2007 is that all the countries represented therein agreed on highlighting the relevance of Tax Education as the basis to constitute a democratic citizenry, asserting that it constitutes education in values to conform a new tax culture.<sup>4</sup>

Civic values of respect, integrity, cooperation and solidarity, among others, arise from social processes as well as individual acceptance in which, by different means, citizens become convinced that it is more useful and efficient to adopt them in their behavior, to the detriment of others that foster disrespect, transgression, dishonesty and lack of solidarity.

Therefore, as defined by the Spanish IEF, tax education shall become a topic to: i) identify the different public assets and services; ii) learn their economic value and social relevance; iii) acknowledge their source of financing, especially tax sources; iv) establish the rights and duties that arise from the public supply of goods and services; v) internalize the attitudes of respect for what is public and, therefore, financed with everyone's effort and employed for the common good; vi) internalize the tax responsibility as one of the underlying values of social coexistence in a democratic culture, identifying compliance with tax obligations as a civic duty; and vii) understand that taxation, with its two aspects - revenue and government expenditure-, is one of the areas in which values such as equity, justice and solidarity in a democratic society are materialized.

The development of a genuine tax awareness –and fiscal in general– consists in assuming that above the specific tax models, ever-evolving as expectable in every dynamic society, there are a series of underlying criteria in the cooperative financing of the public and common needs. The main criterion is that of citizenship, which implies assuming the social responsibilities as a necessary counterpart to the exercise of civic rights.<sup>5</sup>

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<sup>4</sup> Goenaga, María (*Tax Sociology Department of the Institute for Fiscal Studies of Spain, (IEF, as per the Spanish acronym): Conclusions of the International Seminar on Civic-Tax Education. Buenos Aires, Argentina, October 6-10 of 2007.*

<sup>5</sup> *Institute for Fiscal Studies, IEF: Tax Education in Spain, 2005. By María Luisa Delgado Lobo, Marta Fernández-Cuartero Paramio, Ascensión Maldonado García-Verdugo, Concha Roldán Muñio and María Luisa Valdenebro García.*

The foregoing places the development of the tax culture under a framework of action that greatly exceeds immediacy, since it is mostly aimed at middle and long-term objectives.<sup>6</sup> This differentiates it from other Tax Administration actions, generally centered on short-term results as well as from the Tax Administrations' assessment criterion to measure the impact of its actions, since the long-term condition mentioned above requires closer assessment of the sociological variables rather than the economic ones.

### 3. REASONS FOR COMPLIANCE

For a State to be able to meet its objectives of protecting the common good and providing citizens the basic public services they require, it needs resources that are mainly produced by the taxes paid by citizens.

The payment of taxes is the specific expression of compliance with regulations. It entails abidance by the law in effect, whether by subjection or will. In other words, it expresses an attitude that is determined by coercion or else by the individual conviction in a social function. Coercive force is expressed by laws, their mandatory compliance and, eventually, the sanction or punishment for noncompliance therewith, while conviction is based only on a strongly rooted tax culture.

They are not two self-excluding notions –according to Argentine authors Etkin and Estévez-, since the legal framework and the obligation to comply therewith are always present and articulated in the concept and practice of the prevailing order<sup>7</sup>, to the extent the taxpayer's motivation does not arise from the mandatory nature and the fear of sanctions, but from a personal conviction that relates to the will to meet the civic responsibility of contributing to the support of the State.

The tax event is a twofold act between the taxpayer and the State, in which the latter assumes a double function: collecting taxes and

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<sup>6</sup> *Comment by Sergio Rufail (AFIP, Argentina) in the Virtual Civic-Tax Education Forum: "Succeeding in cultural changes requires the same time as the one required to implement them. Maybe we may identify short-term results, but they shall be tied to the degree of acceptance of the initiatives rather than the concrete changes, achieved and internalized by students or citizens. Tax Education is a long-term vision."*

<sup>7</sup> *Etkin, Jorge and Estévez, Alejandro: Tax Environment and Tax Education Strategies. AFIP Institute, Argentina.*

returning them to society in the form of assets and public services. It is a regulated social process, in which tax compliance responds to a legal mandate that the taxpayer shall obey and the authority must enforce according to the powers vested by law.

The foregoing underlines the fact that the payment of taxes responds, above all, to a legal mandate. Thus, the source that legitimates the performance of the Tax Administration is, fundamentally, the law, and therefore, the exercise of the authority arising therefrom. Therefore, citizens' tax awareness may be strengthened by applying the strictest control mechanisms, provided that the State evidences an honest and efficient administration.<sup>8</sup>

Regardless of the fact that society is governed by a democratic system or otherwise, compliance with tax obligations responds to a legal order, formed by norms, terms and specific sanctions, which empower the tax authority to collect taxes and act against those who fail to meet the payment obligation.

Nevertheless, the scope of action of the TA exceeds the mere collection of taxes, just like the working area of the public health system, for example, exceeds the mere assistance in case of illness. Just like child nutrition is basis for any public health system, the Tax Administration shall conceive civic-tax education as part of its core functions. This is something that is not so evident for many Tax Administrations. Some consider tax education as something superfluous, or, in the best of cases, an accessory or ancillary instrument to their core processes, without taking into account that the development of the tax culture represents, in the long term, one of the most solid and reliable bases underlying the collection process.

#### **4. WHY PROMOTE A TAX CULTURE?**

The tax compliance obligation established by a legitimate authority and in line with a specific legal system, may be sufficient to achieve the tax collection objectives, depending on taxpayers' perception of risk and the TA's capacity to audit and enforce sanctions. Nevertheless, it shall always be an obedient, passive, and very likely, reluctant compliance. On the other hand, the natural willingness to pay, a self-imposed commitment, shall always be stronger and make the tax system

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<sup>8</sup> Montúfar, Rodrigo: *Modern Tax Law Trends*, page 57. Guatemala, 2000.



more sustainable in time since it shall be founded on a responsibility accepted and shared by citizens, in the framework of a more open, participative and democratic society.

This is not detrimental to the importance of the inherent authority in the performance of every Tax Administration; quite to the contrary, it seeks to underline the fact that tax compliance based on conviction not only responds to the inherent TA objectives, but also the need to assert democratic coexistence according to the observance of duties and exercise of the civic rights of the social conglomerate. Therefore, for a democratic relation with social cohesion, it is a priority to build a voluntary compliance environment against a coercive compliance one,<sup>9</sup> although both are equally legitimate and convergent since they translate into a same attitude: compliance with the law.

It should be pointed out, nevertheless, that individuals better respect and abide by self-imposed regulations. José Bernardo Toro calls this the *principle of self-foundation* and defines it as the order created by the individuals that shall live thereby, and comply and protect it, rendering it the only order spurring freedom and the core element of governance.<sup>10</sup>

Obligation-based compliance arises from the legal order, the punitive force and the fear of punishment –which are legitimate though not self-founded elements-, to the extent conviction-based compliance originates in the taxpayer proper and thrives on his understanding, responsibility and commitment; in other words, on self-founded and legitimate principles, which adds value and endows this type of compliance with greater consistency and sustainability.

## **5. LAW, MORALITY AND CULTURE**

In certain social contexts we may perceive a rupture or dysfunction between the law, morality and culture, which are three systems that govern human behavior. This theory led the Mayor's Office of Bogotá, Colombia, headed by Antanas Mockus, to make the decision of prioritizing the so-called Civic Culture, a set of programs and projects geared at improving the conditions of civic coexistence by means of a conscious behavioral change, based on the assumption that the

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<sup>9</sup> *Idem.*

<sup>10</sup> *Toro, José Bernardo: Education for democracy.*

voluntary modification of the habit and beliefs of the group may become a key component of the public administration performance and the common government-civil society agenda. Thus, in the experience of Bogotá, the Civic Culture strategy was devised as an instrument to enhance the moral and cultural regulation, as well as to succeed in a greater consistency among them and between them and the observation of the law.

Along such lines of thought, the strategies for the development of the tax culture may be also conceived as tools to harmonize the ethic and cultural values, for them to result in the respect for legislation and the due compliance therewith.

The furtherance of truly effective tax or fiscal policies is not possible without relying on the target human conglomerate. In order to reach a better end in taxation, the human and social factor should be considered, as recommended by tax sociology.<sup>11</sup> All the tax regulations and plans conceived in an office run the risk of being fruitless if due attention is not paid to citizens' beliefs, attitudes, perceptions and behavior forms, their personal and collective morality, and even their ideas on how to organize coexistence.<sup>12</sup>

Its relevance is made evident especially in societies affected by weak tax awareness and an ineffective State, factors that are generally tied to –and worsened- by the crisis in social values that reinforces the theory of divorce among culture, morality and the law. In many cases, this convergence of elements adverse to taxes, and taxation in general, goes hand in hand with the cult of individualism and the prevalence of conditions that prioritize it above social responsibility, solidarity and the pursuit of the common good.

Under such circumstances, tax education may by no means be reduced to the dissemination of practices that only serve to fulfill the requirements of the tax system, which, although vital, are mechanical and ever-changing tasks in time. Neither shall it be limited to the scope of the tax formality, the legal order and the reasons for compliance therewith, but it shall be, necessarily, an education focused on the cultural change and the prioritization of ethics in the social conglomerate.

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<sup>11</sup> Montúfar, Rodrigo: *Op Cit*, page 58.

<sup>12</sup> IEF: *Op Cit*

## 6. PERCEPTIONS AND ATTITUDES

One of the most relevant processes for the growth of organizations is made up by their credibility in the eyes of the users of their services. In such regard, the essence of the social life and the modification of behaviors arise from the perception and beliefs of individuals on the entities and leaders that head them.

In the case of Guatemala, for example, for many years the image of the tax authority or Tax Administration was tied to incompetence, inappropriate use of resources, and illicit acquisition of wealth by former officials and poor contribution of public resources to the development of communities. The latter applies in spite of the performance of the Tax Administration in the last decade, focused only on collection and lacking any influence on government expenditure. Nevertheless, taxpayers fail to make this distinction of functions, which underscores the fact that it refers to both sides of the same coin: on the one hand, society's contribution to the State, and, on the other, the form in which the State returns it in the form of public goods and services.

Although the notion of reciprocity is basic and easily understood (taxes in exchange for public services), the development of the tax culture is tied to an even broader notion, *tax citizenship*, which offers a more comprehensive view of taxation, in which the civic duty of paying taxes, financing of rights and support of the State converge on the one hand, and the appropriate use of resources, transparency of expenditure, accountability and the importance of the social audit or civic surveillance on the other.

But the essence of the tax culture extends beyond this, since it does not condition compliance to reciprocity or any other external element, but, to the contrary, perceives it as an inalienable responsibility that stands on its own, free from any factor that may diminish or restrict it. Therefore, the actions for the development of the tax culture require processes to enable the emergence of changes, as regards perceptions as well as attitudes in the individual and the social aspects, which translate in the conscious and voluntary contribution of taxes. Of course, this does not hinder the importance of the actions to improve transparency of government expenditure, the social function of taxes and the credibility of the institution in charge of collecting revenue.

As part of an integral strategy that seeks to improve collection while changing the public perception of tax compliance, a process arises

for the development of the tax culture. This is not at all easy when we realized the extent and strength within different social groups of an array of beliefs and values not only contrary to taxation, but, in general, the observation of basic regulations of coexistence and abidance by the law.

There are countless cases in which wittiness and native cunning to evade taxes are celebrated, as well as the use of stopgaps to avoid them or avoid the controls by the Tax Administrations, whether for internal or customs taxes. Such beliefs become genuine *anti-values*, additional hurdles in the already difficult task of promoting the culture of legality and tax compliance.

In an interesting article entitled “Fiscal and Tax Psychology”, Mónica Díaz Gómez points out: “the archetype of the “native cunning” in evading taxes is accepted by the Venezuelan society owing to the absence of a genuine and deep tax culture. The taxpayer’s psychology is marked by a strong trend towards fraud and justifies the attitude with frequently heard questions: Why should I pay taxes if public services are inefficient? Why should I be a compliant taxpayer if the corrupt steal our tax money? For many, committing tax fraud is a form of pleasure that enhances personal vanity and proves skills before others. It is believed that human social behavior is determined by the principle of the pursuit of pleasure and that is why the selfish nature of the human being makes him fond of his possessions or what he believes to be his possessions; thus the difficulty in paying the taxes due with pleasure and voluntarily”.<sup>13</sup>

Examples of this type prevail in many Latin American countries, where genuine taxation antiheroes appear—or heroes of fraud- in social sectors that tend to be very tolerating with such type of illegality, whether it is minimized regarding the most serious violations of the law or even justifying it based on a myriad of arguments, from the pretext of government corruption to those tied to the user or consumer interest, who *may purchase at lower prices without taxes*.

Such beliefs shall not be deemed a component of a “culture”; rather, they are social behaviors or social behavioral patterns, frequently related to a double morality, which in public condemns illegality

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<sup>13</sup> Díaz Gómez, Mónica: *Fiscal and Tax Psychology*.

while practicing it in private. Thus, the strategy for the development of the tax culture as one of the pillars to support the improvement of collection shall be marked by an integral nature and a long-term approach, since there are many different factors that increase the collective imaginary, in addition to the fact that a change in values and attitudes is not achieved overnight and without an intensive and systematic intervention to define it.

This undoubtedly requires a strategy made up by clear working areas, consistent and appropriately structured that supplement and improve each other as a function of the development and improvement of civic values as well as the improvement of the awareness on the tax obligations. Therefore, it is not a matter of isolated assignments, specific campaigns or sporadic interventions in one target group or the other, but rather a broader and more sustained educational effort, since only on such basis shall the current and future taxpayer subjectivities be modified; that is to say, redirecting beliefs, values and behaviors that shall result in the practice of new social habits and attitudes before taxation in the future.

## **7. ADOPTION OF STRATEGIES**

### **7.1 Objective and scope**

The chief objective of the tax culture is to instill behaviors in favor of tax compliance and against tax fraud, by conveying ideas and values that may be internalized at the individual level and valued at the social one. This implies a cultural change that explains the long-term condition, normally one of the most relevant features in every strategy for the development of the tax culture.

One of the conclusions of the International Seminar on Civic-Tax Education, mentioned before, was that there are no “recipes” for the adoption of the strategies geared at the development of the tax culture, since the inherent features in each country as well as the resources available to each Tax Administration are the factors that ultimately determine the type and scope of the actions to be undertaken in the area.

Likewise, it would be ideal to be able to work on all “fronts” and by means of a combination of strategies to reach the different beneficiaries of the program, but this generally stumbles over the inherent limitations of the available resources, in addition to the fact that the processes

feature different paces and specificities requiring different timeframes and spaces.<sup>14</sup> There are significant differences, for example, between preparing a didactic handbook for teachers, creating a radio campaign, creating a Web page and putting together a stand in a school fair.

The important aspect is that each Tax Administration clearly defines its tax development objectives and sets forth its priorities according to such objectives and the resources available. Gastón Bruzzone, from the Formal Education area of AFIP, explains the Argentine experience: “In our case we started with training courses for elementary school teachers and authorities. Later we incorporated the secondary and higher education levels. But I think that in our case, the education teams of the Tax Administrations, it is more effective to work in stages. The important aspect is not to lose sight of the fact that we are undertaking a very long-term effort; that cultural changes are sustained and extended in time and, therefore, it is always possible to add actions to those already implemented successfully.”<sup>15</sup>

## 7.2 Stakeholders

The Tax Administration may be the first stakeholder in the development of the tax culture and act accordingly, to define, promote and finance it, but it is by no means alone in this effort. The education administration is called upon to play a key role and it is clear that the rest of the public administration shall also form part of the process. In fact, it shall be deemed a State policy and not a government policy, a permanent program and not a cyclical project, so that not only the tax agency in each country assumes responsibility over the tax education program (although it shall be the sole authority for its content), but many other players should become involved and alliances be pursued in such respect: the rest of the Tax Administration, ministries of education, the private sector, municipal or provincial corporations, etc.<sup>16</sup>

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<sup>14</sup> Comment by Sergio Rufail (AFIP, Argentina) in the Virtual Civic-Tax Education Forum: “As regards the level at which we should begin, I believe in ALL the levels in which we may sustain the strategy in time. All levels are important, but as we move higher, the strategy shall be improved, strategists shall become increasingly convinced and more prepared, since the arguments shall be increasingly more difficult to contain.”

<sup>15</sup> Bruzzone, Gastón (AFIP, Argentina): comment in the Virtual Civic-Tax Education Forum.

<sup>16</sup> Goenaga, María: *Op Cit*

Moreover, alliances with other players (private companies, NGOs, international agencies) legitimate the message of the program since they do not represent the voice of the state, but the private commitment to common interests.<sup>17</sup>

### 7.3 Beneficiaries

Some believe that all the actions of the Tax Administrations –including tax education– shall be focused exclusively on the taxpayers, effective or potential, since they constitute the social base of effective collection. From this standpoint, it is normal to consider taxation as an event that only pertains to adults and, more specifically, adults that conduct a certain type of economic activity subject to taxes. Therefore, the young would have no reason to worry about taxation, since they are totally foreign to the tax event until they start to participate in the economic activity and become responsible for formal tax obligations. From this standpoint, the tax education of the younger citizens would lack sense.<sup>18</sup>

The Institute for Tax Studies of Spain poses the following questions: Is it possible to assert that children and youths are totally foreign to the tax event? Shall the education system ignore this fact? Reality indicates otherwise: neither are the latter foreign to the surrounding world, including the economic activities and taxation, nor should the school ignore the tax event, to the extent it is a matter of citizenship and a fundamental part of the educational mission is, or should be, to educate the citizens of tomorrow, that is to say, to provide for the necessary conditions for individuals to learn to adapt their behavior to the regulations in effect in their society.

Tax norms form part of the set of social norms to be met by an adult individual in a democratic society, by which the tax responsibilities should form part of the set of values that every citizen shall assume, respect and defend.<sup>19</sup> According to this approach, shared by the representatives of the Tax and education Administrations gathered in Buenos Aires, in October of 2007, children and youths are the genuine

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<sup>17</sup> *Rufail, Sergio. Op Cit*

<sup>18</sup> *IEF: Op Cit*

<sup>19</sup> *Idem.*

and natural beneficiaries of the tax education programs: “Formal tax education shall reach all levels, since its approach entails complexities and interests inherent in each development stage. A child learns basic coexistence rules. A teenager understands the social sense of taxes. A professional individual embraces rules and habits for his/her performance.”<sup>20</sup>

The other important beneficiaries of the actions of the tax culture are citizens. “The efforts targeted at them shall be as intensive as those geared at children and youths within the formal education. In the middle term, citizens shall convey such values to their children, from their personal conviction”,<sup>21</sup> in addition to the fact that the taxpaying population of the present belongs to this sector, which along with corporations make up the great *market* of the Tax Administration overall. Although the TA can not and shall not disregard the commitment of informing and guiding taxpayers on the formal taxation aspects; that is to say, the norms and practice of tax compliance, the essence of the tax education transcends the mere *knowledge of taxes* (what they are and how to pay them), to focus on the social and ethical context to which they pertain, which is more related to the reason and purpose of paying taxes in the framework of a coexistence model governed by rights and duties for all the members thereof.

Lastly, a third relevant beneficiary of the tax education programs is the Tax Administration and Finance Ministry staff, which ultimately constitutes the face of taxation in the eyes of citizens, from the standpoint of revenue as well as the administration and allocation of expenditure. According to Rodrigo Montúfar, one of the Directors of SAT of Guatemala, the tax education efforts shall be permanently focused on the officials and employees of the Tax Administration, for them to know and duly enforce the tax laws and learn how to guide the taxpayer to pay taxes correctly.<sup>22</sup> This creates the need to include public servants in general in this target sector, many of whom frequently fail to realize the relation of taxation and their performance.

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<sup>20</sup> *Rufail, Sergio. Op Cit*

<sup>21</sup> *Idem.*

<sup>22</sup> *Montúfar, Rodrigo: Op Cit, page 40.*



## 7.4 Scopes and messages

By virtue of the ultimate goal of contributing to the development of citizenship, the strategy shall not be limited to the tax sphere, but also extend to the fiscal area. Eurosocietal defines it as follows: if the appropriate compliance with the tax obligations is one of the pillars that sustain the arch of civilized coexistence, the other is the appropriate management of the government expenditure programs. A country may enjoy an effective and efficient Tax Administration, but if Justice is venal, or Education and Health deficient, or the government officials are dishonest, the building shall be unsafe. The tax education shall not lose sight of the other aspect of the public budget and also see to the other aspect of tax fraud that relates to government expenditure. Thus, tax education is a strategy not so much to improve collection, but to build a better society with everyone's effort.<sup>23</sup>

A basic aspect required to define the strategies of development of the tax culture is the understanding of the social elements tied to the behavior of the groups. Even when behaviors are common, each group features its own codes, in many cases learned from one generation to another, conveyed from parent to children, teachers to pupils, as well as influential players to the public opinion.

All this is transformed into truths by means of a beliefs and behaviors' socialization process, which enables it to be validated informally, but transcends and is acknowledged as a commonly accepted attitude.

Thus, the development of the tax culture requires the creation of new codes, new messages, new educational content and new forms of communication that enable to approach the different groups appropriately, easily and reliably.

The need to adopt tax education strategies is inversely proportional to the level of tax compliance. The more and better citizens meet their tax responsibilities, the less necessary it appears to foster the tax culture. Even so, countries with high levels of tax compliance, such as Canada, United States, Switzerland and New Zealand, include tax development in their educational programs to "prepare for adult life".<sup>24</sup>

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<sup>23</sup> Eurosocietal, *Taxation Sector: Op Cit*

<sup>24</sup> IEF: *Op Cit*

## 7.5 Education as the pillar

Undoubtedly, the backbone in the development of the tax culture is education. It constitutes the most powerful tool to transform individuals' ways of acting and thinking. Isn't a society's culture the result of education? That is where the Tax Education mission finds its purpose and its interest in the educational processes.<sup>25</sup> Thus, if issues relative to health, environment and nutrition, road safety education or education on electoral topics are included in the education systems, then the development of the tax culture and tax education shall be also included.<sup>26</sup>

According to an African saying, "a whole people are necessary to educate a child". This is the approach followed by Bernardo del Toro when he asserts that the greatest challenge in any democratic society is that of building a public education for democracy, that is to say, focused on the development of citizens who give life and sustainability to democracy: knowledge makes sense from the standpoint of democracy to the extent school contributes to form individuals capable of building the social order that enables an honorable life for all, in cooperation with others.

According to Del Toro, democracy is not natural in the human being. Democracy is an invention and, by virtue thereof shall be taught and learned. Thus, one of three first purposes to meet in a democratic development process is that children understand that, in social terms, the existing order and the relations arising in society are not natural, but built by people, and therefore, modifiable. When an education system believes that everything is natural, it is very easy to accept that there are children that may pass the school year and others that may fail, without any fundamental. But when we learn that the social order is created, the only logic is that all children succeed, because school success may be created and built. A first feature of democratic education and the democratic *ethos* in a democratic culture is that everyone understands that all these notions shall be taught and learned because they do not come naturally.

Such criterion is equally valid for the development of the tax culture. In a democratic society, taxes derive from social agreements made into laws by virtue of the power that the citizenry proper delegates

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<sup>25</sup> Salas, Dolores (SAT, Mexico): comment in the Virtual Civic-Tax Education Forum.

upon lawmakers and authorities. Therefore, the tax system represents a self-imposed social commitment that every citizen shall live by and respect, based on the same values that enable to exercise civic rights and obligations. It is a creation that, just like democracy, shall be taught and learned because it entails notions and values that are not natural, but created by the society in which they live and according to the State in which they wish to live.

Values are not inherently educational contents but the basis of the education strategy, and require a cross-sectional and ongoing treatment in the education curricula overall -from elementary to higher education-, in line with the notion that the most relevant means to teach and learn them shall be based on experience, since it enables a better understanding and incorporation thereof.

Nevertheless, it is not recommendable to limit the messages and content of fiscal development to one educational current or the other. Just like the educational sphere is unlimited when it comes to education for life, the same applies when it comes to educating for civic life, which is ultimately the fundamental end of the tax culture.

In fact, functional interactions exist among formal, non-formal and informal education: complementary, supplementary, substitution, reinforcement and collaboration relations as well as intervention, so that, even if school forms part of the formal education system, it may include non-formal and informal processes. It is even considered that the formal educational institutions should increase the use of resources from the other two educational trends. In the framework of formal education, the knowledge obtained by individuals in non-formal and informal contexts should be valued and accepted. It becomes necessary to adapt to platforms that enable and promote the coordination among instances, in order to optimize the complementarity.<sup>27</sup> The genuine tax culture is instilled in all levels of education, for future citizens to be convinced of the need to contribute to the development of the community.<sup>28</sup>

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<sup>26</sup> IEF: *Op Cit*

<sup>27</sup> Trilla Bernet J, CEAC, Barcelona, Spain: *non-formal education*.

<sup>28</sup> Montúfar, Rodrigo: *Op Cit*, page 30.

## **7.6 Conditions of the strategy and its complementarity**

One of the performance issues that tend to arise in every tax education strategy is to phase in and harmonize the educational contents in line with the principles and purposes referred to in this document. Conveying them to the intermediation agents, chiefly teachers, is another crucial topic, particularly owing to the importance of the school environments in facilitating learning and incorporation of the civic values by means of the appropriate instruments, for example, educational material and games, discussion workshops, practical experiences, etc.

The selection of the audiences and the means to reach them constitute additional relevant challenges for the strategy and entails the need to articulate the latter in the form of sequential or complementary projects, as well as establish objectives and inherent indicators for each one of them.

The examples mentioned set forth two of the basic conditions to be featured by the tax culture strategies: performance continuity and specificity of its actions. In line with these, they also highlight, among others, the necessary socialization with other players; its cross-sectional nature in the education system; its dissemination towards non-formal and informal spaces; and its inclusion in the government agenda as well as the media, which tends to be an important sphere in the development of images and perceptions that influence their social behavior.

But there are also other strategies inherent in the TA, which may supplement and strengthen its tax culture action, such as the case of all those referred to taxpayer service. The complex tax systems, cumbersome formalities, failures in the guidance of taxpayers or inappropriate taxpayer assistance practices are not good allies to foster the tax culture. To the contrary, they foster counterproductive effects thereupon; to the extent they undermine the image of the TA and affect its credibility.

Thus, the adoption of actions to simplify and make the tax and customs processes more transparent, as well as rendering better taxpayer services may be very instrumental to improve the purposes of the tax education strategy and, in general, the social perception regarding the performance of the collection agency.

## 8. THE EXPERIENCE OF GUATEMALA

Until three years ago, Guatemala had no significant experience in aspects related to the tax culture. Except for certain isolated and basic attempts, the issue was not included in the public agenda. It wasn't until 2005 that the Tax Administration undertook an integral effort in such direction, by means of dissemination and promotion actions, as well as different formal, non-formal and informal education projects.<sup>29</sup> This short but intense experience has been an input for this document, by which we have made a critical review and provided feedback on our vision on the development of the tax culture and its importance as a strategy to promote voluntary compliance.

For example, during the program design phase, SAT tried to separate the tax culture in its capacity of obligation and duty to pay from the final end of resources and the form in which they are "returned as services" to society. This is due to the fact that they are two functions from two different institutions and the Tax Administration has no control over the distribution of income.

Nevertheless, in the discussion workshops that we conduct with the participation of local authorities and civil society from the twenty-two departments (provinces) of the country, it became very clear and obvious that there is no better promoter of the tax culture than appropriate government expenditure –efficient, rational and transparent-. In other words, society itself showed us that an important stimulus (or lack of stimulus) for taxation is made up by the management and allocation of government funds, in addition to the fact that, in the case of many countries –among them Guatemala-, the enforcement of taxes is deemed a discretionary act, related to the positive or negative perception on the use of funds.

One of the objectives of the development of the tax culture shall be, precisely, to break the vicious circle and create awareness that

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<sup>29</sup> In order to define each one of them, we shall adopt the notions defined by the Institute for Fiscal Studies of Spain, IEF:

- *Formal education: is the one developed within the educational system when it is marked by a formal denomination that leads to the achievement of a degree, diploma or certificate authorized by the education administration.*
- *Non-formal education: is the one developed outside of the educational system through courses or training activities that do not result in a degree, diploma or certificate authorized by the education administration.*
- *Informal education: it refers to every educational process that is delivered intentionally or unintentionally by any means and by any institution.*

taxation is not only a legal obligation, but a duty of each person with society. Additionally, the individual shall be convinced that meeting such responsibility grants the moral authority required to demand the Government Administration to make the appropriate and transparent use of public funds.

It is worth pointing out in the case of several Latin American countries –including Guatemala- that our people represent diverse cultures and, therefore, the tax culture strategies shall be adapted to such diversity to be effective in each one of the groups that make up our societies.

For the implementation of the Permanent Tax Culture Program in February of 2005, we did not rely on an initial measurement of citizens' taxation knowledge, which would have been desirable. In order to develop the program strategy and select the actions and priorities, an initial proposal was the starting point addressed in the discussion workshops, as mentioned above.

Among the lessons learned in such workshops, we may mention:

The appreciation of the social aspect of taxation, that is to say, the relevance of considering the other side of the coin—the allocation of revenue-.

The importance of social participation in the management and execution of the tax culture development projects.

The need to develop an integral strategy with three areas: Education (Formal and non-Formal), Promotion (Informal Education) and Dissemination, based, in turn, on three cross-sectional axes: Information, Training and Awareness.

### **8.1 Actions of the permanent tax culture program**

Hereunder, we briefly describe the actions developed to the present as part of our integral strategy:

Information considers aspects such as the dissemination of the program, its content and actions, the creation and maintenance of the Tax Culture Portal on the Internet, the implementation of different awareness campaigns and the publications on the basic information contents, for children and youths as well as adults and taxpayers in general (for example, the publication on the media of different

informative and educational press publications: infomercials on tax, customs and the country's tax history).

Development refers to all the educational actions in its different approaches (formal, non-formal and informal), among which the following are included:

- a) Inclusion of the tax culture in the elementary school curricula, in addition to the distribution of school texts and tax education games;
- b) Joint work with the Ministry of Education on the review of the educational curricula of the basic education and diversified high-school cycles as well as on the curricular transformation of the program for the Bachelor's Degree in Accounting;
- c) Development of a program to support the professional development of individuals with the Bachelor's Degree in Accounting based on the implementation of a higher tax education course (onsite and virtual) and supplemented by an academic certification project for such professionals;
- d) Taxation training courses, for taxpayers as well as individuals with a Bachelor's Degree in Accounting who conduct intermediation activities between the former and the TA;
- e) Development of a tax training program in Mayan languages for the different rural areas in the country;
- f) Staging two tax culture musicals for schools and public activities, as well as production of the audiovisual versions thereof;
- g) Execution of the Tax Lottery program in the 22 departments of the Republic, conceived to stimulate consumers in general to request the invoice of their purchases of goods and services;
- h) Presentation of an interactive audiovisual exhibition and a space for computer games in an area with important assistance of children and families;
- i) Production of a musical video clip mainly focused on the teenage audience, disseminated on different media: television, radio, the Internet and cellular telephony; and
- j) Production of a television series for children in the educational entertainment area.

Lastly, the creation of tax awareness plays a vital role in the Education as well as Dissemination projects and activities, since it seeks that the two previous axes (information and development) transcend the minds of beneficiaries and become principles and perceptions that translate into voluntary compliance behaviors, by the present as well as future taxpayers.

## 8.2 Inter-relations

Apparently, the school environment is not proper of the Tax Administrations, which underlines the relevance of relying on the support of the education authorities, but, above all, achieving the commitment of teachers on the issue. In the case of Guatemala, the cooperation process among the Tax and Education Administrations is still incipient, but the initial experience has set forth that classrooms are fertile ground not only for the formal educational actions, but also for the informal ones, such as school competitions and theater plays, for example.<sup>30</sup>

Although education is by excellence the environment to develop the tax culture –particularly in the case of children and youths –, the other great field of action of the strategy adopted in Guatemala is that of dissemination, as set forth, which includes advertisements via conventional media (newspapers, radio, television) to alternative media advertising (outdoor signs, artistic performances, sports events), including the production of different electronic and printed material, and the specific Internet Portal.

The dissemination actions not only enable to reach other target groups, but also supplement the activities aimed at children and youths. Additional and different educational mechanisms<sup>31</sup> always coexist with school, among which we may mention the media, especially relevant by their coverage and influence.

In the case of Guatemala, the commitment of other public players is a relevant need, chiefly because, as we have mentioned before, the functions of the Tax Administration are limited to collection, while the expenditure allocation is a function of the Central Administration and, particularly, the Ministry of Public Finance. Thus, the actions for the development of the tax culture shall not exclude the references on how to manage and invest government resources, since the issue calls for this conceptually integral approach.

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<sup>30</sup> *Comment by Sergio Estrada (SAT, Guatemala) in the Virtual Civic-Tax Education Forum: “Not every initiative shall be considered as a formal education initiative. Certain efforts may be very effective from the alternative or non-formal standpoint, provided they are well managed. The important aspect is that every action responds to a strategy carefully defined by the TA and devised in terms of impact pursued as well as cost/benefit for the administration.”*

<sup>31</sup> *Trilla Bernet: Op Cit*



### 8.3 Strategy principles and features

The development of the SAT tax culture has enabled to observe a series of principles, which in line with the features of its initial definition and those incorporated in the course of its performance, have granted it an inherent physiognomy, which in turn has facilitated its incorporation in the public agenda. Among such distinctive features we may mention the following:

**Direction:** relevant products, messages and actions for each target group have been developed, and in spite of conveying a single core message, they have been adjusted to the language and features of the members in each segment.

**Mechanism:** in addition to the above, the use of stimuli such as images, music and other audiovisual elements has been key to strengthening the creation and dissemination of the relevant messages.

**Message:** one of the notions learned from the program's practices and actions is the use of clear and simple language, accessible to all publics, and maintaining a single message for each one of the products or services, avoiding ambiguity or unnecessary digressions.

**Consistency:** it is inherent not only conceptually, but also as regards perception, which attaches importance to the use of images, characters, colors, forms and all the stimuli related to an immediate identification of the products or services with the core message.

**Nature:** a working methodology has been adopted, which on the one hand calls upon reason essentially based on common sense, and on the other, focuses on the audiences' emotional perceptions on aspects such as kindness, happiness, humor and enthusiasm of teamwork, which generated identity and identification with the program's content and objectives.

**Facilitation:** it is achieved by stimulating thoughts and emotions, games, knowledge based on new materials and the adoption of traditional and alternative communication channels that include the Internet as a technological element.

**Tools:** a variety of tools have been employed such as: books, games, electronic devices and Internet applications, which may be within the reach of the different target groups and are easy to reproduce thereby.

**Audiences:** the appropriate selection of the audiences has been a process implying deep efforts with key players and has been performed in the interior of the country to know the attitudes and perceptions of the different audiences as regards tax matters, as well as their reactions before different program actions.

**Products:** a diversity of educational as well as communicational products and materials have been designed by specialists after an adequate validation, which have served to create a “basis of trust” and a link between the program and its different target groups.

**Receptiveness:** aside from isolated expressions of skepticism or rejection, we have detected receptiveness, acceptance and other positive reactions to the tax culture efforts in the course of the development of the program, which has been used to extend the social pillars thereto and work on the articulation of new alliances with different institutions, public, private and international.

**Team:** this is a key factor in the strategy, on the one hand due to the fact that the creation of a multidisciplinary working team has enabled to create messages, products and approaches with different professional views and on the other, that the alliances with other players and institutions enhances the program and favors its sustainability.

**Support:** no strategy may operate if it lacks the necessary financing. From the beginning, the program has relied on the support of the three main Tax Administration authorities, set forth an appropriate budget for the projects and actions defined since 2005, and since 2007 it has been supported by a dedicated administrative unit that directly reports to the senior authority of the institution.

#### **8.4 The local environment and reciprocity**

In several native communities of Guatemala the tradition of making contributions of different nature has survived (monetary, in kind or in labor) to carry out work or activities for the benefit of the community. This contribution, called *kuchuj* in the Mayan *k'iche'* language, represents an ancient social practice that clearly illustrates the principle of reciprocity mentioned before, since it constitutes the materialization of a payment or investment prior to obtaining a good or service aimed at satisfying a collective need.

Likewise, numerous native communities follow the tradition of gathering contributions to pay for the expenses of Mayan spiritual ceremonies or rituals, as well as in the churches of different religious denominations we find the payment of the tithe by which the congregation finances the material support of the church and, in exchange, receives a spiritual gratification according to its beliefs.

Such examples not only express the importance of reciprocity as the ground for the voluntary contribution in exchange for a collective or individual benefit, but also state the relevance of the local environments, relatively closed or limited, so that the practices of a genuine, collaborative, self-founded practices may be materialized and sustained therein, and tied to the transactional notion of “give in order to receive”.

Such type of local experiences may constitute a good starting point to initiate tax culture projects that, from the micro or local viewpoint, may enable to build cases that show good practices on the issue, whether in school, a youth club or an artistic or sports association.

For example, in Guatemala, SAT is launching a pilot project on the “model municipality” (named Sound Municipality), which in its first stage seeks to lay the groundwork for a municipal tax compliance model based on intensive taxpayers’ registration campaigns and the use of the mandatory invoice in all the transactions of goods and services, as well as the deepening of numerous tax culture projects and actions in the municipality, especially in the educational field.

### **8.5 Insight and exploring**

The dynamic of every strategy to develop the tax culture requires more insight of its actions on ground that has proven fertile, as well as exploring new areas to extend or supplement the efforts of the educational experience.

For example, the formal education actions, on the basis of their nature and broadness, appear among the ones requiring more insight, but they may be also strengthened by the application of distance education tools, which although posing the challenge of promoting access to new technologies, present attractive conditions in terms of economy, coverage and impact.

As regards the approach and contents, the experience of the tax culture program in Guatemala features a progressive migration to the broadest sphere of citizen development, which opens the doors to a new dimension for the scope thereof, while it offers a more diverse array of educational options and potential strategic alliances.

Finally, understanding the relevance of improving taxpayers' service and assistance has lead SAT to incorporate this type of initiatives into its strategic institutional plan for 2008-2011, under the motto "easy and sound", precisely with the purpose of underscoring, on the one hand, its commitment to making formalities and procedures easier and more transparent, while, on the other it emphasizes the importance of achieving full, fair and accurate compliance with tax obligations. The continuity of its tax culture strategy, as well as the expansion and deepening of the actions undertaken in this field, is called to contribute in the achievement of the objectives of such broader institutional strategy, since they already constitute a significant component thereof.

## **9. CONCLUSIONS**

1. The payment of taxes is the expression of compliance with a legal norm, which may be determined by the obligation to respect the law or the conviction that tax compliance is a civic duty. The latter is the behavioral expression of the tax culture, which consists in the set of principles and values that determine compliance as the result of the understanding and self-founded acceptance of the regulations that govern it.
2. The source that legitimates the performance of the Tax Administration is, fundamentally, the law, and, therefore, the exercise of the authority stemming therefrom. Compliance with tax duties responds to an order established by law, marked by regulations, terms and specific sanctions, which grant the tax authority the power to collect taxes and enforce authority against those who fail to meet their tax obligations. Nevertheless, in order to promote democratic coexistence with social cohesion, it is of utmost priority to create a voluntary tax compliance environment rather than an enforced compliance one, although both are equally legitimate and convergent in the sense that they translate into a same attitude: abiding by the law.
3. The tax culture is integrated into a broader notion, that of *tax citizenship* –which spans the correct compliance with such

obligations, from the standpoint of revenue as well as government expenditure- and relates to the other two spheres of social values: the culture of legality and the development of citizenship, that is to say, the development of responsible citizens that exercise their rights and meet their obligations.

4. The Tax Administration shall conceive civic-tax education as part of its core functions, since the development of a tax compliance culture in the long-term constitutes one of the strongest and reliable bases for collection, by taking the form of a responsibility accepted and shared by citizens.
5. Nothing advances the tax culture better than an adequate government expenditure, since according to the reciprocity principle, the efficient, rational and transparent use of public resources -by transforming them into goods and services for the common good- legitimates the State collection function and motivates society's voluntary compliance with tax obligations.
6. The development of the tax culture shall be deemed a systematic and permanent long-term effort, sustained by principles, geared at the reinforcement of civic values and, consequently, focused on present as well as future taxpayers (children and youths), since it constitutes one the bases to create and sustain democratic citizenship.
7. The tax culture development strategy constitutes a tool to harmonize the ethic and cultural values to contribute in the promotion of the culture of legality.
8. The need to adopt strategies to develop the tax culture is inversely proportional to the level of compliance with tax responsibilities. Even so, countries with high levels of tax compliance promote tax education as part of the school curricula to prepare for adult life.
9. The tax culture is fundamentally aimed at instilling behaviors in favor of tax compliance and against tax fraud, by conveying ideas and values that may be internalized individually and valued socially. This entails a cultural change that underlies the long-term condition as one of the frequent and most important features of any tax culture development strategy.

10. There are no “recipes” for the adoption of strategies geared at the development of the tax culture. They are rather the inherent features in each country, as well as the availability of resources for each Tax Administration, which ultimately determine the type and scope of the pertinent initiatives. The most important aspect is that each Tax Administration clearly defines its tax development objectives and establishes its priorities according to them and the resources available.
11. The Tax Administration is logically the largest stakeholder in the development of the tax culture, but this does not make it the only one. The education administration and the rest of the government administration is also part of the process, since it shall genuinely take the status of a State policy rather than a government policy, of an ongoing program and not a cyclical project, with the participation of the local administrations and other sectors and civil society institutions.
12. Since the tax norms shall constitute a part of the set of values that every adult individual must assume, respect and protect in a democratic society , children and youths, to the extent they are future citizens and taxpayers, are the natural beneficiaries of the tax culture programs. Also included are the current, effective and potential taxpayers as well as the staff of the Tax Administration and public servants in general.
13. The backbone of the development of the tax culture is education in its different modalities (formal, non-formal and informal), since it represents the most influential means to transform individuals’ behavior and ideas.
14. Just like in the case of the democratic culture, the agenda of principles and values that constitute the tax culture shall be taught and learned, since it entails notions and fundamentals that are not natural, but created by the pertinent society where individuals live and according to the type of State envisioned.
15. The taxation-related values are not, per se, educational contents, but they constitute the basis for the education strategy and require a cross-sectional and ongoing approach in the overall educational curricula.

16. Tax education may by no means be reduced to the dissemination of practices that only serve to fulfill the requirements of the tax system, which, although vital, are mechanical and ever-changing tasks in time. Neither shall it be limited to the scope of the tax formality, the legal order and the reasons for compliance therewith, but it shall be, necessarily, an education focused on the cultural change and the prioritization of ethics in the social conglomerate.
17. Although education is by excellence the fertile ground for the tax culture –particularly for children and youths-, its effectiveness is normally supplemented and enhanced by information and dissemination actions, by conventional as well as alternative means of communication.
18. Institutional support, availability of appropriate resources, conscious assessment and selection of the available options, the appropriate selection of audiences, clear and consistent messages, as well as the connections that are established with the target groups, are relevant conditions to further any tax education strategy, to the extent they may be defining for its effectiveness.
19. Local experiences may constitute a good basis to start tax culture projects, which, from the micro or local standpoint, enable to build cases of good practices on the issue.
20. The strategies for the development of the tax culture shall be marked by continuity in its furtherance, specificity in its actions, socialization with other players, cross-sectional intervention in the education system, extension into the government public agenda as well as the media. Likewise, they may be supplemented and enhanced with other Tax Administration strategies, such as those related to taxpayer assistance.

## **SOCIAL LEGITIMIZATION OF THE TAX POLICY AND CULTURE**

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### **INTRODUCTION**

An evaluation is made of the joint impact of tax policy and public expenditure in the distribution of income and household expenditures. The main purpose of this work is to summarize the results achieved by a study group formed by Latin American countries.

In this context, it is important to know how the Government, through its tax and expenditure policies, has modified the distribution of welfare in the region and extract policy lessons from said experience.

Detailed charts are shown below:



Graphic 1

**Theil's Index on the Distribution of Personal Income:  
Inequity originating within the country and from international comparison  
(1820 - 1992)**

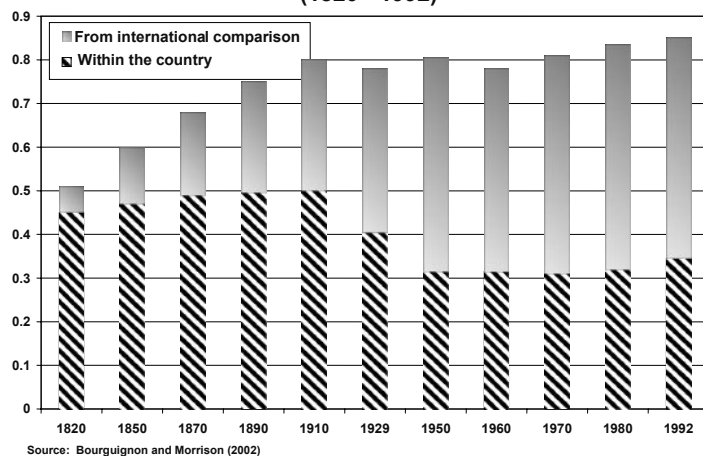


Chart 1

	Bolivia 2000	Colombia 2003	Ecuador 2003	Perú 2000	Venezuela 2003
<b>Deciles according to Per Capita Income</b>					
Gini from Income	0.556	0.537	0.407	0.535	0.423
% of Income of 20%+	0.63	0.60	0.47	0.57	0.57
% of Income of 40% - 20% + / 40% -	0.06 10.3	0.10 5.9	0.15 3.1	0.10 5.7	0.12 4.9
<b>Deciles according to Per Capita Expense</b>					
Gini from Expense	0.472	0.518	0.346	0.470	s/d
% of Expense of 20%+	0.55	0.58	0.43	0.53	s/d
% of Expense of 40%- 20% + / 40% -	0.11 5.2	0.10 5.5	0.20 2.2	0.14 3.9	s/d s/d

Chart 2

Income Distribution in the ANC according to World Bank			
	Year	Ginii	Decile10/Decile1
Bolivia	1999	57.8	143.5
Colombia	1999	57.6	57.8
Ecuador	1998	56.2	63.6
Peru	2000	49.4	46.2
Venezuela	1998	47.6	28.2

Chart 3

TAX STRUCTURE OF THE ANDEAN COMMUNITY COUNTRIES					
	Bolivia 2000	Colombia 2003	Ecuador 2003	Peru 2000	Venezuela 2003
<b>Total Tax Revenues</b>	<b>19.8</b>	<b>23.8</b>	<b>19.6</b>	<b>14.3</b>	<b>28.3</b>
<b>Tax Revenues – Soc. Sec. – EP</b>	<b>18.1</b>	<b>15.6</b>	<b>15.7</b>	<b>12.2</b>	<b>9.8</b>
VAT	5.6	6.3	6.4	4.9	4.7
Sales Tax	1.9	--	--	--	--
Excise	3.9	1.1	0.9	1.8	0.7
Other indirect	--	0.4	0.0	--	--
Income taxation	2.3	5.0	2.7	2.7	1.9
- Corporate	1.9	4.3	2.1	1.6	1.7
- Individuals	0.4	0.7	0.6	1.1	0.2
On Real State	2.9	1.8	0.2	0.0	--
Taxes on Foreign Trade	1.3	1.0	1.5	1.6	0.8
Others	--	--	4.0	1.2	1.7
Social Security Contributions	1.7	3.6	3.3	1.7	0.5
Surplus EPNF	--	4.6	0.6	0.4	18.0

Chart 4

<b>1. VAT</b>					
<i>Deciles according to home income</i>					
<b>1 Progressiveness. B</b>	<b>Bolivia (1)</b>	<b>Colombia</b>	<b>Ecuador</b>	<b>Perú</b>	<b>Venezuela</b>
Effective Tax/Income rate (in %)					
1st -	6.98	10.80	4.59	29.70	6.43
2nd -		8.56	4.15	13.30	7.16
2nd+		5.39	4.89	5.80	8.77
1st +	8.00	4.71	5.15	4.30	9.47
Gini income before VAT	0.556	0.537	0.408	0.535	0.423
Quasi - Gini of VAT	0.547	0.469	0.445	0.358	0.473
Kakwani (If<0=> regressive; If>0=> progressive)	-0.009	-0.068	0.038	-0.177	0.050
<b>2. Redistribution</b>	<b>Bolivia</b>	<b>Colombia</b>	<b>Ecuador</b>	<b>Perú</b>	<b>Venezuela</b>
Gini income after VAT	0.557	0.541	0.406	0.547	0.427
Transfer from 50%- to 50%+ (or from 50%+ to 50%-)	-0.05%	-0.20%	0.09%	-0.60%	-0.22%
Losers	2 y 3	1 al 6 y 9	9 y 10	1 al 8	10
Memo: VAT Collection (as % of GDP)	5.6	6.3	6.4	4.9	4.7
<i>/(1) Quintiles</i>					

Chart 5

<b>VAT- Who pays the tax?</b>	<b>Bolivia</b>	<b>Colombia</b>	<b>Ecuador</b>	<b>Perú</b>	<b>Venezuela</b>
<b>40% -</b>	<b>7%</b>	<b>14%</b>	<b>14%</b>	<b>19%</b>	<b>10%</b>
<b>20% +</b>	<b>62%</b>	<b>55%</b>	<b>52%</b>	<b>44%</b>	<b>60%</b>
<b>20% + / 40% -</b>	<b>8.9</b>	<b>4.0</b>	<b>3.7</b>	<b>2.3</b>	<b>6.2</b>

Chart 6

<b>Excise Taxes on Fuel</b>		
<i>Deciles according to home income</i>		
<b>1. Progressiveness</b>	<b>Bolivia (1)</b>	<b>Perú</b>
Effective Tax/Income rate (in %)		
1st -	13.95	0.40
2nd -		0.32
2nd +		1.04
1st +	2.43	2.34
Gini income before Tax	0.556	0.535
Cuasi – Gini Fuel	0.336	0.781
Kakwani (si<0=> regressive; si>0=> progressive)	-0.220	0.246
<b>2. Redistribution</b>	<b>Bolivia</b>	<b>Perú</b>
Gini income after Tax	0.565	0.532
Transfer from 50%+ to 50%- (or from 50%- to 50%+)	-0.45%	0.14%
Losers	1 al 4	10
<b>3. Who pays the tax</b>	<b>Bolivia</b>	<b>Perú</b>
40% -	17%	3%
20% +	39%	82%
20% + / 40% -	2.3	27.4
Memo: Collection as % of GDP	2.7	1.1
<i>(1) Quintiles</i>		

Chart 7

<b>Alcoholic Drinks (including Beer)</b>					
<i>Deciles according to home income</i>					
<b>1. Progressiveness</b>	<b>Bolivia (1)</b>	<b>Colombia</b>	<b>Ecuador</b>	<b>Perú</b>	<b>Venezuela</b>
Effective Tax/Income rate (in %)					
1st -	0.28	1.10	0.07	2.20	0.98
2nd -		1.27	0.06	0.90	0.78
2nd +		1.08	0.04	0.60	0.64
1st +	0.09	0.79	0.04	0.40	0.43
Gini income before Tax	0.556	0.537	0.408	0.535	0.423
Cuasi – Gini Alcoholic Drinks	0.415	0.432	0.313	0.425	0.287
Kakwani (si<0=> regressive; si>0=> progressive)	-0.141	-0.105	-0.095	-0.110	-0.136
<b>2. Redistribution</b>	<b>Bolivia</b>	<b>Colombia</b>	<b>Ecuador</b>	<b>Perú</b>	<b>Venezuela</b>
Gini income after Tax	0.556	0.538	0.408	0.536	0.424
Transfer from 50%+ to 50%- (or from 50%- to 50%+)	0.00%	-0.05%	0.00%	0.03%	-0.04%
Losers	1 al 4	3 al 7	1 al 7	1, 2, 6 y 9	1 al 9
<b>3. Who pays the tax</b>	<b>Bolivia</b>	<b>Colombia</b>	<b>Ecuador</b>	<b>Perú</b>	<b>Venezuela</b>
40% -	14%	13%	21%	15%	15%
20% +	48%	49%	41%	50%	44%
20% + / 40% -	3.3	3.8	1.9	3.3	2.9
<i>(1) Quintiles</i>					

Chart 8

<b>Excise Taxes on Tobacco and Tobacco By-products</b>					
<i>Deciles according to home income</i>					
<b>1. Progressiveness</b>	<b>Bolivia (1)</b>	<b>Colombia</b>	<b>Ecuador</b>	<b>Perú</b>	<b>Venezuela</b>
Effective Tax/Income rate (in %)					
1st -	0.53	0.98	0.08	0.28	1.97
2nd -		0.55	0.09	0.17	1.15
2nd+		0.15	0.18	0.06	0.65
1st+	0.04	0.11	0.17	0.05	0.34
Gini income before Tax	0.556	0.537	0.408	0.535	0.423
Cuasi – Gini Tobacco By-products	0.336	0.235	0.463	0.369	0.181
Kakwani (si<0=> regressive; si>0=> progressive)	-0.220	-0.302	0.056	-0.166	-0.242
<b>2. Redistribution</b>	<b>Bolivia</b>	<b>Colombia</b>	<b>Ecuador</b>	<b>Perú</b>	<b>Venezuela</b>
Gini income after Tax	0.556	0.538	0.407	0.535	0.425
Transfer from 50%- to 50%+ (or from 50%+ to 50%-)	0.00%	-0.05%	0.00%	-0.01%	-0.08%
Losers	1 al 4	1 al 5	6 y 8 al 10	1 al 7	1 al 8
<b>3. Who pays the tax</b>	<b>Bolivia</b>	<b>Colombia</b>	<b>Ecuador</b>	<b>Perú</b>	<b>Venezuela</b>
40% -	20%	28%	11%	19%	23%
20% +	43%	37%	50%	44%	37%
20% + / 40% -	2.1	1.3	4.6	2.4	1.6
<i>((1) Quintiles</i>					

Chart 9

<b>1. Progressiveness</b>	<b>Colombia</b>	<b>Ecuador</b>	<b>Peru</b>	<b>Venezuela</b>
Effective Tax/Income rate (in %)				
1st -	0.02	0.01	3.11	0.00
2nd -	0.08	0.04	1.06	0.00
2nd +	0.05	0.89	1.11	0.00
1st +	3.07	2.56	1.67	0.99
Gini income before Tax	0.537	0.408	0.535	0.423
Cuasi – Gini Individual Income Tax	0.894	0.831	0.582	0.840
Kakwani (si<0=> regressive; si>0=> progressive)	0.357	0.423	0.047	0.417
<b>2. Who pays the tax</b>	<b>Colombia</b>	<b>Ecuador</b>	<b>Perú</b>	<b>Venezuela</b>
40% -	0%	0%	10%	0%
20% +	99%	93%	64%	100%
20% + / 40% -	497.0	311.0	6.7	n/c
<i>Memo: Collection as % of GDP</i>	0.7	0.7	1.1	0.2

Chart 10



## Tax Structure of Latin America MERCOSUR and ANC

-2004-

Regions and Countries	% PBI						
	Total Income without social security)	Social Security	Direct Taxes	Indirect Taxes	General Goods and services	Specifics	Import duties
<b>MERCOSUR</b>	<b>26</b>	<b>6.2</b>	<b>7.8</b>	<b>18.2</b>	<b>13.3</b>	<b>1.52</b>	<b>0.98</b>
Argentina	23.3	3	8.5	14.8	9.5	2.1	3
Brazil	29.2	7.8	8.6	20.6	15.4	1.5	0.5
Paraguay	11.9	1.1	2.1	9.8	4.7	1.1	2.2
Uruguay	18.7	5.7	4.3	14.3	9.9	3	1.4
Venezuela	11.1	0.6	3.1	8	6.4	0.7	1
Chile	17.3	1.4	4.2	13.2	8.4	1.7	0.6
<b>Andean Community</b>	<b>15.4</b>	<b>2.4</b>	<b>6.1</b>	<b>9.3</b>	<b>5.9</b>	<b>1.7</b>	<b>1.1</b>
Bolivia	20.6	2.4	8.3	12.3	8.9	1	1.5
Colombia	17.6	2.8	8.4	9.2	5.9	2	0.9
Ecuador	9.6	3	2.3	7.3	5.2	0.6	1.4
Perú	13.3	1.6	3.9	9.5	5.4	2	1.2
<b>Latin America</b>	<b>20</b>	<b>4.1</b>	<b>6.7</b>	<b>13.3</b>	<b>6.5</b>	<b>1.7</b>	<b>0.7</b>

Note: The data of the regions are calculated as weighted averages

Chart 11: VAT

(Deciles according to Individual income)

	Progressiveness		Redistribution				
	Kakwani <sup>a</sup>	Transfer <sup>b</sup>	Losers	40% -	20% +	20% + / 40% -	VAT as % of GDP
Bolivia	-0.009	-0.05%	2 and 3	7.0%	62.0%	8.9	5.6
Colombia	-0.068	-0.20%	1 to 6 and 9	13.9%	55.4%	4.0	6.3
Ecuador	0.038	0.09%	9 and 10	14.1%	51.8%	3.7	6.4
Peru	-0.177	-0.60%	1 to 8	18.8%	43.8%	2.3	4.9
Venezuela	0.050	-0.22%	10	9.8%	60.5%	6.2	4.7
Costa Rica	-0.085	-0.16%	1 to 9	9.4%	62.2%	6.6	4.9
Dominican, Rep	-0.185	-0.25%	1 to 9	18.9%	46.1%	2.4	3.9
Guatemala	-0.136	-0.39%	1 to 8	16.5%	50.3%	3.0	4.8
Honduras	-0.090	-0.25%	Quint. 1 to 4	13.0%	54.0%	4.2	6.2
Nicaragua	-0.094	-0.17%	1 to 9	12.6%	55.8%	4.4	6.4
Panamá	-0.089	-0.06%	1 to 5 and 10	9.9%	60.0%	6.1	1.6

a (si<0> regressive; si>0> progressive)

b from 50%-to 50%+ (or from 50%+ to 50%-)

Chart 12: Individual Income Tax:  
(Deciles according to Individual income)

	Progressiveness					
	Kakwāni <sup>a</sup>	Transfer <sup>b</sup>	Losers	40% - 20%	+20% + / 40% -	
Colombia	0.357	0.80%	10	0.2%	99.4%	497.0
Ecuador	0.423	0.50%	10	0.3%	93.4%	311.0
Peru	0.047	0.13%	10	9.5%	63.6%	6.7
Venezuela	0.417	0.25%	10	0.0%	100.0%	n/c
Costa Rica	0.332	0.69%	10	0.2%	96.4%	482.0
Dominic, Rep.	0.397	0.62%	10	0.0%	96.9%	--
Guatemala	0.316	0.10%	10	1.9%	92.7%	48.8
Honduras	0.330	0.48%	Quintil 5	0.0%	95.3%	--
Nicaragua	0.348	0.76%	10	0.0%	94.3%	--
Panamá	0.631	0.85%	10	1.8%	95.5%	54.0

a (si<0> regressive; si>0> progressive)

b from 50%-to 50%+ (or from 50%+ to 50%-)

Chart 13:  
Individual Income Tax: Transfers

Country	Change in income participation from 10+ Transfer From 50+ to 50-			
	Before IIT	After IIT	Transfer	Transfer
Colombia (03)	44.5	43.7	-0.80	-0.15
Ecuador (03)	29.9	29.4	-0.50	-0.22
Peru (00)	41.2	41.1	-0.13	-0.02
Venezuela (03)	41.9	41.7	-0.25	-0.10
Honduras (05)	45.13	44.37	-0.76	-0.30
Panamá (05)	51.3	51.3	-0.04	-0.03
Guatemala (00)	49.3	49.2	-0.09	-0.03
Nicaragua (01)	48.91	48.15	-0.76	-0.16
Costa Rica (04)	46.73	46.03	-0.70	-0.26
Dominican Rep. (04)	45.28	44.65	-0.63	-0.22

## **SOCIAL LEGITIMATION OF THE TAX POLICY AND CULTURE**

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*CONTENTS: Introduction. -Part I: Overview. -1. Legitimacy. -2. Fairness of the Tax System. -3. The virtual circle of tax compliance and the vicious circle of tax evasion. -4. Public power to challenge decisions. -5. Competencies and credibility of the Tax Administration and the tax policy bodies. -6. Expenditure or employment of revenue. -Part II: Brief description of certain SUNAT products that promote a greater degree of legitimacy. -a) Virtualization. -b) Tax booths. -c) Auditing, control, neutrality and risk management. -d) Long-term culture and Peru Generation. -e) Transparency. -Part III. -1. Context and diagnosis. -2. Objectives. -3. Implementation. -a. Planning process. -b. Creating the general framework for the interaction and objectives in each working group. -c. Terms. -d. Counterparts and allies. -e. Theme-based working groups. -4. Difficulties. -5. Results. -Annex 1. -*

### **INTRODUCTION**

This document addresses the topic of the social legitimation of the Tax Policy and Culture. Hereunder, after certain general ideas on the topic, we shall propose and describe, to the fullest extent possible within the space limitations, the experience of the Tax Administration of Peru on such issue.

Currently, taxes are related to States with societies in which the rule of law is peacefully accepted as a general coexistence standard. In such societies, it is assumed that the majority of citizens meet their legal obligations and, among them, the tax obligations, and those who proceed otherwise are punished to the fullest extent permitted by law, as it should be.



Nevertheless, coercion and control of compliance with tax obligations are and have been the most traditional means to ensure and improve the levels of compliance with the tax obligations. Additionally, and very clearly, citizens' spontaneous cooperative attitudes as regards the payment of taxes seem to be the exception in a significant number of modern societies.

Nevertheless, collection or the improvement thereof shall not exclusively rely on a model based on coercion by the State and its tax administration. Not only would the coercion effort required to undertake this be inadmissible in democratic systems, but also, excessively onerous and unjustifiable.<sup>1</sup> Additionally, the optimum degree of the auditing effort is determined not only by the resources employed by the State and the revenue of the tax administration, but also by the costs related to the distortions occasioned by the increases in tax rates and the marginal benefit of government expenditure.<sup>2</sup>

Therefore, the good performance of the tax systems requires a good dose of taxpayer cooperation.

The cooperation on the basis of voluntary compliance and coercion involved in the control of compliance and noncompliance with tax obligations is not, in fact, an alternative procedure, but a supplementary one to facilitate tax collection and the improvement thereof. Currently, it is clear that "controlling" noncompliance or "facilitating" and promoting compliance with tax obligations does not constitute a true dilemma.

The degree of effort in controlling and promoting voluntary compliance involved in collection chiefly depends on the relative costs thereof, of the tax gap to be bridged and the stage of development and effectiveness of the democratic mechanisms available in society at a given time.

One of the first conditions for the collaboration of taxpayers to occur is the existence of citizens' awareness regarding the civic duty represented by the payment of taxes (the tax culture), but for such purpose, it is necessary that a broad spectrum of society internalizes the legitimate nature of the tax policy and the tax culture to be disseminated. Thus, the relevance of studies to discover the variables that influence taxpayers'

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<sup>1</sup> Sevilla Segura, José. *Tax Policy and Procedure*. Institute for Tax Studies. Madrid. 2004. p. 164.

<sup>2</sup> *The Tax System and its Effect on the Performance of the Economy: a Review of the Bibliography*. Pablo Serra. Working Document. Central Bank of Chile, December 1998. p. 5.

voluntary compliance, and among them, the relevance attached to the variable on the “social acceptance and legitimation” of taxes.

“The social acceptance of taxes may be improved: if its enforcement stems from a broad political consensus; if citizens, in general, understand that the system is fair and that public revenue is used effectively; if citizens rely on adequate education and information and, finally, if the administration facilitates citizens’ compliance with their obligations”<sup>3</sup>

## **PART I: OVERVIEW**

### **1. LEGITIMACY<sup>4</sup>:**

Firstly, we shall be aware of the fact that the policies that seek to improve the social legitimacy of taxes may require administrative reforms that go beyond the scope of the tax administration’s performance and, therefore, affect the public sector in general –existence of a public administrative career, stable and well-remunerated; an independent tax administration, with a sufficient degree of limited discretionary power; institutional *ex post* controls that enable government officials to perform as facilitators, etc-.

Thus, the social legitimation of the tax policy and the tax culture could feature all the dimensions coverable in a study of the public sector overall (including the structure and strengthening of institutions, as well as the democratic mechanisms of society). Such a broad scope is not the subject of this document, and neither is it relevant thereto. Notwithstanding, this notion is worth remembering, since, legitimacy is not a topic or a task that the Tax Administration may cover completely or achieve on its own; in other words, it shall inevitably involve the performance of a number of actors and the need of political will, resources, and a good and strong guidance.

In order to legitimate taxes and motivate citizens’ voluntary compliance, the latter shall perceive that the taxes established are fair and met by the totality of taxpayers and, additionally, that the revenue obtained is employed appropriately. We shall briefly address these notions.

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<sup>3</sup> *Sevilla Segura, José. Tax Policy and Procedure. Institute for Tax Studies. Madrid. 2004. p. 165.*

<sup>4</sup> *Legitimacy. 1. f. The quality of legitimate. Legitimate. 3. adj. Certain, genuine and truthful in any respect. DICTIONARY OF THE SPANISH LANGUAGE – Twenty-second Edition.*

## 2. FAIRNESS OF THE TAX SYSTEM

The first variable that contributes to the social acceptance of taxes is the broad conviction regarding the fairness of taxes. Therefore, a precondition for the social acceptance of the tax is that citizens perceive fairness in the design of the tax policy.<sup>5</sup>

The features of the tax structures in the countries stem from the political and institutional forces difficult to modify. The probability of success of the minimum and necessary consensus underlying the tax regulations depends, among other factors, on political and social pressures and restrictions faced by the State in the effort to collect taxes. Therefore, minimum consensus is required as well as democratic channels and instruments to obtain fair outcomes of the tax policy.

Notwithstanding, taxes and the form by which they are collected are perceived by large sectors of the world population as inequitable and cumbersome, with the broad opinion that there is malfeasance and inefficient use of government resources.<sup>6</sup>

Latin American governments shall foster long-term tax agreements on the basis of certain policies and strategies.

From the procedural standpoint, they may promote regulations and practices that improve fiscal transparency; they shall lead the discussion on the tax issues, for example, by supporting the institutions with political independence and technical capacity that contribute in the improvement of the tax discussion or foster innovative modalities for the direct participation of citizens in tax decisions.

The elements of a tax system within a democratic system, by definition, are represented in the will of the majority. Depending on the features of the political process, the creation of regulations –the tax policy– could also admit a certain degree of citizens' intervention. Resorting to the opinion of experts, of the taxpayers who shall bear the burden and costs of taxation, discussing and listening to the stakeholders, helps not only to disseminate tax regulations in advance<sup>7</sup>, but also to internalize the need of their enactment and the fairness and equity of the measures, strengthening their social acceptance.

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<sup>5</sup> *The Tax System and its Effect on...* p. 8.

<sup>6</sup> *The Fiscal Agreements in Latin America. IDB. Research Department. Vol. 12, January-April 2007. p. 1.*

<sup>7</sup> *Sevilla Segura, José. Tax Policy and Procedure. Institute for Tax Studies. Madrid. 2004. p. 165.*

From the substantive standpoint, the fairness of the tax policies and the tax systems is empowered by emphasizing the balance of the principles of taxation –broadly known and disseminated- incorporated in the tax policy discussion and outcome.

**Efficiency.** The concept of neutrality is tied to the notion of efficiency, which arises from the optimum allocation of resources via the market. In order for taxation to be neutral, it shall distort the allocation of resources via the market to the minimum extent possible.

**Simplicity.** It entails a small number of taxes, with high yields and few exemptions and the removal of specific tax incentives. The tax system should feature low compliance and administration costs.

**Flexibility.** It refers to the adaptability of the tax system in the face of changes in circumstances.

**Fairness.** Equal treatment to those in similar circumstances and different treatment for those in a different condition to bear the burdens imposed by taxes.

**Responsibility.** The tax system shall be transparent in order to generate the political, administrative and legal responsibilities of the measures adopted.

### **3. THE VIRTUAL CIRCLE OF TAX COMPLIANCE AND THE VICIOUS CIRCLE OF TAX EVASION**

Another requirement for the social legitimation of taxes is that citizens perceive that the majority of taxpayers meet their tax obligations. When tax evasion becomes pervasive, taxpayers feel less compelled to meet their tax obligations.

In social psychology, the broad notion exists that subjects observe the behavior of others to decide what is acceptable, reasonable or expected in their social environment (Cullis and Lewis, 1997).

Spicer and Lundstedt (1976) provide econometric evidence that the number of tax evaders known for an individual makes tax evasion more likely, and also detect that the feeling of discomfort that makes an evader act against his/her principles may psychologically stimulate a change in the individual's inherent original beliefs.

In a significant number of countries, the majority of citizens fail to meet their legal and tax obligations and, surprisingly, such attitude does not generate the social rejection we would expect. In such societies, in spite of the punitive laws in effect that, in many cases, include broad and modern typifications -even of a criminal nature- the enforcement of such legal penalties and imprisonment for tax evasion crimes have very little incidence, in other words, they are uncommon.

Unfortunately, in Peru there is still a high tolerance towards tax evasion. Effectively, although 92% of citizens consider that avoiding the use of payment receipts in order to avoid taxes is an act of corruption, 75% of the population features a high or medium tolerance regarding this behavior and, in general, 70% tolerates tax evasion if certain that he/she shall be go unnoticed.<sup>8</sup>

Literature indicates that voluntary compliance is a self-reinforcing variable: the higher the number of complying individuals, the greater the number of individuals who decide to comply.<sup>9</sup> This “virtuous circle” is inversely related to the “vicious circle” of tax evasion, according to which the latter thrives on feedback, since personal behavior also depends on the degree of respect for the social traditions and the degree of coincidence with the behavior of other taxpayers –compliant individuals tend to be “more honest”, but also tend to believe that tax evasion is less than compliance-.<sup>10</sup>

This is a field in which there is supplementary concurrence of the coercion that compels a certain number of subjects to comply and therewith, as a byproduct or indirect effect, the voluntary compliance produced in those who follow the exemplifying behavior, even when it has been induced.

#### **4. PUBLIC POWER TO CHALLENGE DECISIONS**

The public power to challenge decisions is the possibility of challenging the decisions on tax matters and the allocation of revenue in public hearings. The public power to challenge decisions is essential for the citizens to perceive the tax policy and the outcomes thereof, taxes, as legitimate, in order to spur the highest degree of voluntary compliance with tax obligations. In turn, the public power to challenge decisions depends on:<sup>11</sup>

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<sup>8</sup> *PROÉTICA / CONFIEP and PUCP surveys.*

<sup>9</sup> *Sevilla Segura, José. p. 166.*

<sup>10</sup> *The Tax System and its Effect... p. 12.*

The visibility of taxes. Property and income taxes are more visible or perceptible for citizens than VAT, and the latter is more visible than the taxes on production and foreign trade.

The simplicity of the tax system. When the tax system is made up by rules or regulations with clear and distinct mandates, the understanding and discussion of the tax policies by experts as well as laymen is facilitated, and therefore, ultimately, voluntary compliance itself. Additionally, experience indicates that the cost of administering a tax, as well as the possibilities of tax evasion and tax avoidance, increase with the complexity of the tax.<sup>12</sup>

The level of consolidation of the available democratic mechanisms in society and the law is worth mentioning.

## **5. COMPETENCIES AND CREDIBILITY OF THE TAX ADMINISTRATION AND THE TAX POLICY BODIES**

Another relevant factor or source of legitimacy is based on the credibility in the leadership of the Tax Administration and the other bodies in charge of the tax policy design and formulation, human resources' skills, quality of service and transparency and accountability.

Among other reasons, credibility is based on the appropriate exercise by the Tax Administration and the public instances devoted to the tax policy of their functions or powers, with full respect for tax equity –the public administration loses legitimacy if its public power is used inequitably and with disregard for the rights of citizens and taxpayers<sup>13</sup>–

The tax debtors' perception of the equity of the tax administration and the tax policy bodies in the exercise of their functions influences their willingness as regards compliance with tax obligations.

The performance of the competencies and the services of the Tax Administrations, as well as the public institutions in general, take up

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<sup>11</sup> *The Fiscal Agreements in Latin America. IDB. Research Department. Vol. 12, January-April 2007. p.5.*

<sup>12</sup> *The Tax System and its Effect on... p. 32*

<sup>13</sup> *A survey on tax administrations in the OECD-member countries in 2004 indicated that two thirds featured formal statements that specified the rights of taxpayers and the services to be expected from the Administration. Tax Administrations in OECD and Selected Non-OECD Countries: Comparative Information Series 2006 (February 2007). Prepared by Forum on Tax Administration. OECD. p. 48.*

a significant portion of the government budgets. Society's demand for services increases, while, on the other hand, the State is faced with increasingly greater budgetary restrictions. Society expects services with greater value, that is to say, an improvement and a lower cost thereof. The dilemma of the States and the Tax Administrations therein, is either to increase the productivity and the quality of their services, or reduce them. The pressure exerted on the States arises from the demand for services with better efficiency, efficacy and accountability.

The Tax Administrations and the tax policy bodies that duly and equitably meet their basic functions of providing resources to the State, reducing compliance costs for tax debtors<sup>14</sup>, contributing to the tax base expansion, combating and reducing tax evasion, increasing the tax culture, win the trust and credibility of their subjects.

Additionally, the functions and services undertaken by the Tax Administration and the bodies of the tax policy shall be delivered by officials who show:

- a. **Honesty:** understood as a behavior according to ethical norms and principles, without pursuing personal advantages or benefits.
- b. **Service culture:** focusing actions at knowing, satisfying and exceeding taxpayers, users of foreign trade and workers' expectations, assisting in facilitating tax compliance by simplification and guidance.
- c. **Excellence:** willingness to make the greatest effort, obtain ongoing best results in time, achieving taxpayers, users of foreign trade and workers' satisfaction, with resource efficiency, minimizing costs and optimizing the quality of services.
- d. **Innovation:** capacity of modifying things even on the basis of unprecedented methods. Guiding others in their actions, simplifying procedures and improving services.
- e. **Integrity:** understood as the capacity of being consistent with institutional principles and actions. Maintaining the image of government official even by ensuring that private life and behavior do not interfere with this responsibility.

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<sup>14</sup> *Almost all the OECD-member countries issue general rulings that are disclosed to the public and, upon taxpayers' request, private rulings. In the last few years, the Nordic countries and Chile and Spain have issued pre-filled tax returns for taxpayers. Both experiences increase predictability, while reducing taxpayer compliance costs. Tax Administrations in OECD, p. 60 and 83.*

## 6. EXPENDITURE OR EMPLOYMENT OF REVENUE

Another precondition for the social legitimation of the tax policy and the tax culture is the role played by the dissemination of the revenue basis and the knowledge of the appropriate allocation thereof.

When we refer to the social legitimation of the tax policy and the tax culture, from the standpoint of government expenditure and the operation of the State mechanism, on the one side, reference is made to the historic experiences of civil disobedience as regards the payment of taxes.

In the 1st century of our era, the Zealots were accused of promoting a tax resistance against the Romans. Jesus himself was accused of instigating a tax resistance against Rome prior to his prosecution.<sup>15</sup>

Over one century ago, a group of non-Anglican British citizens initiated a large-scale tax resistance campaign against the subsidies granted by the government to religious schools.

In 1964, singer Joan Baez made tax resistance a national issue when she publicly announced her decision to withhold 60% of the taxes she was required to pay that were allocated to funding the Vietnam War. The American pacifist A. J. Muste –who in 1948 founded the tax resistance group by the name of Peacemakers- issued a Tax Resistance statement that was endorsed by Baez, pacifist David Dellinger, poet Lawrence Ferlinghetti, MIT linguist Noam Chomsky, Nobel Prize winner Albert Szent-Gyorgyi and thousands of others.

For the opponents of the tax resistance tactics, civism and social ethics should lead the good citizen to subjection to the sovereignty of the liberal states and governments that represent the majority of citizens. The good citizen, as stated,<sup>16</sup> should comply and promote the changes via the constitutionally admitted methods, and not by means of civil disobedience.

But, it is not necessary to go to extremes such as anti-war, religious or conscientious objections to admit the inappropriate allocation of the

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<sup>15</sup> **“Then, the whole assembly of them arose and brought before him Pilate. They brought charges against him saying: “We found this man misleading our people; he opposes the payment of taxes to Caesar and maintains that he is Christ, a king.” (Luke 23, 1-2).**

<sup>16</sup> *The Ethics of Passive Resistance.* Rev. J. G. James. *International Journal of Ethics*, 1904.



revenue collected and the inefficient operation of the state mechanism, grounds that may reasonably deprive the tax policy and the tax culture of legitimacy and, therefore, negatively impact voluntary compliance with taxes.

The Committee on Taxation and Citizenship established by the British Fabian Society concluded in its final report delivered in the year 2000 that the prevailing feeling in the perception of the British regarding the tax system and public and state services was described as a “disconnection”.<sup>17</sup> Such disconnection reduces the public support of any tax system and fosters tax resistance, generating a fertile ground for tax evasion and tax avoidance.

Presently, the State's performance vis-à-vis tax matters is under close scrutiny by the population. According to data from Latinbarometer for 2003, 75% of Latin-Americans consider that taxes are not used efficiently; only 31% is satisfied with the quality of health services and 51% with the education they receive.

On the other hand, according to the Global Competitiveness Report for 2005, on a scale from 1 to 7, the businessmen surveyed consider that the quality of public schools scores 2.5, the quality of infrastructure 3.1 and the quality of government expenditure overall, 2.6.<sup>18</sup>

The extent by which tax evasion and tax avoidance may become “intolerable” in society depends to a certain degree on the perception of the government administration: the greater the weaknesses of the inefficient government allocation of revenue, the lesser the loss tied to tax evasion (Cullis and Jones, 1998, p.208).

The social expenditure that is effectively allocated and efficiently implemented is one of the key instruments of the tax policy to improve equity in the distribution of income and meet the basic needs.<sup>19</sup> The social expenditure may also bear a negative impact on the economy and the willingness towards voluntary compliance with tax obligations, since, it may grant inappropriate incentives to the economic agents or otherwise be badly administered, contributing to the impairment of the legitimacy of the tax instrument in both assumptions, and impacting the perception thereof as an instrument of fairness.

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<sup>17</sup> *Owing to the lack of knowledge regarding the tax system, the level of taxes in international comparative terms and of the purpose and employment of resources, as well as the evidence of squandering and low quality of the public services rendered.*

<sup>18</sup> *Data taken from The Tax Agreements in Latin America. IDB. Research Department. Vol. 12, January-April 2007. p. 1.*

<sup>19</sup> *The Equity of the Tax Policy in Andean Countries. Andean Affairs Bulletins, May 2007, Andean Community p. 13.*

## **PART II: BRIEF DESCRIPTION OF CERTAIN SUNAT PRODUCTS THAT PROMOTE A GREATER DEGREE OF LEGITIMACY**

We have previously mentioned the general idea that the policies that seek to improve the social legitimacy of taxes require an endless number of actions that exceed the Tax Administrations' mere scope of performance.

Likewise, as regards Peru, we highlighted the high tolerance towards tax evasion: 75% of the population features a high or medium tolerance for this behavior and, in general, 70% tolerates tax evasion if they feel certain they shall go unnoticed.

Nevertheless, the latter data differ with citizens' perception of their national tax administration (SUNAT, as per the Spanish acronym) according to the outcomes rendered by the survey "The Government Administration in Peru (2007)" that set forth that 76% of the survey respondents think that the current SUNAT performance is positive for the country's business environment.

On the other hand, 56% of the population trusts the SUNAT<sup>20</sup>. This percentage, although small, has been consistently improving since the surveys were started in 2003.

Likewise, 61.4% of businessmen trust SUNAT<sup>21</sup>.

Considering these variables, we shall describe a series of actions that the Tax Administration of Peru has adopted, which we consider have had and still have an impact in promoting improvements of the social legitimacy of the tax policy and the tax culture.

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<sup>20</sup> *Information from the IV Annual survey on trust in the institutions – Metropolitan Lima and Callao, conducted in October 2007 by the Public Opinion Group of the University of Lima.*

<sup>21</sup> *Information from the VIII Annual survey for business leaders on the economic and business situation in Peru – conducted in October 2007 by the Public Opinion Group of the University of Lima, with the samples taken from Board Chairmen of the top 1,000 companies in the country during 2006, according to the ranking developed by Peru: The top 10,000 companies. Perú Top Publications. Lima. 2007.*

### a) Virtualization

As we have mentioned before, the good performance of the tax systems requires a good degree of taxpayers' voluntary compliance and this is easier to achieve to the extent the compliance cost is low and tolerable.

Along such lines, SUNAT has undertaken a number of modifications of its processes in order to systematize a significant part of the interaction among taxpayers and SUNAT, taking advantage of information technology as a channel to facilitate compliance while increasing the tax control level.<sup>22</sup>

For such purposes, SUNAT has identified the steps or formalities required from a taxpayer in the ideal business life cycle, starting with registration in the Single Taxpayers' Registry, compliance with monthly obligations, authorization to print payment receipts and the eventual transactions regarding the changes in the information provided by the taxpayer at the time of registration.



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<sup>22</sup> Facilitation shall not be deemed lack of control. In fact, it refers to controlling to the same extent or even more strictly, but with alternative tools that are friendlier and more cost-effective, whether because they generated savings for the taxpayer (lower compliance costs) or for the Tax Administration (lower administration costs).

Considering this taxpayer life cycle, numerous products and services have been developed, such as:

**1. Registration:**

- a. Registration of individuals via the Internet,
- b. Modification of the data on the Single Taxpayers' Registry (RUC, as per the Spanish acronym) via the Internet (individuals and corporations),
- c. Likewise, a project is underway for the integration with notaries and public registries, in order to simplify the registration of corporations in the RUC, in order to eliminate such step. This project should be implemented in the first semester of this year.

**2. Tax statement and payment:**

- a. Filing tax statements completed with the Electronic Filing System (PDT, as per the Spanish acronym), a software created by SUNAT, available free of charge for taxpayers, via the Internet,
- b. Payment of tax statements via the Internet, against a predefined account or with credit or debit card,
- c. Filing requests to stop income tax withholdings for self-employed individuals via the Internet,
- d. Payment of collection documents issued by the administration,
- e. Filing refinancing requests for tax debts; this includes monitoring and pre-rating.

**3. Payment receipts:**

Presently, the authorization to print payment receipts does not entail an additional formality for the taxpayer, since for a number of years this procedure has been performed directly in the authorized printing house selected by the taxpayer for such purpose. In this respect, almost 100% of the authorizations are performed with the virtual options enabled by SUNAT.

At the same time, SUNAT has been developing a project for the electronic issuance of receipts for professional fees and electronic invoicing, which shall be phased in during the first semester of 2008.

It is worth mentioning that in order to access virtual formalities, the administration grants the taxpayer an access code for the secure

SUNAT Virtual Online Operations (SOL, as per the Spanish acronym), which is called **SOL Code**, free of charge. Presently, over 2 million taxpayers rely on this code that is delivered in person employing similar security levels to those of a banking institution in delivering account or credit card codes.

#### 4. Accounting:

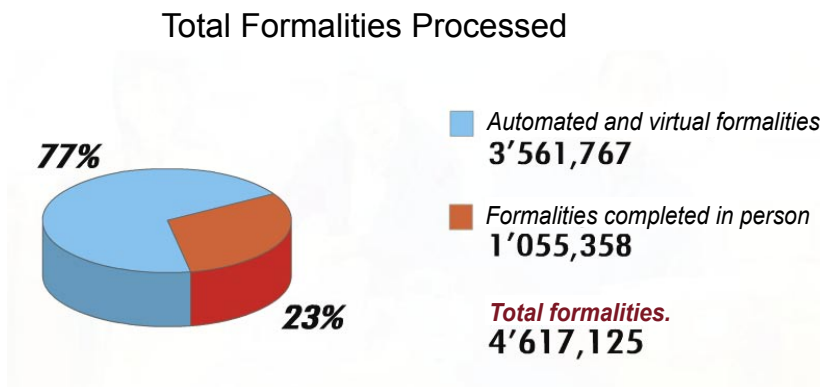
The project for the electronic receipts for professional fees foresees the automated generation of the income and expenses book subsequently, which shall be available on SUNAT's Internet portal.

#### 5. Others:

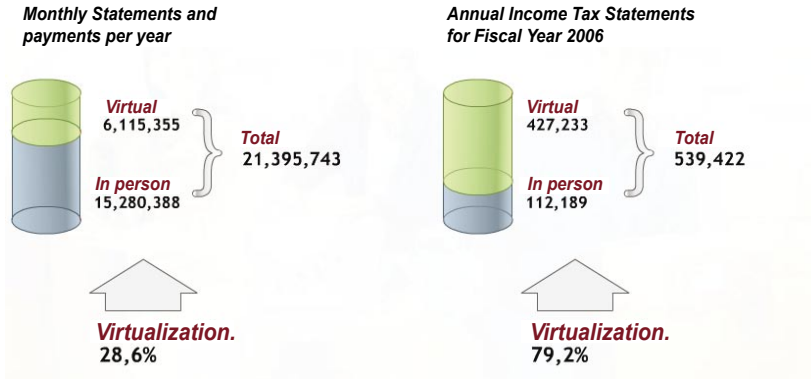
Implementation of portals for specific segments, with ad-hoc information according to the taxpayer universe, in a simple and clear language. We plan to implement 3 portals: for small and medium-sized taxpayers, for foreign investors (including information in English) and for self-employed workers.

#### Outcomes:

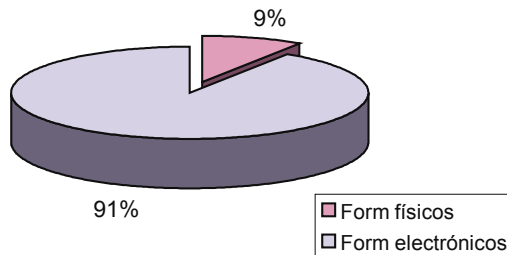
Hereunder, we present figures on the number of formalities processed in 2007, and monthly and annual tax statements and payments. It is worth mentioning that in the case of the monthly statements and payments, 91% are submitted without a form, whether via the PDT or Easy Payment system (by which the taxpayer delivers information to the bank teller verbally to make the statement and/or payment, and the latter validates the information) and 9% via a physical medium.



### Service Channel Statistics



### TAX STATEMENTS ACCORDING TO FILING METHOD



Printed forms vs. Electronic forms.

#### b) Tax booths

SUNAT, in order to fulfill its collection functions, has been implementing a number of electronic solutions that require taxpayers' intensive use of Information and Communications Technologies (ICT), in order to facilitate their compliance and optimize the access to their information. Under this framework, it has enabled Internet-based tax statements since the end of 2003.

Nevertheless, this technological advance faced an important challenge: in our country the digital gap is very broad, understood as the lack of access of the majority of the population to the Information and Communications Technologies. Currently, two-thirds of the citizens

that access the Internet are individuals from Socioeconomic Levels C, D and E, and only 14% has an Internet connection at home, out of which approximately 44% is aged between 18 and 35. Likewise, the chief indicators of the use of ICTs in Latin America stated that Peru was among the countries with the poorest technological infrastructure in the region, mostly regarding PCs and telephone lines that facilitate access to the Internet. In particular, SUNAT had a few PC for public use to enable taxpayers to complete the Electronic Statement Program (PDT, as per the Spanish acronym), but said devices were not connected to the Intranet and had no Internet access.

Considering that the majority of the population had no PCs at home and the importance of the Internet connection in order to access electronic services, SUNAT implemented the Tax Booths in their Taxpayer Service Centers, which are available for citizens nationwide.

With a view to facing the digital gap, SUNAT created a model booth with infrastructure and equipment (PCs and printers) to provide access to their virtualized services, designing and implementing a secure access system, free of charge, to said technology in the majority of the Taxpayer Service Centers nationwide. This model is described hereunder:

1. We have taken advantage of the IT equipment available from the replacement of technology of internal SUNAT users, which were operational and fit to be used in the booths.
2. We used the existent infrastructure in the Taxpayers' Service Centers, which required the installation of modules for the booths.
3. Open source software was employed to the extent possible.
4. In order not to affect the existing security levels and mainly to avoid jeopardizing the SUNAT Intranet, we installed a parallel network to the one in the Taxpayers' Service Centers. This entailed savings in certain types of existing equipment.
5. In order to avoid the misuse of the booths, we have restricted access to the Web sites that are unrelated to tax issues and likewise, assigned staff for direct assistance to the users of the booths, who also control them.

The outcomes are very encouraging.

- As of the year 2007, we have implemented **51 Tax Booths** in different institutional branches, where we have installed over **250 PCs** and assistance is provided to taxpayers as regards the use

of the virtual services. This has enabled to greatly exceed 2 million users assisted via this tool.

- Conservative figures<sup>23</sup> indicate that the implementation of the booths has saved taxpayers in excess of S/. 1 million (approximately US\$ 330 thousand) in PC rentals for public booths.
- The Tax Booths offer a personalized assistance service on the use of the virtual SUNAT products, free of charge, also contributing to prepare the citizen, so that, when he/she relies on a connection of his/her own, he/she may complete procedures without difficulties.
- The model applied is simple but highly reliable, which makes it easy to replicate and could serve as an example for other institutions that decide to provide access to their users.

In this regards, it worth mentioning that the replication efforts have been already proven, since the Accountants' Association of Lima is facilitating the temporary set up of our Tax Booths in their offices, during the Income Tax returns submittal period for the fiscal year.

Also, SUNAT won the APEC contest- Digital Opportunity Center 2006 (Asia - Pacific Economic Cooperation) in the digital gap category, with the Tax Booths product, presented under the name of Taxpayers' Internet Booth.

### **c) Auditing, control, neutrality and risk management**

The effective burden of the tax system on taxpayers depends not only on those who are in charge of legislating on tax matters, but also on those who administrate them and the way in which they do so.<sup>24</sup> In such regard, the control strategy is not only relevant per se in order to achieve the tax administration's strategic objectives, but it may also become a hurdle to achieve a higher objective such as the improvement of tax awareness and the resulting voluntary compliance.

On the basis of this scenario, the selection criteria for taxpayers to be audited, as well as the form and focus of such audits, may significantly influence citizens' perception regarding the degree of equity of the tax

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<sup>23</sup> Calculations assume that taxpayers take half an hour to complete their statement and the cost of renting a PC in an Internet booth for that amount of time is approximately S/. 0.5 or US\$ 0.17.

<sup>24</sup> Scotchmer, 1992.



system. In other words, the more arbitrary the selection of the taxpayers or the greater disparity in the forms of controlling taxpayers of different “size”, the greater the perception of inequity among taxpayers, which impacts the legitimacy of the tax system and consequently, fosters tax noncompliance (via tax avoidance or tax evasion).

The Risk Management criteria apply in this scenario. This type of analysis is broadly known and is geared at promoting taxpayers' voluntary compliance by means of two channels:

1. On the one hand, it seeks to rationalize the auditing actions so they are geared at the segments of taxpayers with a greater noncompliance risk, or alternatively, where the multiplying effect in each auditing action is maximized.

Therefore, selection is based on the intelligent use of the information from internal sources as well as third-parties, thus comparing the truthfulness and accuracy of the statements delivered by taxpayers while taking increasing advantage of the new technological facilities.

2. Additionally, the allocation should be cost-effective, in order to strike a balance between the audit coverage and depth, considering that Tax Administrations rely on limited resources.

Thus, the performance of in-depth and long-term audits shall be reserved for very special cases, in which the amounts involved and the modalities of tax avoidance or tax evasion are more sophisticated. At the same time, intermediate scope controls are applied on specific taxpayers' segments (according to their economic sector, size, geographic location, market and others) and, also, a large number of mass audits are conducted expeditiously and at a low cost in order to maintain the perception of risk in the largest groups of taxpayers.

In this regard, risk management not only enables a more effective and efficient performance of the tax administration, but is also the key element to reflect a greater equity of the tax system and support the ongoing efforts to generate a strong tax awareness in time.

#### **d) Long-term culture and Peru Generation**

It is clear that legitimacy may not exist without prior knowledge of the role of the State and of taxes.

This entails the need to develop a tax culture in the population, in order for the citizen to become aware of the need and benefit of paying taxes and forsake the tolerance towards tax evasion and tax avoidance. Evidently, such effort shall be successful only if it goes hand in hand with a sustained effort to make the State performance more transparent and efficient, so that the payment of taxes may be justified as the condition that enables to rely on a state mechanism that duly sees to citizens' demands and needs. Thus, the effort towards the Tax Reform shall go inevitably hand in hand with a call to the State's modernization and strengthening.

SUNAT has deemed the creation of tax awareness as one of its strategic institutional objectives for the 2007-2011 periods, with the purpose of reducing tolerance towards tax evasion and tax fraud by strengthening civic values.

In such regard, although the activities related to tax education in SUNAT date back to 1993, they become especially relevant in 2007 with the launching of the Generation Peru Project, which seeks to generate stronger values among citizens and greater social cohesion and economic competitiveness on the basis of two components:

The civic values' component (including tax awareness) includes a Tax Culture and Awareness Program.

This program initially seeks to instill civic values in children, and promote the rejection of tax evasion and contraband in young individuals. Likewise, it promotes tax compliance for citizens overall.

As regards professors, the curriculum has been modified, introducing a 120-hour course certified by the Ministry of Education of Peru, which includes tax contents and provides tools to facilitate the educational work overall, not only with regards to tax matters. The program's goal is to generate 10 thousand trained professors by 2011.

On the other hand, students receive this content by means of plays, puppets, games, didactic material, illustrated books, fairs, and others.

Obviously, the contents shall be adapted to students' age and until 2011 we plan to involve 120 thousand kindergarten and elementary school students (ages between 5 and 12) and 80 thousand high school students (ages between 12 and 17)<sup>25</sup>.

It is worth underlining that for this audience, we have recently launched the character by the name of Ayni (a small Humboldt penguin), whose name means "collaborative work" in Quechua. Ayni has the mission of promoting values in children together with Mateo and Clarita.

As regards higher education, we periodically hold seminars, university meetings, essay contests and courses for the schools of education, law, administration, accounting and economics, among others. The goal in this segment is to reach 40 thousand young students by the year 2011.

Finally, the rest of the population is covered via short radio broadcasts, newspaper articles, participation in fairs, plays, virtual contests and other similar initiatives.

As regards competitiveness, the Program to Improve Entrepreneurs' Skills has been established.

This program seeks to overcome part of the limitations faced by small entrepreneurs in Peru. Among them, we may mention the low educational level, the culture of informality, the lack of management and accounting skills, lag in the adoption of technology, inadequate market insertion, high cost of access to credit, among others; which entail low productivity and competitiveness, informality, lower profitability, and greater mortality.

The program has foreseen employing young students as a mechanism to convey knowledge and development. Therefore, this impacts not only the business venture but the young individual him/herself, enabling better training and the opportunity of quickly gaining working experience.

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<sup>25</sup> *The initiatives described are based on two criteria:*

- *Students and teachers are the key players in the educational process.*
- *The school system and extra-curricular activities are the environments in which the socialization processes occur.*

For such purpose, the State has opened a selection process for one thousand young students from State universities in the last courses of their careers in order for them to attend an extensive course on business issues (among which the tax issue is an important but not exclusive component). Upon concluding the course, participants shall be invited to visit approximately 10 thousand small businesses to assist and convey knowledge in the course of a year.

At this point, it should be mentioned that professors shall permanently monitor and assist the young students of the course and they shall become the link between the entrepreneur and the specialists from multiple state entities.

It is also worth noting that the course as well as participants' remuneration during the course and for their year as assistants subsequently, shall be assumed by the State.

As it stems from the discussion at the beginning of this document, Generation Peru is a project aimed at setting the groundwork for long-term legitimacy, competitiveness and social cohesion and in such regard, the outcome of greater tax compliance is only one of its results.

#### **e) Transparency**

After asserting that the State plays a social role, it is necessary to emphasize that – at least in the democratic states – such function entails commitments with the citizenry and one of its chief commitments is related to accountability and transparency in the access to public information. In effect, relying on public information that objectively answers the questions on government expenditure costing, financing, the beneficiaries thereof (and those who do not benefit), its distribution, and the evaluation of the quality of the service rendered are extremely relevant for citizens since transparency enables the discussion of the government acts and also, deters officials from behaving inappropriately.

In Peru, the main tool is provided by the Public Information Transparency and Access Act - Act N° 27806. This is the regulation under which SUNAT provides numerous means to access information to the general public:

1. SUNAT's Web portal features a section on the transparency of the institutional performance<sup>26</sup> and presents updated information on topics such as institutional planning, periodical performance reports since 2001, institutional budget, purchases and contracts, agreements on performance outcomes signed with the Ministry of Economy and Finance of Peru, human resources' information, queries on the goods' allocation resolutions, activities of officials and provisions on the discipline, rationality and austerity of expenditure.

On this point, the degree of transparency reached at the level of foreign trade transactions<sup>27</sup> is worth highlighting since the SUNAT Web page not only enables to obtain information on the ranking of foreign trade operators, detailed statistical annual reports since 1999 and monthly statistics' bulletins, but also, download detailed information on each export or import transaction and even drilled-down information on the basis of criteria such as tariff item, country or import or export system.<sup>28</sup>

2. Likewise, we rely on the Tax Note, an institutional monthly document geared at citizens who wish to obtain monthly detailed and updated statistical information. Currently, the Tax Note includes 45 statistical charts.

The Tax Note is released in printed as well as virtual format. In the case of the virtual edition, the information spans monthly series with information dating back 10 years<sup>29</sup> and texts for analysis may be downloaded from the SUNAT Web page in Microsoft Word or Adobe Acrobat format. Also, all the statistical charts detailed may be downloaded in the Microsoft Excel format.

3. Finally, we also rely on query mechanisms that are activated by the submittal of Form N° 5030 "PUBLIC INFORMATION ACCESS REQUEST", which may be filed via the help desk or sent via the Internet<sup>30</sup>.

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<sup>26</sup> [www.sunat.gob.pe/gestionTransparente](http://www.sunat.gob.pe/gestionTransparente).

<sup>27</sup> [www.aduanet.gob.pe/aduanas/informae/estadisticasComExt](http://www.aduanet.gob.pe/aduanas/informae/estadisticasComExt).

<sup>28</sup> Once the query is forwarded, it is centrally processed by SUNAT and the flat file with the information is posted on the institutional Web page (in a ZIP file) with a request identification number for it to be downloaded by the person who entered the query.

<sup>29</sup> The date of each series depends on the date on which it was incorporated into the Tax Note. Additionally, citizens may request older information.

<sup>30</sup> Form 5030 enables the requesting party to follow the request submitted.

It should be mentioned in this regard that in 2007 we received 14,365 requests for access to information and by January 2008, 92.4% had been processed. The following chart shows the number of requests received according to the type of information required. As it may be observed, most of the requests for information come from the Peruvian Judiciary, individuals and the National Police force.

FORM N° 5A. TYPE OF INFORMATION REQUESTED						
Type of information requested	Number of requests processed and not processed	% Incidence over the total number of requests	Number of requests processed	% processed	Number of requests not processed	% Unattended
Information requested by the Judiciary	7283	50.70%	6805	47.37%	478	3.33%
Information requested by the Attorney General's Office	968	6.74%	844	5.88%	124	0.86%
Information requested by the National Police Force	1990	13.85%	1808	12.59%	182	1.27%
Information requested by the Prosecutor's Office	84	0.58%	84	0.58%	0	0.00%
Information requested by government offices (ministries, public bodies, etc.)	932	6.49%	867	6.04%	65	0.45%
Information requested by private Institutions and corporations	681	4.74%	662	4.61%	19	0.13%
Information requested by individuals	2404	16.74%	2185	15.21%	219	1.52%
Other	23	0.16%	22	0.15%	1	0.01%
Total	14365	100.00%	13277	92.43%	1088	7.57%

### **PART III: CASE STUDIES: DIALOG WITH ADVISORY GROUPS AS A FORM OF ESTABLISHING A FEEDBACK CHANNEL WITH SOCIETY**

The Superintendency of Tax Administration decided to implement a dialog and mutual cooperation instance between the institution and the taxpayers represented by the business associations, involving them as allies in the campaign to disseminate the need to strengthen compliance with tax obligations. Thus, SUNAT undertook a new participative management initiative in order to minimize the conflicts and tensions inherent in the State-Citizenry relation, such as the one existing between the regulatory simplification will and the need to control the tax norms, in an environment of great economic and social complexity.

The outcome has been a greater consensus and adhesion regarding the enforcement and compliance of the tax obligations by businessmen and more openness and flexibility by the Tax Administration; this entails a greater perception of legitimacy by citizens. Practice has enabled taxpayers to rely on simple procedures that reduce tax compliance costs, participate in the development of the products and services designed by SUNAT, as well as in the tax dissemination tasks. Overall, a more efficient performance of the administration on the basis of more appropriate procedures to the benefit of taxpayers. It is worth mentioning that this product has been considered by the “*Ciudadanos al día*” (Compliant Citizens)<sup>31</sup> association as a “good government practice” in the sphere of citizens’ consultation and participation; in 2007, it was finalist in the annual award in this category.

#### **1. CONTEXT AND DIAGNOSIS**

Since the beginning of this decade, SUNAT has approved a number of regulatory provisions geared at combating tax evasion, broadening the tax base and, consequently, increasing collection. Such measures have contributed in growing the tax pressure to 15.6% of GDP in 2006, the highest level in the last 27 years (1980).

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<sup>31</sup> [www.ciudadanosaldia.org](http://www.ciudadanosaldia.org): “*Ciudadanos al Día*” is a private non-profit organization made up by a group of professionals from different areas with experience in the public administration. It was created with the purpose of generating incentives and new tools that enable to improve the quality of government performance on the basis of transparency of the information, citizen participation and monitoring, and the rendering of citizen-centered services. It also pursues the promotion of citizen consensus on the topics on which different views converge regarding the solution of the most important issues in the country.

For SUNAT, this increase in the tax pressure entails providing more revenue to the State so it may achieve its goals. Nevertheless, the institution has become increasingly aware that as a tax collection entity, it requires not only an institutional, legal and formal basis, but also the legitimacy that promotes citizens' compliance with such obligation. Therefore, we deem it is our duty to promote increasing efforts to approach our subjects.

Therefore, in November 2004, SUNAT organized a foreign trade meeting<sup>32</sup> and in the course of this meeting, a set of common issues for taxpayers and users of foreign trade transactions were revealed, which called for a concrete action by the Tax Administration.

At the time, SUNAT lacked the appropriate channels to inform society regarding the grounds for the measures and actions adopted, as well as their adequacy to improve the country's macroeconomic stability and the efforts to counter unfair competition. Likewise, we were aware of a set of processes that required ongoing improvements, but also that they be appropriately identified and prioritized according to citizens' needs and expectations.

In the face of such situation, SUNAT decided to implement a dialog and mutual cooperation instance between SUNAT and taxpayers represented by a number of associations, mainly of the business sector. Therefore, SUNAT pursued a new method of participative management to achieve greater legitimacy in its actions and allies for the growth of the country.

## **2. OBJECTIVES**

The main objective of the method implemented is to sustain and improve a permanent communication channel with society via the trade associations, which enable to legitimate SUNAT actions as a tax collection agency and facilitator of foreign trade<sup>33</sup>.

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<sup>32</sup> *It is worth remembering that in the case of Peru, the administration of internal taxes and customs duties is the responsibility of the National Tax Administration Superintendency–SUNAT.*

<sup>33</sup> *SUNAT deems the foreign trade facilitation component of great relevance; to the extent it is included in the institutional mission statement.*



The following are deemed ancillary objectives:

- Learn about the needs and expectations of society.
- Provide solutions for administrative issues of general interest.
- Implement feasible initiatives that facilitate voluntary compliance with tax and customs obligations.
- Facilitate foreign trade.
- Coordinate actions to contribute to the creation of tax awareness.

### **3. IMPLEMENTATION**

The following activities were developed for the implementation of the method:

**a. Planning process, which defined the methodology and the measures required for the success of the practice. The following actions were undertaken in this process:**

- Creation of two Working Groups, one for customs duties and the other for internal taxes.
- Creation of a Technical Secretariat for each Working Group, which provides technical support, performs coordination work prior to each meeting, drafts the minutes for the meetings and internally monitors compliance with the agreements adopted.
- Defining the Working Groups' objectives.
- Designing the internal organization structure for each Working Group.
- Identifying the counterparts in each working group. For such purpose, invitations were extended to the most representative trade associations from all the economic sectors in the case of Internal Taxes; for Customs, we invited the associations that participate in the different stages of the foreign trade process.
- Adoption of monthly meetings for the Working Groups.
- Defining the implementation and working method of the technical teams or working sessions according to the topic under discussion, as well as the frequency of their meetings. According to the relevant topic, SUNAT designated professionals from each National Intendancy involved in the process. Likewise, the trade associations appointed their representatives.
- Defining the method to address the topics that do not require a working group.
- Dissemination of the joint working practice with the trade associations within the institution in order to obtain the commitment

of the different responsible instances and, thus, achieve the effective allocation of resources for the implementation thereof.

**b. Creating the general framework for the interaction and objectives in each working group:**

In order to ensure the productivity of the exchange, it is necessary to define its content in advance.

Among the most relevant tasks of the customs group, we may mention the identification of the issues arising from the construal of regulations and customs procedures, as well as the assessment and recommendation of mechanisms that expedite such procedures and the presentation of initiatives to improve the legislation in effect. On such basis, we are meeting the provisions in the General Customs Act, which sets forth that the State shall promote the participation of the economic agents and foreign trade operators in customs services.

On the other hand, the Internal Taxes' Working Group is in charge of evaluating the initiatives set forth by the representatives, as well as working together to modernize, simplify and facilitate compliance with tax obligations.

**c. Terms:**

The planning stage, once the decision to set up the Working Groups had been made, took approximately two months, and mainly involved:

- Appointment of the Technical Secretary,
- Identification of the Working Groups' objectives.
- Internal organization design.
- Definition of participants.
- Internal identification of proposals to be submitted to the Working Group.

**d. Counterparts and allies:**

Presently, advisory groups involve the main business and productive trade associations of Peru. In such respect, the trend foreseen is to gradually extend the practice towards other groups, always in line with the strict technical nature of the contents.

The Advisory Group on Customs issues is made up by the representatives of the following institutions:

- National Superintendency of Tax Administration (SUNAT, as per the Spanish acronym),
- Ministry of Foreign Trade and Tourism (MINCETUR, as per the Spanish acronym),
- National Agricultural Health Service (SENASA, as per the Spanish acronym),
- Ministry of Economy and Finance (MEF, as per the Spanish acronym),
- Customs Agents' Association of Peru (AAAP, as per the Spanish acronym),
- Exporters' Association of Peru (ADEX, as per the Spanish acronym),
- The International Air Cargo Association (TIACA),
- International Cargo Agents' Association (APACIT, as per the Spanish acronym),
- Maritime Agents' Association (APAM, as per the Spanish acronym),
- Association of Courier Services' Businesses (APESE, as per the Spanish acronym),
- Private Airport Services' Association (ASAEP, as per the Spanish acronym),
- Maritime Association of Peru (ASMARPE, as per the Spanish acronym),
- Peruvian Association of Port Operators (ASPPOR, as per the Spanish acronym),
- Association of Warehouse Terminals of Peru (ATAP, as per the Spanish acronym),
- Foreign Trade Society of Peru (COMEX PERU, as per the Spanish acronym),
- National Society of Industries (SIN, as per the Spanish acronym),
- National Mining and Oil Society (SNMP, as per the Spanish acronym),
- National Fisheries' Society (SNP, as per the Spanish acronym),
- Chamber of Commerce of Lima (CCL, as per the Spanish acronym),
- National Chamber of Commerce, Production and Services (PERUCAMARAS, as per the Spanish acronym),

- National Council of Users of the International Physical Distribution System (CONUDFI, as per the Spanish acronym).

Additionally, the Advisory Group on Internal Taxes is made up by the representatives of the following institutions:

- National Superintendency of Tax Administration (SUNAT, as per the Spanish acronym),
- Ministry of Economy and Finance (MEF, as per the Spanish acronym),
- National Confederation of Private Business Institutions (CONFIEP, as per the Spanish acronym),
- National Fisheries' Society (SNP, as per the Spanish acronym),
- Chamber of Commerce of Lima (CCL, as per the Spanish acronym),
- Association of Exporters (ADEX, as per the Spanish acronym),
- National Chamber of Commerce, Production and Services (PERUCAMARAS, as per the Spanish acronym),
- National Society of Industries (SIN, as per the Spanish acronym),
- Association of Banking Institutions (ASBANC, as per the Spanish acronym),
- Foreign Trade Society of Peru (COMEX PERU, as per the Spanish acronym),
- National Mining and Oil Society (SNMP, as per the Spanish acronym),

Additionally, the SUNAT relies on allies in this initiative, since we have worked in collaboration with different public and private entities that have enabled the implementation of the products arising from the working groups. Among them, we may list:

- Ministry of Economy and Finance- (MEF, as per the Spanish acronym),
- Electronic Government Office (ONGEI, as per the Spanish acronym),
- Government Accountant's Office,
- Ministry of Labor and Social Development- (MINTRA, as per the Spanish acronym),
- National Institute of Defense of Intellectual Property Rights – (INDECOPI, as per the Spanish acronym),

- Ministry of Transportation and Communications-(MTC, as per the Spanish acronym),
- Ministry of Foreign Trade and Tourism – (MINCETUR, as per the Spanish acronym),
- Banco de la Nación – (BN, as per the Spanish acronym),
- National Registry of Identity and Marital Status -(RENIEC, as per the Spanish acronym),
- National Superintendency of Public Registries – (SUNARP, as per the Spanish acronym).

As it may be observed, since the topics discussed are chiefly of a tax nature, the practice adopted by SUNAT is having direct influence on the activities of other entities, which not only facilitates the concrete objectives but also fosters the openness of the government administrations with a greater participative component.

**e. Theme-based working groups:**

Once the initiatives are discussed and upon asserting the interest of both parties over the furtherance thereof, the working groups are prioritized and established. Such groups are made up by representatives of SUNAT competent areas and the associations involved. As a result of this joint effort, numerous proposals arose to modify the tax and/or customs procedures, drafting internal procedures' handbooks and the Superintendency Resolutions, as well as bills and legislation.

The working groups on customs issues defined to the present are:

- Airport Warehouse Terminals;
- Customs Valuation;
- Tariff Drawback;
- Customs violations and sanctions;
- Transit, transshipment and reshipment;
- Exporting Map;
- Sensitive products;
- Misdemeanors;
- Gradual nature of penalties; extenuating/aggravating circumstances in the enforcement of penalties; and
- Electronic Processing.

The working groups set up for internal taxation issues are:

- Refunds;
- Accounting books;
- Payment receipts;
- Simplification of administrative procedures; and
- Electronic books.

It should be highlighted that as a consequence of the implementation of this practice, we enjoy a greater opportunity of learning about the needs and expectations of the foreign trade taxpayers and users, enabling to improve SUNAT procedures.

#### **4. DIFFICULTIES**

The process described has faced a number of difficulties:

- a. The coordination meetings generate a great expectation in taxpayers. Nevertheless, it is clear that the resources available in the Tax Administration to simultaneously meet the requirements and expectations of the associations are limited. Therefore, it is worth explaining the limitations and prioritizing the actions on a coordinated basis.
- b. Likewise, it is likely that the approach to the initiatives requires regulatory modifications and at least a part of such changes should not depend directly on the tax administration, but should fall under the scope of other offices, whether because of the competency of other institutions or by virtue of the rule of law. Thus, undertaking a dialog mechanism like the one set forth, requires the tax administration to undertake new coordinated efforts with other institutions.
- c. The specific formalities set forth by the legislation in effect as regards the activities of government agencies are worth considering (in the case of Peru, for example, the State Contracting and Acquisitions' Act).
- d. Finally, we should closely consider the relevant role of the tax administration organizational culture, since it shall necessarily evolve from the strict control paradigm to that of facilitation, dialog and collaboration.

## 5. RESULTS

The advisory group on customs issues has held 35 monthly meetings to the present<sup>34</sup> and 38 working group meetings.

On the other hand, the group focused on internal taxation issues has held 30 monthly meetings and 89 working group meetings<sup>35</sup>.

### Annex 1: Certain specific outcomes.

The establishment of dialog instances with advisory groups has enabled taxpayers and citizens in general to rely on simplified procedures, or virtualized procedures when possible, reducing citizens' tax obligation compliance costs.

Hereunder, we point out some of the changes fostered by the process described.

Area	Change Implemented
RUC	1. Update of RUC data via the SOL facility. (SUNAT Online operations via the SUNAT Web portal).
	2. More flexible requirements.
	3. Individuals' registration and removal from the RUC via the Internet.
	4. Internet annulment of taxes and branches.
	5. Notification of activities' suspension and resumption via the Internet.
Services	6. Re-launching of the complaints and suggestions' system via the Internet.
	7. Redesign of the Tax and Customs Assistance module on the SUNAT Portal via the Internet.
	8. Incorporation of the personalized record in Tax Statement 2005 as an automated means to facilitate filing tax statements.
	9. Delivery of SOL codes and dissemination with the support of associations.
	10. Launching of SUNAT e-Mailbox and e-bulletin.
	11. Implementation of an Internet reporting system.

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<sup>34</sup> As of January 2008.

<sup>35</sup> Annex 1 lists a number of the topics discussed.

Area	Change Implemented
Refunds	12. Development of the Benefits' Statement Program (PDB, as per the Spanish acronym) – Exporters.
	13. Refund of the Income Tax Favorable Balance and the Extraordinary Solidarity Tax (IES, as per the Spanish acronym) 2004- for individuals via information crossing processes. .
	14. Virtual form for the General Sales Tax Refund formality.
	15. Refund of unapplied withholdings and receipts for the General Sales Tax.
	16. Increase of the interest rate paid by the State on the refunds for the unapplied withholdings and/or receipts for the General Sales Tax.
	17. Automated refund of the annual Individual Income Tax favorable balance for fiscal year 2005 based on information crossing processes. <sup>36</sup> .
Receipts	18. Receipts for optical disks' imports to avoid under-valuations.
Discounts	19. A uniform minimum application amount of the system was set at S/. 700 (approximately US\$ 240) per transaction, for all goods and services.
	20. We eliminated the requirement to file a certificate of good standing deemed necessary to release the funds frozen by the discounts' system. Alternatively, the automated Internet-based pre-rating system was implemented.
	21. Implementation of discounts on cargo transportation applied only on transactions for amounts in excess of S/ 400 (approximately US\$ 135).
	22. Notification of transfer allocation information via the Internet.
Payment Receipts	23. Extension of the validity of payment receipts until the issue of a new set of rules.
	24. Issue of the Superintendency Resolution (RS, as per the Spanish acronym) that governs remittances of goods.
	25. Automated issue of receipts for extraordinary transactions for the purpose of the General Sales Tax (Form 820) with the subsequent review.
	26. Annulment of Payment Receipts via the Internet.
	27. Elimination of the requirement to file a police report copy in case of theft.
	28. Enabling the change of jurisdiction without the need to annul payment receipts.

<sup>36</sup> The term was reduced to 2 months, much shorter than the previous one for such formalities.



Topic 1.1 (Peru)

Area	Change Implemented
Tax Statements and Payment	29. Expansion of the Internet-tax payment option to the largest taxpayers of the Regional Intendancy of Lima.
	30. Implementation of credit card tax payments.
	31. Implementation of queries and payments via the Internet.
	32. The tax base for the Fourth Category income withholdings was reduced for the purpose of Income Tax (self-employed workers; in general terms, individuals who undertake a profession or trade on their own). Likewise, the period for the effectiveness of the suspension was reduced and the virtual form was implemented.
Tax Debts' Installment Plans	33. More flexible requirements to register in the general Tax Debts' Installment Plans regulations set forth in Article 36° of the Tax Code of Peru.
Coercive collection	34. The complaints filed regarding the enforcement of attachments through banks were solved.
TUPA	35. Review of the procedures in the Administrative Procedures' Single Text (TUPA, as per the Spanish acronym) of SUNAT in 2006.
Accounting Books	36. Issue of the Accounting Books' regulation.
Transfer Pricing	37. The deadline for the delivery of the Transfer Pricing Technical Report was modified.
Inflation Adjustments	38. An accounting methodology proposal was set forth for the treatment of the inflation adjustment in deflation periods.
Foreign Taxpayers' Proceedings	39. The virtual procedure and form for SOL-based income and withholdings' certificates were established.
Answers to queries	40. A 35-business day term was established to answer general queries.
Mandatory Criteria	41. The national operating units were instructed for the compliance thereof subject to penalty.
Electronic Tax Statement Program (PDT) for the Tax on International Transactions (ITF)	42. Information from exempted transactions was removed.
PDT 618	43. Update of the PDT for trust and mutual funds.

Lima, January 28<sup>th</sup>, 2008

## **POLICIES FOR COMMUNICATING WITH SOCIETY AND NEW METHODS FOR RENDERING THEM MORE EFFICIENT**

**José Antonio de Azevedo Pereira**

General Director

General Directorate of Taxes

(Portugal)

*CONTENTS: Summary. -I. Introduction. -II. Core axes of an efficient communication policy. -1. Informing taxpayers of their rights and obligations and supporting them in the compliance thereof. -2. Developing in citizens (taxpayers) a greater perception of equity and justice in the tax system. -3. Collaborating to deter tax evasion and tax fraud. -4. Contributing to a greater “tax education” and developing a “compliance culture” in citizens. -III. Portuguese Tax Administration communication policy. -1. Taxpayers’ access to tax status information and assistance in the compliance with tax obligations. -2. Developing in citizens (taxpayers) a greater perception of equity and justice in the tax system. -3. Deter tax evasion and tax fraud. -4. Contributing to a greater “tax education” and developing a “compliance culture” in citizens. -5. Certain indices on the performance of the Portuguese Tax Administration in the last few years. -IV. Conclusions.*

### **SUMMARY**

The communication policy adopted by the Tax Administrations is increasingly considered an issue of great relevance in any strategy geared at increasing taxpayer’s voluntary compliance.

The adoption of an effective communication policy is fundamental to achieve taxpayers’ greater acceptance and understanding of the Tax Administration mission and, consequently, a greater trend towards compliance with tax obligations.

Maximizing the levels of voluntary compliance is only possible if we adequately inform taxpayers about their obligations and rights and on the form of meeting and exerting them. On the other hand, the

better knowledge of the Tax Administration's activity and the outcomes thereof is also a significant factor to induce compliance and, on the other hand, deter tax evasion and tax fraud.

Thus, communication plays a relevant role in determining taxpayers' behavior. Therefore, in the current "information society" the challenge faced by the Tax Administrations is to use effectively the new potentials created by such society, favoring a greater approach to taxpayers and inducing higher levels of voluntary compliance with tax obligations.

An efficient communication policy comprises four fundamental aspects:

- i) To ensure that taxpayers know their rights and obligations, enjoy fast and simple access to the information on their tax status and receive the support required to meet their tax obligations on an appropriate and timely basis;
- ii) To provide citizens (taxpayers) information on the activity that the Tax Administration performs and the results obtained for them to develop a greater and better perception of equity and justice of the tax system;
- iii) To develop the perception of risk and the costs related to noncompliance, by way of the dissemination of the outcomes achieved by the Tax Administration in the area of control actions –automated and based on inspections (type of actions conducted, tax assessed, interest assessed, punitive interest application, criminal prosecution);
- iv) To engage actively in the tax education of citizens, creating awareness on the relevance of taxes in the Rule of Law and the Social State, specifically investing on the youngest sectors of the population. It is very important to foster conditions for the young to develop a greater civic and tax awareness that will prevail in their adulthood and makes them more cooperative citizens, compliant with tax obligations.

## **I. INTRODUCTION**

The communication policy adopted by the Tax Administrations is increasingly deemed a topic of great relevance in any strategy aimed at improving taxpayer's voluntary compliance.

As we know, tax collection is not a popular task, especially among citizens, therefore, the adoption of an effective communication policy is vital for taxpayers' better acceptance and understanding of the Tax Administration's mission, and consequently, a greater predisposition towards compliance with tax obligations.

The form in which the Administration relates to its subjects, taxpayers, is vital for their perception of the tax system and the respective behavior, and the communication policy is, naturally, an essential factor in this relation.

Maximizing voluntary compliance levels is only possible if taxpayers receive adequate information on their obligations and rights and on the form of complying and exerting them. On the other hand, knowing the Tax Administrations activity and the results thereof is also a relevant factor to induce compliance and, inversely, deter tax evasion and tax fraud.

An efficient communication policy plays a vital role in taxpayers' behavior. In the current "information society", the challenges facing the Tax Administrations is to effectively use the new potential created by such society, favoring a greater approach to taxpayers and inducing higher levels of voluntary compliance with tax obligations.

## **II. CORE AXES OF AN EFFICIENT COMMUNICATION POLICY**

In my view, an efficient communication policy shall fundamentally consider four aspects:

- Informing taxpayers of their rights and obligations and supporting them in the compliance thereof;
- Developing in citizens (taxpayers) a greater perception of equity and justice in the tax system;
- Collaborating to deter tax evasion and tax fraud;
- Contributing to a greater "tax education" and developing a "compliance culture" in citizens.

Following I shall briefly refer to how each of these four axes translates.

## **1. INFORMING TAXPAYERS OF THEIR RIGHTS AND OBLIGATIONS AND SUPPORTING THEM IN THE COMPLIANCE THEREOF**

The first axis – taxpayer information and support- is, naturally, fundamental for the voluntary compliance indices.

If taxpayers do not know or understand the rules that govern them, they shall face greater difficulties to meet their tax obligations, even if initially there is a predisposition towards compliance.

Therefore, it is the role of the Tax Administration to ensure taxpayers the fast and simple access to information on their tax status and assist them in complying with their tax obligations.

In this axis of communication, the Tax Administration shall make available to taxpayers multiple access channels - Internet, e-mail, personal assistance, telephone assistance, fax or mail – considering the different needs and diverse taxpayer profiles.

Regardless of the diversity of channels through which interaction with the Tax Administration is possible, Internet shall be the priority for taxpayers to access information, whether of a general or specific nature; that is to say, the one referred to the specific taxpayer status. The growing reliance on the Internet is fully warranted by the fact that it is the interaction channel that guarantees lower costs, for the administration as well as taxpayers (mostly in terms of convenience, availability and expeditiousness).

On the other hand, the Tax Administration shall increasingly adopt a proactive attitude, informing taxpayers on the deadlines of their tax obligations, disseminating the new services available (for example, new online services) or informing them of the legislative amendments and their respective consequences. Therefore, the E-mail and SMS tools appear as the most appropriate means of communication, given their advantages in terms of fast communication and taxpayers' perception that they are easily accessible.

Corporate TV is also another medium that the Tax Administrations may employ to carry relevant information to taxpayers, whether in the axis

under consideration or the axes I shall refer to later. The availability of this communication channel in the personalized assistance offices to disseminate the useful contents for taxpayers and for the Tax Administration proper constitutes another means to increase the efficiency in the communication with citizens.

Lastly, the Tax Administration shall also rely on diagnosis instruments that enable to assess the quality of assistance and the services it renders taxpayers by regularly conducting surveys/questionnaires that allow to measure the levels of taxpayer satisfaction and identify improvement and services' expansion opportunities.

## **2. DEVELOPING IN CITIZENS (TAXPAYERS) A GREATER PERCEPTION OF EQUITY AND JUSTICE IN THE TAX SYSTEM**

The dissemination of easily accessible information for citizens relative to the resources allocated to the Tax Administration, the activities and actions developed and the results achieved, apart from contributing to a greater transparency of the Tax Administration and enabling to evaluate the respective performance, is also a key factor for citizens to develop a greater perception of equity and justice in the tax system.

For example, in this context, I understand the great relevance of disseminating data regarding the taxpayers' control and selection mechanisms and the respective results and average collection terms, specifically, coercive collection

As regards the communication media to be employed in disseminating the Tax Administration activity, actions and results, the Internet and Corporate TV appear as the most appropriate internal channels.

On the other hand, it is an axis of great importance with respect to the mass media (for example, newspapers, magazines, radio and television), given the broad coverage they ensure.

## **3. COLLABORATING TO DETER TAX EVASION AND TAX FRAUD**

The perception that tax noncompliance entails risks and high costs is a key factor to deter tax fraud and tax evasion, and thus, it is vital that the Tax Administration's communication policy contributes in the development of such perception.

In this regard, the Tax Administration shall inform citizens the measures and actions implemented with the purpose of detecting and combating tax evasion and tax fraud and disclosing the achievements.

In this case, resorting to the mass media, in addition to the Internet and Corporate TV channel constitutes a key factor for this axis of communication, since they enable reaching the majority of citizens/taxpayers.

#### **4. CONTRIBUTING TO A GREATER “TAX EDUCATION” AND DEVELOPING A “COMPLIANCE CULTURE” IN CITIZENS**

Last, but not least, it is worth noting the Administration’s communication policy contribution to “tax education”- for the development of a “compliance culture”.

We know that citizens do not appreciate paying taxes, in general terms. Therefore, I believe that a greater awareness as regards the relevance of taxes in the Rule of Law and the Social State and more information on the form in which the taxes we pay are employed, are key factors to develop in citizens a greater predisposition towards the payment of taxes; that is to say, to generate in citizens the “compliance culture”.

Likewise, in this area, the Tax Administrations may and shall play a relevant role, since in this case, and in spite of the wish that the actions undertaken reach the largest number of citizens, children and youths are the most relevant beneficiaries, since they are the taxpayers of the future.

As regards the education axis in the communication policy, the means that the Tax Administrations may employ are quite different. For example, the participation in the creation of school curricula that incorporates tax education subjects, the development of educational publications and games, inclusion of a tax education area on Web sites, implementing and participating in fora on the topic, etc.

### **III. PORTUGUESE TAX ADMINISTRATION COMMUNICATION POLICY**

Following, I shall focus on certain aspects of the Portuguese Tax Administration communication policy – of the General Tax Directorate (DGCI, as per the Portuguese acronym) – in the different axes mentioned.

## **1. TAXPAYERS' ACCESS TO TAX STATUS INFORMATION AND ASSISTANCE IN THE COMPLIANCE WITH TAX OBLIGATIONS**

Taxpayers' right to be informed on the appropriate construal of tax regulations, in general, and their tax status, in particular, is embodied in the Portuguese tax legislation. The DGCI makes available multiple channels aimed at ensuring taxpayers' access to the relevant information for the appropriate compliance, in due time and manner, of their tax obligations.

In spite of the diversity of existing channels (personal, telephone, e-mail and fax/mail), the Internet increasingly stands as the strategic channel for the Portuguese Tax Administration, whether for the purpose of disseminating general or specific information.

As regards the general information available on the Web site, we may highlight all the tax legislation in effect; a section for FAQs (Frequently Asked Questions) relative to the different taxes and other tax issues; publication of the Administration's opinion as regards relevant information requested by taxpayers; the administrative instructions published by the services (such as, circulars, communications); the tax calendar, with the deadlines for taxpayers' tax obligations; and programs with sample tax assessments.

As regards the specific information, the Internet features a set of relevant data on taxpayers' tax status. For example, taxpayers may access (i) registry information and directly modify it; (ii) queries on the status of their tax statements; (iii) queries on tax debts and, simultaneously, request information and clarification in such respect or even proceed to their payment; (iv) queries on infringement proceedings.

Currently, taxpayers may file almost all the tax statements via the Internet. Internet-based filing is mandatory for corporations and individuals that perform professional or business activities. The Portuguese Tax Administration relies on the Internet and this has spurred in the last few years a significant growth in the adhesion by taxpayers to this channel for the compliance with their tax obligations, including those who are not mandated to file via the Internet.

The following chart illustrates the evolution of Internet-based tax statements by individuals and shows the significant growth of tax statements filed according to this modality in the last few years.



### Internet –Tax Statements Filed by Individuals

	≤2003 *	2004	2005	2006	2007
<b>IIT – Phase 1</b>	306,935	441,961	782,566	1,138,737	1,707,205
<b>IIT - Phase 2</b>	229,560	507,802	950,806	1,138,517	1,225,668
<b>Total</b>	536,495	949,763	1,733,372	2,277,254	2,932,873

\* Accrued Value

In 2007, the IIT (Individual Income Tax) statements filed via the Internet for the first time exceeded the number of statements filed on paper, with 60% of taxpayers filing their statements electronically (52% in Phase 1 – comprising taxpayers who only earn income from employment and pensions, who are not mandated to file their tax statements electronically; and 72% in Phase 2, comprising taxpayers who earn a different type of income).

One of the key factors that spurred the significant growth of the individual tax statements filed via the Internet recorded in 2007 was the implementation of the pre-completion system for tax statements.

This system is only available for the statements filed via the Internet. In the year 2007 (when the implementation was launched), the pre-completion system covered the income from employment and pensions, and the withholdings on such income.

In 2008, the pre-completion initiative was significantly expanded to include the following amounts:

- Mandatory social security contributions;
- Union contributions;
- Withholdings on professional and business income and identification of the withholding agencies;
- Advance payments made in the area of the professional and business activities;
- Capital gains subject to mandatory taxes and withholdings;
- Withholdings on equity increases;
- Exempted income subject to taxation and withholdings;

In addition to relying on the Internet channel, the Portuguese Tax Administration has prioritized e-mail, to not only answer the requests

for clarification filed by taxpayers, but also as the preferred tool to forward communications, messages and announcements.

In fact, the e-mail channel is increasingly employed to forward informative messages on the new Internet services available and the form of accessing them, as well as to send announcements to taxpayers, with relation to the deadlines to meet tax obligations, along with the information on how to meet such obligations.

By issuing such announcements/alerts, we intend to assist taxpayers in the compliance with their tax obligations in due time and manner, while we come closer to them and reduce the costs tied to compliance with such obligations.

In the short term, we also intend to employ **SMS Messages** in order to issue alerts and announcements to taxpayers when possible.

In the future and in the framework of the implementation in the Finance Services of an Assistance Management System in an IT application that enables the dissemination of content via a Corporate TV system, the DGCI intends to develop and make such potential more dynamic by the production of informative content of interest for taxpayers.

Along with the availability of multiple access channels, the DGCI annually performs diagnosis with the purpose of evaluating services and levels of customer satisfaction (taxpayers).

The methodology employed consists in, fundamentally, conducting questionnaires and personal interviews for the different types of users and seeks to evaluate:

- The functionalities, services and access channels most widely used with regards to the Tax Administration;
- The levels of satisfaction of different types of users in their relation with the Tax Administration;
- The key difficulties perceived in such relation;
- Improvement suggestions.

The results of the questionnaires are posted on the Internet and the mass media, specifically newspapers.

## **2. DEVELOPING IN CITIZENS (TAXPAYERS) A GREATER PERCEPTION OF EQUITY AND JUSTICE IN THE TAX SYSTEM**

In the axis of taxpayers' greater perception of the tax system equity and justice, it is vital for taxpayers to enjoy simple and easy access to the information on the activities conducted by the Tax Administration and the performance results.

In the case of the Portuguese Tax Administration, traditionally, the availability of such information has been based on the public dissemination of the Annual Plans and Activities' Reports.

In the last few years, the Portuguese Tax Administration has become increasingly aware that citizens' knowledge of its activity and results bears a positive impact. Consequently, it has decided not only to make the information rendered at this level broader, but also the diversification of the means employed for such purpose, especially taking advantage of the potential in the new technologies introduced as regards communication.

Therefore, in addition to posting on the Internet the foregoing documents (plans and activities' reports), we regularly make available statistical data relative to the revenue collected from the different taxes, whether the one arising from the amounts filed voluntarily by taxpayers or from tax inspections (adjustments on the amounts filed by taxpayers).

The implementation of new automated control and information crossing mechanisms and the respective outcomes are also disseminated, and the same applies to the actions performed by the inspection services. The results are disclosed as aggregate figures, which protects the confidentiality thereof.

In this axis, the most broadly used communication tools are the Tax Administration Web site (a priority channel for this purpose as well), presentations to specialized entities, mass media (especially, newspapers) and the DGCI quarterly publication.

## **3. DETER TAX EVASION AND TAX FRAUD**

Another axis of the efficient communication policy shall be, as mentioned above, effects that deter tax evasion and tax fraud, arising from an increased risk perception and the costs tied to noncompliance.

In this regards, and in line with the foregoing axis, it is vital that taxpayers access the information that enables them to evaluate the efficacy of the actions undertaken by the Tax Administration in combating tax noncompliance. Taxpayers shall perceive that there is an effective action against noncompliance and that the Tax Administration demands noncompliant taxpayers to amend their situation, with a significant cost increase.

In order to reach this purpose, the Portuguese Tax Administration has disseminated, systematically and recurrently, the control actions, automated and inspections, and the respective results, such as the number of debtors and irregular situations detected, the tax and interest amount assessed, the punitive interest applied, the number of cases under criminal prosecution, etc.

The tools employed in the dissemination of this type of results are, fundamentally, the Tax Administration Web site and the mass media.

Even in this axis, since 2006, the Tax Administration has been disseminating via the Internet a list of the delinquent taxpayers, which may be accessed by the public.

Disclosing this list is chiefly aimed at inducing taxpayers who hold tax debts to amend their situation voluntarily and thus avoid being included on such list.

This measure has produced a positive effect, since a very large number of taxpayers paid their tax debts.

#### **4. CONTRIBUTING TO A GREATER “TAX EDUCATION” AND DEVELOPING A “COMPLIANCE CULTURE” IN CITIZENS**

In the area of tax education, I shall focus on two recent experiences of the Portuguese Tax Administration.

##### **Tax Education Project**

Traditionally - except for certain initiatives in the implementation of tax reforms- the tax education axis has been largely absent from the Portuguese Tax Administration’s communication policy.

This situation has been recently modified, when we launched in June of 2006, a tax education project, whose main purpose was and still is,

the promotion of greater civic-tax awareness in citizens, in general, and youths, in particular.

The greater focus on the younger segments of the population is justified in the face of the significant role they play in economically developed societies, whether in terms of income (consumption of goods and services) or in terms of government spending (education and health). Thus, it is deemed relevant that they develop and internalize a civic-tax awareness that will prevail in their adulthood and makes them cooperative citizens, compliant with tax obligations.

The initiatives already undertaken in the sphere of this project shall be fundamentally materialized by:

- The development and execution of a traveling Exhibition;
- The design and execution of a game and three books that shall be distributed mostly during the Exhibition.

Thirty panels divided, chiefly, into five chapters make up the Exhibition:

- I) History and life of taxes, with a brief overview of the History of Taxes in Portugal (**When?**);
- II) Why meet tax obligations, based on ethical and civic values and, ultimately, personal and social honesty. (**Why?**);
- III) A brief overview of the Portuguese tax system, highlighting the main taxes under the administration of the General Tax Directorate (**Which ones?**);
- IV) Forms of obtaining revenue, the State Budget, the relevance of taxes to counter deficit, the Tax Administration (**How?**);
- V) Allocation of government funds, that is to say, why tax money is vital and how it is employed. (**What for?**).

The exhibition opened on the premises of the Ministry of Finance in Lisbon and visited other locations thereafter, such as the University of Law of Lisbon and the University of Economy of Coimbra. Currently, it is visiting the city of Porto, in the Office of the President of the University of Porto and shall move onto other cities since its purpose is to tour the whole country.

To date, a very large number of citizens have attended the Exhibition, in particular high school students.

As mentioned before, and in addition to the traveling exhibition, we created a didactic game and two comic books and a more technical book with a brief description of the Portuguese Tax System.

The DGCI plans to continue with the tax education project, promoting other initiatives in the area, such as, the incorporation on its Web site of a specific area on tax education aimed at students, parents and professors.

### **“Request your Invoice” Campaign**

Although it has not been included in the sphere of the tax education project, the General Tax Directorate launched an advertising campaign by the name of “Request your Invoice”, aimed at creating awareness in citizens with respect to the importance of the act of demanding the invoice as regards voluntary compliance with tax obligations.

This campaign was geared at informing citizens with about the role they may play in promoting tax equity and justice, if they adopt behaviors that lead to the economic agents’ greater compliance overall, in this case, by always demanding an invoice when they purchase goods and services. In this regard, the “Request your Invoice” campaign is also in line with tax education initiative.

The campaign was launched in March of 2007 and covered the different mass media, specifically television, for a 2-month term.

At the same time, we designed signs and posters placed in different DGCI buildings and services.

## **5. CERTAIN INDICES ON THE PERFORMANCE OF THE PORTUGUESE TAX ADMINISTRATION IN THE LAST FEW YEARS**

In the last few years, we have experienced a significant growth in the levels of voluntary compliance, fundamentally based on a faster and more effective action against tax evasion and tax fraud. This has been based either on the introduction of automated mechanisms that enabled to conduct mass controls via information crossing actions, or by the effort of the tax inspection, granting it more and better means to combat tax fraud and tax evasion, or even, by making the cooperation with other entities with inspection powers more dynamic.

In fact, the greater focus of the Portuguese Tax Administration on communication has also contributed to the increase in the levels of voluntary compliance, specifically, as refers to the dissemination of the results of their actions, as a form of inducing a greater risk perception, and consequently, a greater predisposition to compliance (always tied to the concern for facilitating compliance, by simplifying tax obligations and disseminating the information and assisting taxpayers with regards to tax obligations' compliance).

For illustration purposes, we present a number of efficiency indices of the Portuguese Tax Administration performance.

The following chart shows the evolution of the revenue collected by the DGCI and the Gross Domestic Product (GDP) at nominal values in the period between 2004 and 2007.

**Gross Revenue collected by the DGCI in % of the GDP**

(Million Euros)

	2004	2005	2006	2007*
<b>Overall revenue collected by the DGCI (TR)</b>	32,278.2	34,091.1	36,639.3	40,187.1
<b>Nominal GDP</b>	144,128.0	148,851.7	155,131.1	162,509.5
<b>TR in % of GDP</b>	22.4%	22.9%	23.6%	24.7%

\* Preliminary

We may observe that the weight of revenue on the nominal GDP has successively increased and that, in accrued terms, the revenue collected by the DGCI increased by 24.5% in the period under study, while the nominal GDP growth was close to 12.8%.

The difference between both growth rates is chiefly based on the improved tax efficiency in the period under study, as we may observe in the following chart, which presents the tax efficiency values for the years under study, determined by the difference of the nominal GDP growth rate and the revenue growth rate net of refunds and corrected for extraordinary effects.

**DGCI Tax Efficiency**

(Percentage points)

	2004	2005	2006	2007*
<b>Tax Efficiency</b>	3.6	3.1	3.3	5.3

\* Preliminary

An identical conclusion may be drawn from the analysis of the evolution of the State's net revenue collected by the DGCI (including income from municipal taxes), as illustrated on the following chart.

### Net Revenue \* of the State administrated by the DGCI

(Million Euros)

	2004	2005	? %	2006	? %	2007**	? %
<b>Direct Taxes</b>	11,307.9	11,519.2	1.9%	12,617.2	9.5%	14,778.2	17.1%
<b>Indirect Taxes</b>	10,756.8	12,206.7	13.5%	12,954.0	6.1%	13,654.9	5.4%
<b>Other</b>	569.9	508.2	-10.8%	540.1	6.3%	621.7	15.1%
<b>Total</b>	22,634.6	24,234.1	7.1%	26,111.3	7.7%	29,054.8	11.3%

\* Net Revenue = Gross Revenue - Refunds - Transfers

\*\*Preliminary

## IV. CONCLUSIONS

- The low popularity of the tax collection task makes the adoption of efficient communication policies one of the key factors to increase taxpayers' levels of compliance with tax obligations. If taxpayers are appropriately informed of their rights and obligations, and even the Tax Administration's activity and the respective outcomes, a greater trend towards compliance shall be achieved.
- An efficient communication policy shall fundamentally span four axes: (i) informing taxpayers, on a simple and expeditious basis, about their rights and obligations and assisting them in the compliance thereof; (ii) creating in citizens (taxpayers) a greater perception of equity and justice of the tax system; (iii) contributing to deter tax evasion and tax fraud; (iv) contributing to a greater "tax education" and the development of a "compliance culture".
- The challenge faced by the Tax Administrations is to use effectively the available communication media, specifically those arising from the new technologies, in order to achieve success in the four axes of the communication policy, adopting solutions that bring them closer to taxpayers, facilitating and improving their relation with the Administration.





## **POLICIES FOR COMMUNICATING WITH SOCIETY AND NEW METHODS FOR RENDERING THEM MORE EFFICIENT**

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*CONTENTS: Summary. -1) Introduction. -2) Definition of scope and content. -3) Discussion. -a) The value of communication, engagement and dialogue as part of a compliance strategy. -b) Integrating an approach of education & outreach, service and enforcement. -c) Education and outreach. -d) Service. -e) Enforcement. -f) Using the media to your advantage. -g) The benefits of enhanced communication. -4) Conclusions*

### **SUMMARY**

The goal of communication for the South African Revenue Service, with its public is in line with its compliance theory. In its most simplified form, the compliance theory, which has three pillars, viz education, service and enforcement, holds that:

- If we reach out and make taxpayers aware of their obligation AND
- If we make it easy for them to fulfill their obligation, THEN
- They would be more likely to comply, AND
- We would be in a position to assert responsible enforcement

This would then naturally imply that our interaction with the public must address:

- **EDUCATION & OUTREACH:** Communicating to taxpayers what their various tax obligations are in terms of the law
- **TAXPAYER SERVICE:** Communicating to taxpayers how they may fulfill these obligations which would include various forms, service channels, dispute resolution mechanisms, etc
- **ENFORCEMENT:** Communicating to taxpayers how we would detect non-compliant behaviour, such as through audits and investigations, as well as the consequences of non-compliance such as penalties, fines, prosecutions etc

The benefits of effective communication policies are mutual.

For taxpayers it provides clarity, certainty, as well as minimizing the burden of compliance. For the revenue administration, leads to cost efficiency and effectiveness, improved compliance and optimal revenue collection.

Without true two-way engagement, aimed at gaining a shared understanding of the realities that face both the revenue administration and the taxpayer, no communications strategy can be successful.

For communications strategies to be successful, it must one the one hand be broad and general, but since one cannot only follow a “one size fits all” approach, it must also include highly segmented and customized methods based on the peculiarities of taxpayers background, needs, preferences and compliance behavior.

The mass media offers an ideal opportunity to touch a broad spectrum of taxpayers, whilst very specific tailored communications strategies are required for different sectors, segments and taxpayer types, using a range of media and messages.

Effective communications approach not only serves to keep our stakeholders informed, it also alleviates pressures on operations through the reduction of unnecessary queries from taxpayers and their tax practitioners / intermediaries. Ultimately, it allows a tax administration to truly influence taxpayers’ compliance behaviour, through ensuring taxpayers’ buy-in and taxpayers being both willing and able to comply with their obligations.

## **1. INTRODUCTION**

Ensuring that taxpayers know what their obligations are, and how to meet them, are critical elements in any compliance strategy.

The use of traditional communications media has proven to be effective, yet there are a number of more innovative mechanisms that could augment the other more conventional approaches.

## **2. DEFINITION OF SCOPE AND CONTENT**

This paper seeks to briefly explore the benefits of an enhanced communication strategy with society, and reflects on relevant

considerations and challenges that inform or influence a communications strategy with society.

### 3. DISCUSSION

#### a) THE VALUE OF COMMUNICATION, ENGAGEMENT AND DIALOGUE AS PART OF A COMPLIANCE STRATEGY

When punishment rather than dialogue is in the foreground of regulatory encounters, it is basic to human psychology to experience this as confrontational, which will result in resentment and resistance on the part of taxpayers.

Substantive dialogue between revenue administrators and taxpayers contributes to a win-win strategy. The role of communication, dialogue and engagement in shaping compliance in a regulatory environment has formed the basis for a number of recent pieces of research. Some of the more relevant findings include the following observations<sup>1</sup>:

- Regulations can be easier to apply, monitor, and enforce if they have been developed in a **process of dialogue and consultation** between the revenue administrator and taxpayers.
- Although **co-operative and persuasive strategies** are not always appropriate, when they are successful they **are superior to punitive sanctions** in effectively and efficiently accomplishing longer term compliance.
- A large body of research confirms that **non-coercive and informal alternatives** are likely to **be more effective than coercive law** in achieving long term compliance with norms, and coercive law is most effective when it is reserved as a last resort.
- There is significant psychological evidence for a “minimal sufficiency principle” that the less powerful the technique used to secure compliance, the more likely is long term internalization of a desire to comply. Compliance can be secured despite weak sanctions through discourse persuasion and co-operation.
- Co-operative **strategies of trust, restorative shaming, and praise** are more effective at increasing business compliance with regulation than the application of formal sanctions.

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<sup>1</sup> For a detailed analysis see for example the paper on “*Reducing the risk of policy failure: Challenges for regulatory compliance*” published by the OECD.

In a South African context we have certainly found the research findings to reflect our own experience.

## **b) INTEGRATING AN APPROACH OF EDUCATION & OUTREACH, SERVICE AND ENFORCEMENT**

Whilst communication to taxpayers is critical, it is equally crucial that the communication not be one-way. Without true two-way engagement, aimed at gaining a shared understanding of the realities that face both the revenue administration and the taxpayer, no communications strategy can be successful.

For any compliance strategy to succeed, a revenue administration needs to understand its taxpayers: What will make compliance difficult for them? What will motivate them to want to comply? What technical changes will compliance mean for their business or manufacturing processes? What financial impacts will compliance have?

An adequate level of understanding of a target population is unlikely to be achieved without significant communication, dialogue and engagement with taxpayers and their representatives, which makes these activities critical elements in a compliance strategy.

This could mean that policymaking processes in the future would consist mainly of interactive working methods between the regulators and the regulated.

Our broader communications strategy and policy uses mass media channels (such as television and most widely read publications) to communicate a range of messages, which are complementary. It is also our submission that any mass communications approach should include the following facets:

- SARS will continually make it easier and simpler for honest taxpayers to comply
- SARS will not hesitate to act against blatant non-compliance
- Details of education channels
- Details of submission channels
- Details of other interactive outreach and compliance activities

In this regard, our recent 2007 media campaign sought to balance the friendly face of SARS with SARS as a regulator.

### **c) EDUCATION AND OUTREACH**

In a South African context we have committed ourselves to engaging with taxpayers and their representatives proactively and constructively. On a practical level we give effect to this commitment through (for example) the following initiatives:

- Continuous engagement with tax practitioners / intermediaries and their professional bodies, ranging from frequent surveys and polls, to opportunities to comment on new business processes, forms and legislation before implementation.
- Walk-about, where we make unannounced visits to businesses, and which allow us to assess compliance attitudes and barriers to compliance first-hand.

Taxpayers' compliance behaviour is typically dictated by one of three variables:

- Their knowledge of their obligations and how to meet them,
- Their willingness to comply, and
- Their actual ability to comply with the set obligations.

For a revenue administration's communications strategy and policy to be effective, it needs to address the entire continuum of these three variables.

**In the South African context we have sought to achieve this through the following:**

- Knowledge of obligations and how to meet them, which we focus on through:
  - Making our tax forms and guides available in all 11 of our official languages (with effect from 2008);
  - Dedicated educational coordinators in regions;
  - Specific focus initiatives to ensure that focus groups are kept informed about their obligations;
  - Analysis of frequent errors made in respect of submissions and declarations, which informs the education platform for taxpayers, and which are communicated to target audiences such as tax practitioners / intermediaries;
- Willingness to comply, which we focus on through the following:
  - We know that lack of adequate consultation may fail to secure target group support for the proposed regulation.
  - We are keenly aware of the impact that high compliance costs have on taxpayers' willingness to comply. Increasingly we are

seeking to implement an approach to ensure that a regulatory impact assessment is done before implementation of new regulations, specifically through proactive and constructive engagement with affected taxpayers.

- o Taxpayers lose confidence in tax administrations if they are required to comply with technical rules that do not appear to relate to any substantive purpose – in our engagements with taxpayers and their representatives we are therefore also increasingly seeking to be more open and transparent about our own realities and the reasons and motivations that drive our business.
- Actual ability to comply with the set obligations, which we specifically focus on through upfront engagement with taxpayers and their representatives, to ensure that we fully understand their ability to comply with obligations. The engagements typically consist of an opportunity to review current developments, to make submissions or propose alternative models, and to provide input aimed at ensuring that the target audience would be able to comply with the obligations set.

#### **d) SERVICE**

From a service perspective, we know that taxpayers' compliance behaviour is similarly typically dictated by one of three variables:

- o Their knowledge of their obligations and how to meet them,
- o Their willingness to comply, and
- o Their actual ability to comply with the set obligations.

Researchers have found that if taxpayers feel they are treated unfairly by a tax administration, then they will often respond by refusing to comply with regulatory requirements. We are therefore also increasingly seeking to ensure that our communications strategy gives taxpayers the assurance that they are being treated in accordance with a set of pre-defined guidelines or rules, and that they know that they have a recourse to an independent complaints body should they feel that they have been treated unfairly.

Our media campaigns therefore also focus specifically on the fact that our service offerings are very much driven by the desire to build brand loyalty, aimed at ensuring taxpayers' willingness to comply, and by the desire to ensure that taxpayers are in fact empowered to comply with their obligations, by making it easy to comply, increasing

our accessibility, and by reducing both the burden and cost of compliance.

However, we are also keenly aware of the fact that different factors motivate different taxpayers differently, and that the realities that impact on their ability and willingness to comply differ between sectors, segments and taxpayer types. A mass media approach is not sufficient in and of itself, and we therefore seek to communicate with taxpayers and engage with them on a range of different platforms and on the basis of a tailored approach which includes:

- A Large Business Centre (focusing on large listed corporates)
- A Small Business Unit (focusing on small businesses)
- A Practitioners Unit (focusing on engagement with tax practitioners / intermediaries)
- A Taxpayer Outreach & Education Unit
- The creation of a dedicated Employers Unit, focusing on engagement with Employers who act as our Agents.

The intention with the dedicated units is aligned with our Segmentation strategy and to ensure that appropriate two-way dialogue and engagement informs our decisions, and that affected taxpayers understand the rationale behind business decisions, that they feel they have had an opportunity to shape the process, and that they are both willing and able to comply with their obligations.

Purely from a more practical perspective, our assessment shows that whenever notices or updates are sent to our tax practitioners / intermediaries, call volumes to the Call Centre tend to drop substantially soon after – this alone gives us some sense of comfort that our tailored communications provide certainty in the market place. In this way, external communication not only serves to keep our stakeholders informed, it also alleviates pressures on operations.

#### **e) ENFORCEMENT**

The third element of our compliance strategy, and a factor that impacts on a taxpayers' willingness to comply, relates to a taxpayer's perception of the probabilities of detection of their non-compliance, and the consequences if detected.

In our communications strategy we focus on the message that SARS will continually make it easier and simpler for honest taxpayers to comply, but will not hesitate to act against blatant non-compliance.



We are therefore also increasingly seeking to communicate the consequences of non-compliance, as well as our successes in detecting and addressing non-compliance, through for example the publication of the names of offenders (albeit only once convicted).

#### **f) USING THE MEDIA TO YOUR ADVANTAGE**

In 2007 SARS launched extensive changes to its assessment process (including the use of Adobe smart returns, the use of scanning technology to process returns, the ability to capture taxpayers' returns electronically whilst serving them over a counter at a branch, and a substantial increase in the use of electronic channels.) Any programme as ambitious as this one was bound to encounter challenges.

One of the key elements to our successful implementation was the involvement of the media and ensuring that they were kept informed about developments at SARS.

Whilst the media should certainly retain its independence, their support for our initiatives remains invaluable. In this regard we are increasingly making use of briefing opportunities for the media, where we specifically seek to sketch the context within which certain developments happen.

Given the correct context, we believe the media should then in a position to comment on the challenges we face more objectively.

#### **g) THE BENEFITS OF ENHANCED COMMUNICATION**

Whilst the benefits of an enhanced communications strategy and policy with society are somewhat self-evident, they do perhaps warrant a specific mention.

- A clear communications policy and approach allows a revenue administration to give effect to its compliance strategy, and to truly influence taxpayers' compliance behaviour, through ensuring taxpayers' buy-in and taxpayers being both willing and able to comply with their obligations.
- It results in fewer errors made by taxpayers and their tax practitioners /intermediaries, which in turn means less administrative intervention required on the part of the tax administration.

- It also means that more costly and confrontational enforcement activities can be held over for the more severe cases of intentional non-compliance.
- Furthermore, upfront engagement and dialogue ensures that business processes that are implemented are perhaps more pragmatic and sensible, with taxpayers being able to comply, which ultimately results in less friction and less rework later in the process.
- External communication not only serves to keep our stakeholders informed, it also alleviates pressures on operations through the reduction of unnecessary queries from taxpayers and their tax practitioners / intermediaries.
- Effective communication is key to bringing a level certainty to taxpayers, and has a positive effect on the compliance culture, and consequent level of compliance.

#### **4. CONCLUSIONS**

A wide-ranging communications approach not only serves to keep our stakeholders informed, it also alleviates pressures on operations through the reduction of unnecessary queries from taxpayers and their tax practitioners / intermediaries. Ultimately, it allows a tax administration to truly influence taxpayers' compliance behaviour, through ensuring taxpayers' buy-in and taxpayers being both willing and able to comply with their obligations.



## **ETHICS AND CORPORATE RESPONSIBILITY IN THE TAX ADMINISTRATIONS**

**Olivier Sivieude**

Human Resources Director  
General Directorate of Taxes  
(France)

*CONTENTS: A) Reminder: What is Deontology?. -B) Why is Deontology so intensively considered within the Tax Administrations?. -C) How does the General Directorate of Taxes, in France, promote its values to improve tax awareness?. -I) Internal action for the valuation of deontology carried out by the DGI. -II) The external action of deontological valuation carried out by the DGI.*

### **A) REMINDER: WHAT IS DEONTOLOGY?**

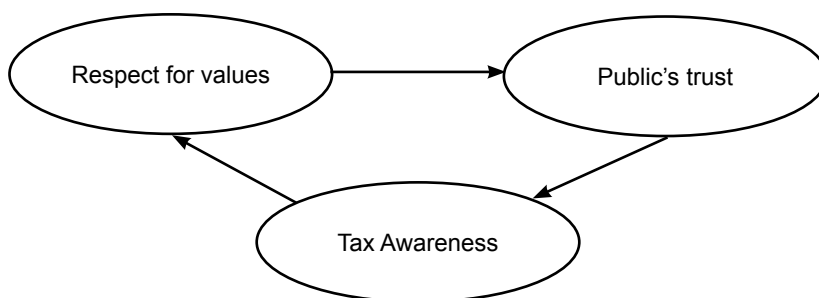
- Deontology may be defined as a series of obligations and behavioral rules that should be observed among themselves by the members of an organization, but also with respect to other individuals.
  - ⇒ Noncompliance with these rules, within or outside the organization may result in sanctions.
  - ⇒ These sanctions must be published in visible places in order to serve as examples.
- However, deontology is also a value referential that underlines the abidance of a collectivity to certain principles (professional secrecy, integrity, neutrality) and serves as basis of its action.
  - ⇒ It is essential that these values be widely shared among the members of an organization. The more they are shared, the more they will be respected.

### **B) WHY IS DEONTOLOGY SO INTENSIVELY CONSIDERED WITHIN THE TAX ADMINISTRATIONS?**

#### **\* Externally**

- The link between a Tax Administration and the Public is always a fragile one.

- The credibility of an Administration depends on the respect for its values (mainly integrity and neutrality).
- Such credibility is one of the fundamental aspects of tax awareness.
- Such credibility has to be earned, it is never acquired.
- Sound instructional actions are necessary: information campaigns during the tax filing season, explanation of new tax measures.



- **Internally**

- There should be respect for deontological values
  - in a Tax Administration where tax is examined and collected, there are risks of noncompliance with professional ethics,
  - preventive or internal control measures will never suffice to thwart noncompliance,
- Ethical values are a strong cohesion factor for a Tax Administration
  - to favor the quality of attention to users,
  - facilitate compliance with their obligations,
  - respond to their questions within the shortest time possible.

**C) HOW DOES THE GENERAL DIRECTORATE OF TAXES, IN FRANCE, PROMOTE ITS VALUES TO IMPROVE TAX AWARENESS?**

- ⇒ Some examples to illustrate this matter ...
- ⇒ Internally (I)
- ⇒ Externally (II)

**I) INTERNAL ACTION FOR THE VALUATION OF DEONTOLOGY CARRIED OUT BY THE DGI**

- 1) Numerous deontological training actions are carried out
- 2) The importance of the deontological values of the DGI are strongly emphasized.
- 3) Internal control, which must look after compliance with deontological rules, is a priority at the DGI.
- 4) Communication actions intended for officials with dissuasive purposes are also carried out.
- 5) At the central offices of the DGI, there is a structure especially in charge of deontology.

**II) THE EXTERNAL ACTION OF DEONTOLOGICAL VALUATION CARRIED OUT BY THE DGI**

- 1) It is essential to better disseminate the purposes of the DGI's action in order to better hold the users liable;
- 2) The Tax Administration should set the example in the use of resources available;
- 3) It is essential to provide the best conditions for voluntary compliance with tax obligations by the users in order to improve tax awareness;
- 4) The continuous concern for equality and neutrality in the treatment given users is a guarantee of sustained awareness;
- 5) Sanctions against fraudulent actions should be exemplary;
- 6) The scope of these actions should be evaluated.

**I) INTERNAL ACTION FOR THE VALUATION OF DEONTOLOGY CARRIED OUT BY THE DGI**

- The DGI strongly suppresses deontological violations.
- and directs actions for appraising deontological values to prevent noncompliances.

**1) Numerous deontological training actions are carried out**

- all newly recruited officials undergo deontological training,
- all Heads of Services (of any rank, from the Departmental Inspector up to the Director) receive deontological training adapted to their functions and seminars are likewise organized;

- The DGI's "Performance Contract" (2006-2008) provides that all officials must undergo deontological training if they have not done so in at least five years.

This action involves around 70,000 officials to be trained in a period of 3 years.

⇒ all training actions are subject to an evaluation.

## **2) The importance of the deontological values of the DGI are strongly emphasized**

- A deontological guide is made available to each DGI official in his Intranet and is systematically used in all trainings;
- The DGI's values are recalled in the introduction of the Performance Contract:

**«Integrity, neutrality and professional secrecy are at the core of our ethics, whereby we endeavor to continue to be irreproachable in fulfilling our missions in the areas of taxation and real estate.»;**

These values are recalled in initial training.

## **3) Internal control, which must ensure compliance with deontological rules, is a priority at the DGI.**

- There is an internal control body, the Main Management Inspection office whose most important mission is internal control;
  - Every year, the heads of local services are assigned internal control objectives;
  - Technical guides and lists are prepared each year to facilitate the application of these controls.
- ⇒ A balance of the DGI's internal control is undertaken each year;
- In addition, all DGI officials are subject to a control of their tax filing obligations.

The territorial directors are annually informed about the balance of these controls.

**4) Communication actions, for dissuasive purposes, are also directed at all officials.**

- To be exemplary, disciplinary sanctions are disseminated every year and commented by the Heads of Services
- Messages are also sent to officials, via Intranet, in order to render them more sensitive to “good practices”.

It is thus that:

- ⇒ computerized applications (national bases) can only be consulted for professional purposes: if this is not so, administrative sanctions are applied.
- ⇒ users are guaranteed strict respect for confidentiality of private data and professional secrecy.

**5) At the central offices of the DGI, there is a structure especially in charge of discipline and promotion of deontology.**

- it is in charge of carrying out preventive activities (training, documentation, ...);
- it conducts administrative investigations and applies disciplinary procedures;
- it constitutes an “observatory” of violations to ethics, on the basis of which internal control practices may be proposed (e.g.: preparation of guides for tracing applications).

**II) THE EXTERNAL ACTION OF DEONTOLOGICAL VALUATION CARRIED OUT BY THE DGI**

**1) It is essential to better disseminate the purposes of the DGI’s action in order to appropriately hold the users liable;**

- **With respect to individuals:**
  - income returns include indications regarding the State’s budget and the allocation of tax revenues
  - open door days of the Tax Administration are also proposed;
  - communication actions are organized for young students and first-time filers (short courses for students during the course of their school period).



- **With respect to enterprises**, seminars and conferences are organized for the benefit of professional organizations when tax reforms are implemented or on matters dealing with fiscal control.

## **2) The Tax Administration should set the example in the use of resources available**

The modernization of the tax services, the dissemination of productivity increases and a constant attention to the administrative cost of the tax, allows for offering users a virtuous image and make them willing to contribute to public expenditures.

This action is carried out without losing sight of the preservation and promotion of the quality of public service.

## **3) It is essential to provide the best conditions for voluntary compliance with tax obligations by the users in order to improve tax awareness.**

In a tax return filing system such as the French tax system, there is a constant concern for tax awareness. Holding users responsible and, accordingly, the development of tax awareness undergo a continuous improvement of the services rendered to the users, by facilitating and simplifying their procedures and especially by rendering the Administration more accessible through the new technologies (telephone, e-mail, Internet....).

- In this respect, the “Program to render tax filing easy” favors the user’s access to the Tax Administration through a certain number of actions. Measurements of the level of accomplishment of said actions are regularly made.
- Thus, for example, the establishment of a Single Fiscal Interlocutor for the companies and individuals is likewise aimed at simplifying access to the tax services.
- The previously prepared tax return was implemented. The data transmitted by third filers (employers, social organizations ...) are taken advantage of and printed in the corresponding sections of the corresponding tax return, with the taxpayers being fully responsible for verifying the printed amounts prior to returning the signed form.
- Distance training actions are regularly proposed to the professionals.

- Actions for providing training in teleprocessing are regularly offered to professionals.

**4) The continuous concern for equality and neutrality in the treatment given users is a guarantee of sustained awareness.**

- Users are capable of benefiting from their rights within the shortest possible terms (mainly with respect to legal claims or tax reimbursements)
- The development of the rescript system and previous agreements on “transfer prices” allows for guaranteeing the juridical situations on validating at the request of the users, the financial and tax amounts they are planning to use.

As regards fiscal control, the respect for reciprocal obligations is “consecrated” in a Taxpayer Charter and in a Verified Taxpayer Charter. In addition, specific measures allow for:

- distinguishing the taxpayer in good faith who benefits upon request, from a regularization procedure during the course of control, on the condition that it be in good faith and that he is up to date in his filing situation;
- undertaking a judicious application of the tax law by favoring the “spirit of the texts” as compared to “the literal meaning”.

**5) Sanctions against fraudulent actions should be exemplary**

Deliberate noncompliances and failure to comply with filing obligations as opposed to the efforts displayed by the collectivity for rendering every user capable of correctly fulfilling his tax obligations should be promptly (the administration should be reactive vis-a-vis filing noncompliances) and severely sanctioned (according to a level of sanction adapted to the seriousness of the facts evidenced).

As for tax fraud, it is the object of systematic judicial follow-up in order that it may be sanctioned with the greatest severity. Penal sentences for tax fraud are the subject of publication in the newspapers to confer them dissuasive publicity.

**6) The scope of these actions should be evaluated**

Independent entities regularly carry out opinion polls among various users. They allow for measuring the level of acceptance of the tax

and being aware of the user's perception of the quality of service rendered.

In addition, user committees have been created and are formed by professionals or individuals who meet regularly to evaluate the information and data devices implemented by the Administration.

**In sum**

Actions intended to internally and externally promote tax awareness should be:

- diversified to adapt to different groups (individuals, professionals, but also underprivileged individuals, school children, ...)
- "massive" in order to be perceived.
- explained in accordance with the deontological values which the Tax Administration endeavors to promote.
- evaluated to determine their effectiveness.

## **ETHICS AND CORPORATE RESPONSIBILITY IN THE TAX ADMINISTRATIONS**

### **Linda Stiff**

Acting Commissioner  
Internal Revenue Service  
(United States of America)

Discussions with our international partners have never been more critical. Without question, one of the greatest challenges we face from a tax administration standpoint in the U.S. is the rapid pace at which our overall economy is becoming more global.

A growing percentage of the tax filings from large and mid-size business are from multinational companies that have a variety of subsidiaries and partnerships operating within an enterprise structure where the ultimate parent is as likely to be foreign as domestic.

In addition, a growing number of U.S. businesses acquire raw materials, inventory, financing, products, and services from foreign businesses.

These are natural outcomes of an increasingly global economy and businesses optimizing their global structures to maximize profits.

Nonetheless, the complexities of globalization and cross-border activity continue to challenge U.S. tax administration.

With multiple domestic and global tiered entities, it is often difficult to determine the full scope and resulting tax impact of a single transaction or series of transactions.

I am sure that many of the tax administrations represented here face similar problems in dealing with the increasing globalization of your taxpayers. I also think it is critical that we continue to share

our experiences and work cooperatively in dealing with the issues presented by globalization.

To that end, I commend you on your topic for today's session – Strategies for the Development of a Tax Culture and I am pleased to offer some insight on one component of that topic – Ethics and Corporate Responsibility for Tax Administrations.

Strong ethical behavior is a core value of the IRS as it must be. This is reflected in our mission statement which says we are to:

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.

It is also reflected in terms of the way we are structured relative to the rest of the Federal Government, in the way we, as an agency, interact with taxpayers, and in the strong personal commitment to strong ethical behavior of our employees.

Allow me to discuss each of those areas individually.

The IRS is somewhat unique relative to other Federal agencies within the U.S. government. Because it is part of the Department of Treasury, it is not classified purely as an "independent agency".

However, in reality it is perhaps the most independent of all U.S. Federal agencies.

For example, unlike most Federal agencies, the IRS is not filled with political appointees who serve at the pleasure of the sitting President.

There are only two political appointees in the entire agency – the Commissioner and the Chief Counsel. All other employees, including me, are career civil servants.

And, though the Commissioner is a political appointee, he or she is nominated for a fixed term, unlike other political appointees.

Specifically, the Commissioner serves a 5 year term – a length of time longer than a Presidential term – as a means of further insulating him or her from political influence.

Another factor supporting the agency's independence is that it does not take positions on policy matters. Our job is tax collection and administration – not tax policy.

We will comment on issues associated with how a particular change in the tax law might be implemented, but we take no position on the underlying tax policy issue itself.

This independence is critical to our relationship with taxpayers. If taxpayers question the independence of the Service on key issues they are less likely to comply voluntarily or to demonstrate strong corporate responsibility.

Strong ethical behavior is also reflected in the manner in which we interact with taxpayers.

The premise of that interaction is that most taxpayers are honest and are willing to pay their fair share. But given the complexity of our tax code, it is sometimes difficult for them to understand or even calculate what their fair share is.

That is why we have in place strong taxpayer service programs designed to assist taxpayers and tax practitioners in any way we can.

Some of the most exciting and innovative programs we are utilizing in terms of working with taxpayers are in the corporate arena. These programs are designed to improve compliance and encourage greater corporate responsibility.

We recognize that we have many things in common with taxpayers, especially our corporate taxpayers.

For example, the IRS wants to get it right in terms of tax administration. We want to ensure compliance with the tax laws.

Corporate taxpayers want to get it right in terms of complying with the tax laws.

Corporate taxpayers also need a level of certainty – so do we. And, we both want to achieve that certainty sooner rather than later.

We also both want to be more efficient. At the IRS, we want efficiency not only in tax administration but in how we manage our organization.

With that as a backdrop we began to look at ways we could work with corporations in the pre-filing environment.

Perhaps the hallmark of our efforts thus far is our Compliance Assurance Program – or CAP.

CAP is a pre-filing compliance assurance process that focuses on issue identification and resolution through real-time interaction between the taxpayer and IRS.

When we launched the CAP pilot program in 2005, we had 17 companies participating. Last year 34 taxpayers participated and for 2007 the number has risen to 73.

The results thus far appear positive. Our initial cases worked under CAP resulted in a reduction in time from filing to case closure from 52 months to just fewer than 6.

But, we know that no matter how hard we work at taxpayer service or corporate responsibility that some taxpayers will still be noncompliant. That is why we balance our strong taxpayer service program with an equally strong enforcement effort.

One of the most recent new tools we have added to our enforcement arsenal is our Whistleblower Office.

This office was established by Congress in 2006 to process tips received from individuals who spot tax problems in their workplace, while conducting day-to-day personal business and anywhere else they may be encountered.

A reward worth between 15 percent and 30 percent of the total proceeds the IRS collects could be awarded, if the IRS moves ahead based on the information provided.

This program involves the individual taxpayer in assisting our enforcement efforts and helps insure that everyone is subject to the same ethical standards.

We also recognize that an important element in promoting voluntary compliance is making sure that lawyers, accountants and other tax practitioners behave in an ethical manner.

That is why we have upgraded dramatically in recent years our Office of Professional Responsibility. This office has broad authority to regulate those who practice before IRS or the Department of the Treasury for incompetence or disreputable behavior.

Until 2002 this office was known as the Office of the Director of Practice. However, in the height of the tax shelter wars, we saw a real opportunity for the office to become a real enforcement tool in combating tax schemes by sanctioning the individuals who promote them.

The office was renamed and has undergone a three-fold increase in staffing in order to better combat ethical abuses by practitioners.

Now, let me spend a few minutes discussing the strong ethical standards that apply to all IRS employees.

The IRS employs approximately 100,000 people in locations spread across the country. But, before we hire any new employee they must first undergo a rigorous background check. Depending on the position this background check can be very extensive and could take weeks if not months.

Once hired, new employees – like existing ones – are subject to various restrictions on their behavior.

Some of these restrictions are imposed by statute.

In 1998 the U.S. Congress passed the IRS Reform and Restructuring Act. Included in section 1203 of that legislation is what IRS employees “fondly” call the 10 Deadly Sins.

They are called that because Congress required that any IRS employee who violated one of these provisions would be terminated. These are broad standards and include such things as:

- Willful failure to get the required signatures on documents authorizing the seizure of a taxpayer’s home, personal belongings on business assets;
- Providing false statements under oath with respect to a material matter involving a taxpayer;
- Any violation of a taxpayer or other IRS’ employee’s civil rights or other right guaranteed by the constitution;
- Falsifying or concealing mistakes made by any employee with respect to a matter involving a taxpayer or taxpayer representative;



- Conviction of assault or battery on any taxpayer, taxpayer representative or other IRS employee;
- Violations of the Internal Revenue Code, Treasury Regulations or IRS policies for the purpose of retaliating against or harassing a taxpayer, taxpayer representative or another IRS employee;
- Willful misuse of taxpayer information otherwise protected by IRS regulations;
- Willful failure to file a timely tax return unless such failure is due to reasonable cause and not willful neglect;
- Willful understatement of Federal tax liability, and;
- Threatening to audit a taxpayer for purposes of extracting personal gain or benefit.

In addition to abiding by these 10 requirements themselves, every IRS employee is required to report possible violations of Section 1203 promptly.

The same law that included the 10 Deadly Sins also included another key provision designed to protect taxpayers. Section of 1204(b) requires the IRS to ensure that managers do not evaluate employees using any record of tax enforcement results or base employee successes on meeting arbitrary production goals and quotas.

This provision is designed essentially to ensure that employees are not encouraged through the use of professional advancement, financial or other incentives to close cases or make assessments based on anything other than their best judgments of the case.

In addition to these statutory provisions, there is a series of overlapping regulatory requirements that ensure that IRS employees behave with only the highest ethical standards.

For example, by virtue of being a division of the Department of the Treasury, the IRS is subject to the Treasury Department's Employee Code of Conduct that is included in the Treasury Ethics Handbook.

The Treasury Ethics Handbook includes interpretive guidance on a variety of recurring ethics issues as well as the Standards of Ethical Conduct for Employees of the Executive Branch.

In addition to these restrictions, every IRS employee is subject to broad ethical standards that apply to all Federal employees. In fact the U.S. has an Office of Government Ethics that exercises leadership in the executive branch to prevent conflicts of interest on the part of Government employees, and to resolve those conflicts of interest that do occur.

The OGE also partners with executive branch agencies and departments – like the IRS – to foster high ethical standards for employees and to strengthen the public's confidence that the Government's business is conducted with impartiality and integrity.

So clearly, IRS employees are subject to a myriad of ethical requirements, the logical question is how such requirements are enforced.

The first step is to remind employees periodically of their ethical requirements. This is done in several ways.

First, employees must take ethics training at least once a year. This is generally done on-line at the employee's convenience.

Second, IRS leadership issues periodic messages to all employees reminding them of their responsibilities under ethic laws.

For example, leadership may post a message on IRS.gov – the IRS website – that IRS employees must file all tax returns on a timely manner.

The third manner for enforcing ethic requirements is more formal. The U.S. has established a Treasury Inspector General for Tax Administration, which is commonly referred to by its acronym – TIGTA.

TIGTA's primary responsibility is to provide independent oversight of IRS activities. It is also committed to the prevention and detection of fraud, waste, and abuse within the IRS and related entities.

A good example of what TIGTA does can be seen by referring back to something I discussed earlier – the prohibition that IRS managers not evaluate their employees using any record of tax enforcement results or base employee successes on meeting arbitrary production goals and quotas.

This is an area where TIGTA will periodically review our work to ensure we are in compliance with the law.

The latest review came in March of 2007 and it found that IRS' efforts to enforce the employee evaluation requirements under Section 1204 are generally effective and are helping to protect the rights of taxpayers.

There are also required financial disclosures by certain IRS officials. Currently there is a broad requirement for financial disclosure by the Ethics in Government Act that all senior officials – including those in the IRS – must complete.

In addition to this, the IRS also requires mid-level officials to complete a financial disclosure form if they participate in such areas as contracting, procurement, or the administration of grants or subsidies or other federal benefits.

As I conclude, let me reiterate something that I think we all know. Strong ethical behavior and corporate responsibility exists only in a **culture** that allows such behavior to flourish.

Likewise strong tax administration can only succeed in such a culture.

That is especially true when the tax collection system is based on voluntary compliance. In such a system, taxpayers must first understand how their fair share **assessment** was determined and that it is the same way that the fair share of their neighbors or corporate competitors is calculated.

They must also believe that everyone is **paying** their fair share and that the money is being used appropriately.

And they must believe that their confidential information is being protected.

These are difficult standards which can only be attained through an open, transparent system that promotes a culture of strong ethical behavior and corporate responsibility.

The IRS collects \$2.2 trillion annually for the U.S. government. We have what is considered by most standards to be a very good voluntary compliance rate of 85 percent.

But, we know that though the voluntary compliance rate is comparatively high, the fact that 15 percent of our taxpayers do not pay all of their taxes on a timely basis could undermine our entire system.

That is why we are spending considerable effort looking at that 15 percent to determine what we might do from a taxpayer service or an enforcement perspective to reduce it as much as possible.

In the end, we know we can not collect every dollar owed. To do that would take enforcement actions so draconian as to be inconsistent with voluntary system that allows us to collect the \$2.2 trillion that we do collect.

It would require us to fundamentally change the way we interact with taxpayers at all levels and it could undermine our culture of voluntary compliance and belief in the ethical behavior of most taxpayers.

Doing that might mean we would collect even less than we do now and spend more resources doing it.



## **TOPIC 2**

### **STRATEGIES FOR FACILITATING TAX COMPLIANCE**



Lecture

Topic 2

## **STRATEGIES TO FACILITATE TAX COMPLIANCE**

**Luis Pedroche y Rojo**  
General Director  
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(Spain)

*CONTENTS: Summary. -Introduction. -1. Causes of Tax Noncompliance. -2. Beneficiaries of The Voluntary Compliance Measures. -3. Measures To Foster Voluntary Compliance. -a) Simplification of tax regulations and their general dissemination. -b) Tax information by request of citizens. -c) Opening new communication channels. -d) Assistance services for compliance with tax obligations. -e) Measures to favor customs brokerage. -f) The Electronic Tax Administration. -g) Fostering social cooperation. -h) Civic-tax education as a preventive measure: an investment in future taxpayers. -i) Communication strategy. -j) Transparency of the Tax Administration. -k) Citizens' opinion. -l) Preventive actions to avoid noncompliance. -Conclusion.*

### **SUMMARY**

The purpose of this presentation is to analyze the different measures aimed at facilitating and fostering voluntary or spontaneous compliance with tax obligations. Its core and inspiring axis is based on the idea of consolidation and improvement of taxpayer assistance and service as, undoubtedly, the best strategy against tax fraud, to the extent they are aimed at preventing it, that is to say, avoiding it. To such end, two previous issues are addressed initially: firstly, determining the causes of tax noncompliance and secondly, the target taxpayers for the voluntary compliance measures.



As regards the causes of tax noncompliance, we provide data taken from different publications and public opinion surveys conducted in Spain. As regards target taxpayers for the voluntary compliance measures, we propose segmenting the different types of noncompliance and, therefore, of the measures' target taxpayers. Both analyses provide a framework to the working area to which the design, development and implementation of the foregoing measures apply.

Once the principles that shall govern any action for the design and implementation of such measures have been defined, a broad array of measures is analyzed, among which we may highlight: firstly, those directly related to the day-to-day performance of the Tax Administrations in this field of activity. Thus, we reflect on the forms of providing tax information to citizens and rendering assistance services and, specifically, the Administrative assessments of tax statements as well as the possibilities offered by the new technologies in this respect.

Secondly, we also set forth measures such as the promotion of social cooperation, participation and tax education programs or the commitment to transparency in the Tax Administration activity as regards actions that contribute, support and favor voluntary compliance with tax obligations. To conclude with this analysis, we mention other measures related to this scope of Tax Administrations' action.

The presentation ends by highlighting the need for a balanced and integral performance for the two great strategic courses of action in the performance of the Tax Administrations in the last few years: on the one hand, increase and improve the services offered to those who are willing to meet their tax obligations and, on the other, develop and intensify the instruments that enable to discover and identify noncompliant taxpayers. Achieving greater efficacy and efficiency along both lines, as two sides to the same goal, is the ultimate objective and the mission commissioned to the Tax Administrations, that is to say, the effective implementation of the State tax and customs system.

Based on the foregoing statements, the Tax Administration information and assistance constitutes a right of taxpayers to enable compliance with their obligations, especially if we consider the complexity entailed by the tax system. Therefore, it is necessary to consolidate modern Tax Administrations that see to the growing demand for services and in which the principles of efficacy, efficiency and taxpayer service are articulated as the core axis in addition to leveraging the opportunities offered by the new information and communication technologies in this area.

## INTRODUCTION

Since its creation in 1992, the Tax Administration has been mandated by Law to enforce the State tax and customs systems effectively as well as the other resources of other national or European Union Administrations and Public Entities, the administration of which stems from a Law or Convention.

It was created under the general State Administration modernization process, based on the idea that the ultimate goal of the Administration is to serve the citizen effectively and efficiently. In this regard, efficacy and efficiency as guiding principles of the administrative function are present in the two main courses of action of the Tax Administration: on the one hand, the taxpayer assistance and information efforts, which pursue reaching the highest degree of taxpayers' voluntary compliance as well as other subjects, facilitating compliance with tax obligations and reducing to the maximum extent possible indirect tax pressure and, on the other, the activity to control or combat tax fraud, from the most severe to the less severe cases, which guarantees the effective application of the tax and customs system, and therefore, the generality and equity in the contributions to the tax burden.

The purpose of this presentation is to analyze the different measures aimed at facilitating and fostering voluntary or spontaneous compliance with tax obligations, based on the idea that the consolidation and improvement of taxpayer service and assistance systems are undoubtedly the best strategy against fraud, to the extent they are geared at preventing it, that is to say, avoid it.

Tax noncompliance, in its diverse forms, is a phenomenon that affects every modern society. All the Administrations undertake efforts to convince society of the value of compliance with legislation for the good operation of the Rule of Law, and try to counter a phenomenon that seriously affects the principle of solidarity and equality of citizens before the law. The combat against tax noncompliance has become one of the fundamental strategic objectives of the Tax Administrations, for ethical reasons, because the efficacy in this struggle is closely tied to the effective application of the principle of tax justice, as well as strictly economic reasons, since noncompliance hinders the sufficiency of government revenue and the stability of the models of economic growth proper.

The need for new approaches adapted to modern democratic societies, open and internationalized, has fostered the pursuit of more imaginative formulae in the combat against fraud, provoking significant mindset changes. Thus, we have shifted from a strategy based only on the correction of behaviors and the extensive use of the coercion instruments to the introduction of measures to prevent noncompliance.

On the other hand, awareness has been raised on the need for Tax Administrations to perform according to their purposes and adjust their means and procedures to predefined objectives. Therefore, the struggle against tax noncompliance shall be described as a planned activity whose strategies and measures shall be partly considered a progressive effort to modify the mindset and behavior of citizens in the face of fraud.

After these introductory comments, and prior to approaching the analysis of the specific measures or strategies to facilitate and increase taxpayers' voluntary compliance, and therefore, reducing the degree of tax noncompliance, it is interesting to address two previous questions: firstly, which are the causes of tax noncompliance and, secondly, who are the target taxpayers for the voluntary compliance measures.

## **1. CAUSES OF TAX NONCOMPLIANCE**

As regards the causes of tax noncompliance gathered in the public survey "**Annual Tax Barometer 2006**", data reflect a polarized situation in Spain. Therefore, half the participants think that tax compliance has improved while the other half thinks it has worsened, with the increasing perception of tax fraud growth. This result should make us reflect upon the causes, without forgetting that compliance and tax fraud are two sides of the same coin.

The "Tax Barometer" evidences that the block of moral causes of tax fraud, such as the lack of honesty and civic awareness, has experienced a slight growth in the last three years, reaching 24%, while the other three blocks (economic, administrative and tax/services' ratio) remain in the mean of the last three years. According to the answers given by the participants and after grouping the different causes of tax fraud, the main causes by which tax fraud prevails in Spain may be summarized in two: on the one hand, the lack of taxpayers' honesty and civic awareness and, on the other, the impunity of certain fraudsters. According to the 2006 participants, concealing economic activities

from the Administration and Social Security is the most detrimental type of fraud for society overall.

## **2. BENEFICIARIES OF THE VOLUNTARY COMPLIANCE MEASURES**

As regards this issue, that is to say, the main beneficiaries of the voluntary compliance measures, from the standpoint of reducing tax noncompliance, we may distinguish four different taxpayers' behaviors:

Firstly, the group formed by the taxpayers who shall be always noncompliant; in other words, a purposeful tax fraud, pursued by noncompliant individuals. In this group, we would find the most serious tax noncompliance behaviors, from those implying full noncompliance with tax obligations (an underground economy), up to the activities purely and exclusively aimed at obtaining inappropriate tax refunds (fraud schemes).

This group of taxpayers is not apparently the main beneficiary of the measures to facilitate and foster voluntary compliance. Although there are certain measures such as tax education at school or the effect induced by tax information, which in the medium and long term may help to reduce it, it is evident that the Tax Administration efforts on this group are focused on controlling and combating tax fraud.

A second group of taxpayers, which may be deemed partially noncompliant individuals, are those who fail to comply only when they have the opportunity or chance. Therefore, it is an accidental but accepted fraud.

In this case the effect of the tax education measures to reduce this type of behavior is clearer. This reduction would arise, on the one hand, from those experienced by the new incorporation of noncompliant individuals and, on the other, a greater receptiveness from this group of noncompliant individuals to the effects of isolation and social stigma from being a tax violator on a highly educated society.

The third group of noncompliant individuals would be made up by those who base their noncompliance on different reasons, but under a common note, which is no other than lack of knowledge or difficulty for certain individuals or corporations in facing the tax world. We may

provide the following examples of the arguments provided by such group of taxpayers:

- Complexity of the tax norm.
- Ignorance of the obligation to file a tax statement.
- Difficulties in completing such statements.
- Difficulties to access the Tax Administration offices.
- The large number of tax obligations to be met.

As it may be inferred, this third group of taxpayers is the target of most of the strategies or measures to facilitate and foster voluntary compliance.

Lastly, there is a group of taxpayers, made up by those who meet their tax obligations. We should not forget that the great majority of taxpayers meet their tax obligations, by which these measures for voluntary compliance shall be equally aimed at compliant taxpayers overall.

Ultimately, the strategies geared at facilitating and fostering voluntary compliance shall be aimed at achieving taxpayers' change of behavior to become part of the last group, the compliant taxpayers.

### **3. MEASURES TO FOSTER VOLUNTARY COMPLIANCE**

Before starting the analysis of the plausible measures to foster voluntary compliance, it is necessary to refer to a series of principles that shall be considered in any effort aimed at fostering voluntary compliance:

1. Full respect of the rights and guarantees of citizens as set forth by law.
2. The first commitment towards citizen assistance for the compliance with tax obligations.
3. Offering convenient, expeditious and simple procedures regarding tax obligations, avoiding unnecessary proceedings and mobility by citizens, with new channels to communicate with taxpayers, facilitating the payment of tax debts.
4. Expeditious and fluent communication with citizens based on the most modern technologies.
5. Security and confidentiality in relations with citizens.
6. Generality and equity in the enforcement of the tax system, for all citizens to contribute their fair share.

7. Professionalism, fairness and transparency in the acts of the Tax Administration, in order to generate the highest level of trust in citizens.
8. Pursuit of efficacy and efficiency in all the tax procedures undertaken by the Tax Administration.
9. Ongoing adjustment to the economic and social context and the new needs of citizens.
10. Participation of other government bodies, institutions and social entities to render services that facilitate citizens' compliance with tax obligations.

These guidelines shall always govern the design and implementation of measures geared at improving voluntary compliance. In the course of this presentation, among the broad variety of measures to favor voluntary compliance, we shall firstly highlight those that relate to the day-to-day work of the Tax Administrations in this area. Thus, we shall reflect upon the need to simplify and disseminate the tax regulations, on how to render tax information to citizens and the rendering of assistance services, among which we may underscore, the Administration's tax assessment as well as the possibilities enabled by new technologies in this sense.

Secondly, we shall also refer to other measures such as fostering social cooperation, participation and implementation of tax education programs or the commitment to transparency in the Tax Administration activity as regards procedures that contribute, support and favor voluntary compliance with tax obligations.

#### **a) Simplification of tax regulations and their general dissemination**

Most certainly, our tax systems are complex and the regulations governing them are permanently modified. We shall acknowledge that none of the three important taxes: Value Added Tax, Individual Income Tax and Corporate Income Tax are simple taxes. Likewise, the Income Tax for Non-residents poses certain issues in its enforcement on the target taxpayers' group. All this entails that the basic elements on which the Tax Administration of each country shall rely are not easy to understand for most citizens. Even businesses, especially if they are small, face difficulties in maintaining adequately updated tax regulations and being well informed on the enforcement thereof and how to appropriately meet their formal obligations.

If we analyze the data from the Tax Barometer 2006, taxpayers' evaluation of the difficulty to understand tax regulations reaches 2.9 on a scale of 4. Although there were no changes for Income Taxes and Corporate Taxes, the evaluation of the difficulty regarding the Value Added Tax has increased to the level attached to the other two types of taxes.

Therefore, it is an unfavorable factor that should be corrected or, at least reduced, on the one hand, by the effort required to reduce to the extent possible the difficulties of such norms, employing language to facilitate its understanding, without detriment to the technical accuracy thereof, and on the other, by developing assistance measures of different sorts, such as creating guides and handbooks to assist in the preparation of tax statements, in a more informal language and employing case studies and examples.

The great difficulty in the compliance with the material and formal obligations imposed upon taxpayers by the tax regulations, as well as their constant amendments and construal difficulties, makes it vital for the Administration to inform taxpayers on their rights and duties and help them in their exercise and compliance respectively. It should be taken into account that this complexity is especially evident in the compliance with tax statements, since most tax regulations provide for the self-assessment procedure.

Consequently, according to the Tax Barometer of 2006, the number of taxpayers that complete tax statements on their own is still a minority (13%), against those who resort to external assistance (87%).

Dissemination of taxpayers' rights and duties appears as a demand arising from tax regulations; thus, the General Tax Act, among other rights provides for the right of taxpayers to be informed and assisted by the Tax Administration in the exercise of their rights and the compliance with their tax obligations. Likewise, and in order to complete this assertion, the Law establishes the duty of the Administration to provide taxpayers the information and assistance required as regards their rights and obligations.

The Tax Administrations shall make all the means available to provide taxpayers the information on their rights and duties, and consider in their communication strategies the specific features of the different types of beneficiaries. Therefore, specific treatment shall be given to the groups of taxpayers that face greater difficulties

in learning about the tax regulations and their tax obligations, as in the case of immigrants and disabled individuals. The Spanish Tax Administration has developed initiatives to reach such groups, among others, meetings and informative discussions in the offices, as well as designing products especially adapted to individuals with certain disabilities. Another specific feature considered by the Spanish Tax Administration in the information and assistance efforts is the Spanish multilingual context. In this case the Tax Administration has fostered the use of Spanish languages different from Castilian on the documents and communications geared at citizens, as a form of broadening the channels by which they may know their rights and guarantees and their tax obligations.

The dissemination of tax regulations and tax information we are referring to is the one provided to citizens in general terms, without any request thereof, and therefore, broad in nature, which may be materialized according to two main courses of action:

1. The first one would consist in the annual publication of the updated texts of the State tax regulations with their amendment from the previous year, as well as a list of all the tax laws passed in the course of such year. Likewise, the appropriate channels to disseminate the administrative criteria in place to enforce the tax regulations shall be established, enabling to query IT databases containing such criteria.

In this respect, new technologies are relevant, since the publication of regulations on the Internet as well as the queries requires a very short time and offers users very useful browsing functionalities.

2. The second course of action would span the non-personalized information communications and initiatives. In this field, the most relevant undertakings by the Spanish Tax Administration are the following:
  - Drafting a Letter of Services aimed at informing citizens of the services provided by the Tax Administration, the quality commitments assumed in their rendering and their rights with regards to their relation to the Tax Administration.
  - The information provided by means of advertising campaigns, institutional as well as specific to Tax Administration products or campaigns, which are performed by different media, press, radio and television.



- Publishing informative booklets aimed at providing taxpayers specific information on the applicable taxes.
- Forwarding communications to inform on the taxation of certain sectors, activities or sources of income.
- Newsletter. The Tax Administration sent 40,541,810 newsletters in 2007.
- Publishing guides and handbooks to draft tax statements for different taxes (basically Individual Income Tax, Corporate Income Tax, Value Added Tax and compliance with other formal obligations) distributed in print at a low cost, as well as via the Internet on the Tax Administration Web page. Specifically, the number of manuals published in 2007 amounted to 387,500, of which 286,000 refer to the IIT, 40,000 refer to the Corporate Income Tax and 61,500 to the Value Added Tax, without detriment to its electronic distribution that enables the partial or total printing thereof.

#### **b) Tax information by request of citizens**

The Tax Administrations shall attempt to reduce the difficulties in learning and interpreting the tax regulations as mentioned before, not only by the foregoing general actions, but also by providing answers to specific taxpayer requests, that is to say, by means of personalized information.

Such personalized information procedures may be undertaken according to different modalities, such as the answers to specific taxation questions, or rendering the full text of certain queries or resolutions upon citizens' request, or otherwise, the answers to the request for information on the status of proceedings in which the requesting parties are stakeholders.

A very useful instrument that enables to provide information faster to citizens is to create a database of frequently asked questions and the answers thereto, so that the information services may rely on the appropriate answers immediately. In Spain, the number of queries to said Tax Administration Database (by the name of *INFORMA*) amounted to 4,818,902 in 2007.

Personalized information and assistance in the case of written queries shall consider, whenever possible, the modality we may call "binding query", by which the answer provided by the Tax Administration to the

query posted is binding for it. This type of queries, or rather answers, assures taxpayers that when they fit the criteria set forth in the answer provided by the Administration, the bodies in charge of enforcing taxes shall abide by the contents therein and also, the Administration's control shall be limited to verifying the consistency of the query, the taxpayer's status and the application of the criteria in the answer provided.

### **c) Opening new communication channels**

The efficacy of the personalized information actions and relation with the Administration may be significantly increased on the basis of a multi-channel strategy, aimed at offering taxpayers different channels for each one to choose the channel deemed most accessible at a lower overhead cost to request and obtain the information required, especially prioritizing those that spare citizens the inconvenience of having to visit the offices of the Tax Administration.

In this sense, one of the most broadly used communication channels is the telephone: 5,270,618 calls were made to the Spanish Tax Administration tax information telephone number in 2007. Centralized management of this service results in an improvement of its efficacy and efficiency, not only because the use of a single number across the national territory makes it easy to remember for citizens, but also because it enables the homogeneity of procedures and a more rational and faster distribution of calls. The Spanish Tax Administration relies on a Telephone Assistance Center that provides telephone assistance for a number of services.

Likewise, the implementation of voice recognition units that enable to carry out repetitive proceedings, which could undoubtedly spare the taxpayers who do not rely on the Internet a visit to the Tax Administration offices. Such units processed 6,373,589 calls in 2007, 7.70 percent more than in 2006, becoming one of the services in greatest demand by taxpayers.

The increasing use of the communication channels offered by the new technologies is especially worth highlighting, a field in which the Tax Administrations have quickly evolved to render their services. It is evident that almost all the Tax Administrations have created a free access area on the Internet that offers all types of information and assistance, together with another restricted area that may be only accessed with a user ID that serves to undertake different proceedings.

Finally, we shall mention the use of original communication channels such as text messages, to which the Tax Administrations shall adapt their services in order to reach the largest number of citizens and spare them, as mentioned before, the visits to the tax offices, which are always burdensome.

Other issues are worth mentioning as regards the communication channels implemented by the Tax Administration. Firstly, the customer service protocols and procedures shall be available, personal as well as telephone assistance and training for the staff performing such tasks, with the purpose of guaranteeing an appropriate treatment of citizens and ensuring they receive the information appropriately. Likewise, great attention shall be placed on the design and configuration of the Internet page, for users to enjoy an optimal use and productivity of the information offered thereby. Each new access by taxpayers to the different services of the Tax Administrations entails a new possibility of resorting to them in the voluntary compliance strategy. Therefore, certain aspects in the rendering of such services shall be improved, such as:

- Avoiding lines and crowds in the offices.
- Avoiding placing citizens on hold over the telephone for a long time.
- Developing a streamlined Web page with an appropriate search system.

#### **d) Assistance services for compliance with tax obligations**

In addition to the measures aimed at providing tax information to citizens, whether of a general or personalized nature, the Tax Administration rendering of assistance or help services constitutes a fundamental course of action to directly facilitate and foster voluntary compliance with tax obligations.

Among this group of measures, we may mention the following ones:

#### **1. IT SOFTWARE TO ASSIST IN THE COMPLETION OF THE MOST RELEVANT STATEMENTS.**

Currently, the Spanish Tax Administration distributes software to prepare twenty-two different tax statement models that cover the three most important tax entities (Individual Income Tax, Corporate Income Tax and Value Added Tax) and the main informative statements. Such software

may be obtained in a CD-Rom at the offices of the Administration or downloaded from the Internet and are geared at assisting taxpayers in filing their statements. Once completed, taxpayers may either print out their statement on a white sheet of paper and file it just like any other pre-defined model, or otherwise file it directly via the Internet, for which it is necessary to rely on a digital signature certificate that fully guarantees the security and confidentiality of the information. Among such software, we may underline, on the basis of its relevance, the "Assistance software to file the Individual Income Tax" (PADRE, as per the Spanish acronym).

The main advantage of this software is the high degree of reliability for taxpayers, since it includes mechanisms that correct the calculation mistakes and incorporates controls that apply criteria derived from tax regulations.

In Spain, in 2007, 27,536,176 statements were filed with assistance software, which accounts for over 98% of the overall Individual Income Tax statements filed, over 86% for Value Added Tax, over 99% of the overall Corporate Income Tax statements filed and over 92% of the overall tax information statements.

## **2. DRAFT INDIVIDUAL INCOME TAX STATEMENT**

Currently, more and more countries send taxpayers informative Individual Income Tax statements completed by the Administration. This strategy intends to facilitate for certain groups of taxpayers their relation with the Tax Administration, avoiding the burden of having to draft their statement. It should be considered that this sector of taxpayers generally interacts with the Tax Administration only once a year.

The draft statement simplifies and facilitates such relation, since, once received, if the taxpayer considers it reflects his/her tax status for the purposes of the tax and is in line with the contents thereof, he/she shall be able to confirm or subscribe it, which renders it a tax statement to all purposes and effects. In case the taxpayer objects, the stakeholder may indicate to the Administration the data deemed incorrect for the rectification thereof, or simply ignore the draft and proceed to the self-assessment.

In Spain, 10,555,831 draft statements were issued for the Individual Income Tax in fiscal year 2006, which accounts for 60% of the Income Tax statements filed in the same period. According to such data, filing the draft allows a high percentage of taxpayers to meet their tax obligations at a low cost and with little contact with the tax office. The draft may be confirmed by a number of different channels, which enables each taxpayer to employ the most convenient one:

- Internet.
- Telephone.
- Tax Administration offices.
- Banks, ATMs, and electronic banking.
- Text messages.

### **3. FORWARDING TAXPAYERS TAX DATA ON THE INDIVIDUAL INCOME TAX**

Sending tax data in Spain is an information and assistance service offered to citizens for them to know the tax data held by the Tax Administration required to meet their Income Tax statements.

The service is offered upon request of the stakeholders and it may be delivered over the telephone by automated voice recognition units, via the Internet or by means of a direct request at the Tax Administration offices.

The information may be received by mail at the stakeholder's tax domicile or via the Internet. Likewise, in order to facilitate the completion of the statement, this information may be automatically fed into the assistance software to prepare the Individual Income Tax. Along with the information, the instructions and a page with potential rectifications and clarifications on the tax data sent is included, which may be placed in the envelope of the statement or forwarded electronically by those who file their statements electronically, so that the clarifications or rectifications may be considered in future audits.

In Spain, 16,627,217 taxpayers received the Individual Income Tax draft or tax data for fiscal year 2006. It is interesting to highlight that, if considered as a whole, the draft statement and tax data forwarding services cover almost 94 per cent of the overall taxpayers registered in this tax, so that they consolidate as the services with the greatest demand that also enable to rely on statements with a greater degree of tax compliance.

#### **4. DRAFTING STATEMENTS AT THE OFFICES OF THE TAX ADMINISTRATION**

Taxpayers registered in the Individual Income Tax who do not rely on a PC or who prefer to do so may request an appointment at the offices of the Tax Administration to have a statement drafted. In 2007, 3,591,536 appointments were requested to draft the Individual Income Tax statement.

#### **5. MEASURES AIMED AT FACILITATING THE PAYMENT OF DEBTS**

Establishing debt payment facilities constitutes an essential element in assisting taxpayers to complete their statements and self-assessments. Among such facilities, we may distinguish the following modalities:

- The different forms of making the debt payments in cash: by debit in a bank account, by credit card, by bank transfers and charged to the tax current account. We should highlight the payment of debts via the authorized related entities, which amounted to 188 as of December 31st, 2007.
- Deferrals and installment plans for tax debts, for those in the voluntary payment stage as well as the enforced collection stage.
- Payment of debts with assets that belong to the Spanish Historic Heritage.
- Extending the possibility of directly debiting the tax debt for the majority of tax statements to benefit from the advantage of charging the debt to the taxpayer bank account on the last day of voluntary payment, regardless of the date on which the statement is filed.

##### **e) Measures to favor customs brokerage**

The introduction of automated procedures for customs brokerage enables the operator, when the goods received are subsequently shipped, to make the request and obtain authorization automatically. This type of measures, along with other IT and management improvements reduce dispatch times for goods and avoids visits by the operators to the Customs Offices.

In this relevant scope of Tax Administration action it is relevant to highlight the introduction of the Authorized Economic Operator in the framework of the European Union that shall enable to rely on an entity that enhances trust in the relations with the Tax Administrations and Customs in such an important area of activity.

#### **f) The Electronic Tax Administration**

Regardless of the foregoing references to the different information or assistance services that may be rendered with the media offered by the new information and communications technologies, a specific reference shall be made to the electronic administration, given the speed and dissemination of the advances in this field and their great impact on the relations between the Administration and citizens.

Among the technological advances and based on the possibility of developing taxpayers' services, we may mention the following:

- Broad use of cellular telephony,
- Enhancements in PC processing and storage capacity and
- Implementation of broadband and wireless networks.

Such fast evolution enables the different Public Administrations to react to citizens' requests electronically. In the case of Spain, the Act on Citizens' Electronic Access to Public Services, passed on June 22<sup>nd</sup>, 2007, has acknowledged the right of citizens to interact with the Public Administrations electronically, thus embodying their obligation to develop the electronic media and systems required to exert such right fully as of December 31<sup>st</sup>, 2009.

The new technologies are playing a key role in the sphere of the Tax Administrations, which is evident in the case of the Spanish Tax Administration, a leading organization in our country as regards the employment of new technologies, by the number of accesses to its Internet page, which exceeded 235 million in 2007, 21.69 per cent more than in 2006. Undoubtedly, such high number of accesses has saved citizens many personal visits to the tax offices, which subsequently saved them time and inconveniences.

Since 1996, when the Spanish Tax Administration launched its Web page ([www.agenciatributaria.es](http://www.agenciatributaria.es)), mostly to offer an information service, the technological development has enabled to provide a growing array of Internet-based taxpayer services.

Its development has occurred in line with the implementation of a free access area and a secure or restricted access area on its Website. The Spanish Tax Administration identifies taxpayers by their digital signature certificate, which guarantees the highest security and confidentiality of taxpayer's relation with the Tax Administration. The dissemination of the Electronic National Identity Card in Spain, which includes this certificate, shall undoubtedly greatly facilitate citizens' possibility of accessing the services offered in this secure area. Presently, certain financial institutions are already allowing the certificate incorporated in the Electronic National Identity Card as a means of identification to access their Web page.

In the free access area, the new technologies have become a communication channel with a great potential to disseminate taxpayers' rights and duties. In the case of Spain, in this area we provide the following services, among others:

- General Information Services: regarding the Tax Administration structure and functions, its annual proceedings' reports, telephone numbers, services' letter, addresses and e-mails of the different offices, etc.
- Tax information access services: tax regulations and queries, pages on FAQs, taxpayer calendar by profiles, and others.
- Internet downloads of the models for tax statements and assistance software to prepare the statements and calculate withholdings.
- Customs information services, foreign trade statistics, Special Taxes' information, revenue information, Community Customs Tariff, Special Taxes' Authorized Dispatches and statement status, etc.

In the restricted access area, we may qualify the development of the Internet as spectacular, given the broad range of processes enabled thereby. In Spain we may underline the following processes:

- Electronic filing of tax statements and the relevant documentation. Undoubtedly, it is the most significant service rendered via the Internet. Enhancing this channel to file tax statements is an ongoing process and we should especially mention the services in the Customs area aimed at expediting Customs brokerage and favor taxpayers' compliance with all the tax obligations via the Internet.



- The payment of self-assessments and filing deferrals and installment plans for tax debts.
- Correction of the informative statements filed.
- Filing requests for reconsideration and other requests for reviews.
- Querying and payment of debts claimed, querying taxpayers' tax information and the tax statements filed and detailed information on the status of tax refunds.
- Reporting the change of tax domicile.
- Requesting and obtaining certain tax certifications, querying the census of European Community operators established in the different States therein and queries on the tax current account transactions and balance.
- Online participation in the auctions of attached assets.

We may provide certain figures for illustration purposes. The Spanish Tax Administration received over 38 million tax statements electronically in 2007, out of which approximately 19 million were Customs and Special Taxes' statements, over 6 million Individual Income Tax statements, over 6 million Value Added Tax statements, over 5 million informative statements and more than 1.2 million Corporate Income Tax statements. The percentage of statements filed electronically (except for Customs statements) over the total number of statements has reached 35.27 percent against 28.33 percent for the previous year.

#### **g) Fostering social cooperation**

Promoting voluntary compliance with tax obligations suggests subscribing agreements with the entities that represent the economic sectors, especially, those representing professionals who participate as tax brokers and cooperate with the Tax Administration in filing tax statements.

We should not forget, as mentioned before, that the difficulty in understanding tax matters significantly increases the number of taxpayers requiring some degree of external assistance to meet their obligations. Such professionals play a key role in the different tax systems since they assist taxpayers in completing and meeting their tax obligations. Voluntary compliance shall be undoubtedly strengthened when the party rendering such type of service to taxpayers pursues the same objectives as those of the Tax Administrations' assistance services.

An example of a recent Tax Administration effort in this sphere is that in 2007 and beginning of 2008, we subscribed 18 agreements with associations representing the tax sector, as well as 118 protocols of adhesion to framework conventions. Likewise, 33 social cooperation agreements were subscribed with entities of the agricultural sector for the electronic filing of statements on behalf of third-parties, as well as 2,361 adhesion protocols of associations and cooperatives, among others, to framework conventions. In this same context, it is worth highlighting that the Tax Administration has subscribed a cooperation agreement with the Spanish Committee of Representatives of Disabled Persons (CERMI, as per the Spanish acronym) and the association by the name of *ONCE* in order to facilitate voluntary compliance of these important groups.

**h) Civic-tax education as a preventive measure: An investment in future taxpayers**

Until recently, it has been normal to consider taxation as an event that involves only adults, and, specifically, adults who conduct a certain type of taxed activity. Therefore, young citizens would have no reason to be concerned over taxation, since they are totally excluded from the taxable event until they start to participate in the economic activity. Therefore, tax education of the younger citizens would be senseless according to this view. Nevertheless, there are reasons that contradict such assertion.

In societies that have reached a certain degree of development and wellbeing, the young start to make economic decisions as consumers of goods and services at an early age. Although such decisions may result in small-scale individual businesses, they are relevant when considered globally and express that consumption by the young produces revenue.

Currently, tax compliance is a behavior that adults shall incorporate without relying on an adequate education in such respect from their early ages. Thus, taxation tends to be perceived as subjection to the public powers lacking any sense of solidarity. It is vital for the new generations that the tax behaviors be preceded by an awareness effort in the development stages, in order to make the young aware that their future prospects shall be very different without the investment in solidarity and equal opportunities implied by citizens' tax effort.

Undoubtedly, the voluntary compliance percentage in adulthood would be very different if children and youths received appropriate tax education, incorporating the behavioral patterns inherent in individuals who shall live as adults in democratic societies that make tax solidarity one of the basic pillars of their social coexistence organization. Values are incorporated in society by means of education, so that, if we were educated in other values, we would incorporate them as well. Therefore, we may assert that values may be changed, but changes of this kind are attained much better from bottom to top. Additionally, it should be considered that their effects shall be experienced in the middle and long term, by which their results are perceived with time.

Although the family group greatly influences the socialization of individuals, as the individuals grow up, such influence is also exerted, and just as powerfully, by other elements and institutions, among which we may underline the educational system. The role of the educational system in conveying the “tax obligation” as part of the social duties, since tax noncompliance is an antisocial behavior, shall influence the attitude adopted before the tax system. And this is a vital factor as regards tax compliance. The educational system may prepare the young with a series of basic tax notions. But the decisive factor would be that students incorporate the idea of taxation as one of the spheres in which the legal and ethical compatibility required between rights and obligations is articulated, where personal interests and common benefits are intertwined.

On the other hand, the function of the educational system is to educate and inform the young. It is a decisive area for the community because it refers to socialization, a process by which individuals learn to adjust their behavior to the regulations in place in their society. An individual living in an advanced democratic society should correctly meet the requirements of the tax system without expecting the coercive pressure of the Administration to be exerted thereupon.

This aspect of socialization becomes even more relevant after the results of the surveys conducted in Spain, as mentioned above, by which the public opinion attributed the persistence of tax fraud to the moral factor and the lack of civic awareness. Tax compliance is a matter of citizenship. The effects of noncompliance, that is to say, tax fraud is detrimental for all citizens, but especially those who assume their social responsibilities and correctly meet their tax obligations. Tax fraud is a complex phenomenon based on a mentality of acquired rights without

any responsibility counterpart. Overall, it is a matter of inappropriate socialization in the ethical values of justice and solidarity.

Therefore, the civic-tax education efforts are one of the most effective forms of disseminating taxpayers' rights and duties and are materialized in the adoption of preventive measures that foster voluntary compliance with obligations by the future taxpayer and enable the creation of tax awareness in society.

Ultimately, tax education shall be a moral education contrary to the fraudulent behaviors focused on the following aspects:

- Identifying the different public goods and services.
- Knowing the economic value and social effects of the public goods and services.
- Acknowledging the different sources of funding for public goods and services, especially the tax-related ones.
- Establishing the rights and responsibilities that arise from the public rendering of goods and services.
- Incorporate attitudes of respect for what is public, and therefore, funded with everyone's effort and employed for the common good.
- Assimilating the tax responsibility as one of the values on which social coexistence is organized in a democratic culture, identifying compliance with tax obligations with a civic duty.
- Understanding that taxation, in its two aspects, income and public expenditure, is one of the spheres in which the values of equity, justice and solidarity in a democratic society are materialized.

In Spain, as part of the Tax Administration Tax Fraud Prevention Plan, a civic-tax education program has been developed, completing the initiatives undertaken in the past, with the purpose of, on the one hand, providing children and teenagers a theoretical structure of the tax responsibility that helps them assume their role of taxpayers with a clear awareness of what is deemed a logical and rational behavior in a democratic society, and on the other, instilling the perception of voluntary compliance with tax obligations as a civic value from an early age. The development of tax education programs includes a set of actions adapted to the different educational cycles of the Spanish education system, among which we may mention:

- Open door days in the Tax Administration offices, which enables schools to visit the Tax Administration offices in their jurisdiction. We held 765 open door events in the course of 2006/2007, with a positive outcome, not only from the standpoint of teachers and students, but also by the officials of the Tax Administration proper, who are eager to participate.
- Presentations in schools. We visited 631 schools in the course of 2006/2007.
- Creation of an Internet civic-tax education portal, with a comic strip and additional content of different types, aimed at informing the young and providing didactic material to educators who wish to discuss the tax topic in their classroom.
- Incorporating the tax subject in the new subject "Citizens' Education" that has been included as a subject in one year in the teachers' training classes as of 2007-2008.

#### **i) Communication strategy**

Creation of a public opinion that generates greater tax awareness in society requires relying, as a fundamental element to such end, on a genuine communication strategy.

In order to promote voluntary compliance with tax obligations, this communication effort shall convey a message that highlights the existing relation between the tax system and the quantity and quality of public services, for citizens to be able to relate their tax contribution to the furtherance of the common good, thus attaching a social purpose to their tax effort that involves them directly.

Consequently and along the same lines as tax education, institutional communication shall call upon the civic values of an advanced democratic society directly stemming from the Constitution, to strengthen the tax awareness of citizens in favor of voluntary compliance and against tax fraud.

Among the measures to be included in the communication strategy we may mention institutional advertising campaigns focused on the creation and strengthening of civic tax awareness, based on the dissemination of the democratic values that sustain the tax system. Likewise, fostering the presence of the Tax Administration in fairs,

workshops, exhibitions, etcetera, at the national, regional or provincial level shall enable to facilitate, in the context of informative transparency, citizens' general knowledge of their actions and outcomes, while conveying specific messages and information to target audiences.

#### **j) Transparency of the Tax Administration**

The transparency of the activity developed by the Tax Administration is a basic principle and key element in the furtherance of a modern, effective and efficient Tax Administration with prestige and credibility before society, which favors the citizens' willingness towards voluntary compliance with their tax obligations.

Undoubtedly, offering institutional information on the outcomes of the functions and activities undertaken, especially control activities, generates an induced effect, since the fact that violations are discovered and punished shall encourage compliant taxpayers to continue complying and foster compliance in those who still pursue noncompliance.

Such transparency, safeguarding in all cases the duty of secrecy and confidentiality of citizen-related information, shall prevail within the organization as well as from the organization towards society. Within the organization, for individuals who work in the Tax Administration to know their goals, objectives and achievements and feel better integrated and involved therewith; and towards society, for citizens, entities and other social actors to know and evaluate the degree of efficacy and efficiency of the activities performed.

The principle of transparency refers not only to the amount of economic and statistical information rendered, but also and above all, the quality thereof. This set of information shall be regularly published according to a plan, based on calendars that citizens shall be informed of so they may become used to them and feel certain that they shall obtain the information required. Additionally, it shall be published in a format that is useful for citizens, that is to say, broken down as required to render the accurate idea of the performance of the public powers and in accessible and adequate media according to modern technologies to enable the study and analysis thereof.

In Spain, the performance of the Public Administration pursuant to the principle of transparency has been an ongoing source of Government concern, whose Delegate Committee for Economic Affairs approved

two Agreements on January 14<sup>th</sup> of 2005 and May 11<sup>th</sup> of 2006, which set forth the commitments assumed by the Tax Administration as regards drafting and publishing the following documents:

1. A monthly Revenue report, which facilitates monthly data and accrued data for the fiscal period of the main taxes, differentiating State revenue and the revenue shared by certain Autonomous Communities in certain taxes, including an inter-annual comparison. A methodological note and a comment on the monthly figures shall be attached to this information. The publication date shall be the 20<sup>th</sup> of the month subsequent to the revenue month mentioned.
2. A monthly report for large companies. A methodological note and comments on the main figures shall be attached to this document. This report shall be ready for publication as of the 5<sup>th</sup> of every month, with the statements of the previous month.
3. Statistics on annual statements. It shall include a breakdown of specific items of the Individual Income Tax, Property Tax, Corporate Income Tax and Value Added Tax, in addition to the data already published in the Tax Administration Annual Report.
4. Statistics of annual accounts. This document shall be included with the statistics already available for the Corporate Income Tax, Value Added Tax and the Model 190, an analysis of the data on the Individual Income Tax and another one of the Property Tax.
5. By means of new actions to foster transparency, a calendar on the reports and statistics was established that marks the specific publication day thereof.

In addition to the foregoing commitments, already achieved, we have continued with the publication of the Annual Report that includes detailed information of the activities and their outcomes. Likewise, on an annual basis, we publish the Guidelines of the Tax Control Plan as set forth by law.

On the other hand, in this framework of commitment to transparency and given its relevance it is worth highlighting the novelty entailed by the approval of the mandate set forth in the Tax Fraud Prevention Act (Act 36/2006 of November 29<sup>th</sup>) by virtue of which the Spanish Administration shall file with the General Courts of Law in the first two months of the year, detailed information of the objectives set forth for that year and every semester, the outcomes of its activities.

### **k) Citizens' opinion**

Knowledge of the social perception of the Tax Administration performance, as regards compliance with its inherent mission and the adequacy and quality of the services it renders citizens to facilitate compliance with their tax obligations may be of great use to undertake improvement actions.

On the other hand, offering citizens the possibility of expressing their opinion by means of surveys, studies and analyses entails opening a channel for public cooperation in the enhancement of services, programs and documents of the Tax Administration.

In the case of Spain, in order to measure the sociological impact of the services offered by the Tax Administration and the efforts to counter fraud, three key instruments are employed, based on personalized taxpayers' surveys, some of which have been mentioned in this presentation:

- a) The Tax Barometer, annually drafted by the Institute of Tax Studies of the Ministry of Economy and Finance, whose main objective is to measure the evolution of the opinion and the tax studies of the Spanish people.
- b) The annual public opinion and tax policy survey conducted by the Sociological Research Center.
- c) The survey on Tax Administration position and image conducted by the organization proper, every two or three years.

Additionally, the Tax Administration conducts audits on specific issues and services. For example, the survey on the services rendered in the campaigns on the Individual Income Tax statement or the services offered via the Internet.

### **l) Preventive actions to avoid noncompliance**

This type of actions incorporate a great legal certainty into the Tax System, by fostering taxpayers' approach to the Tax Administrations before the taxable events occur, or to learn the interpretation of the tax regulations, or to know the tax value of certain assets. Undoubtedly, such actions shall positively result in voluntary compliance of the taxpayers who resort to them.



In the Spanish legislation, such actions are specifically materialized as follows:

- The information preliminary to the purchase or transfer of real estate property, which requires the Tax Administration to inform on the value of the real estate property that shall be acquired or transferred and is binding for the Administration during the three months subsequent to the notification of the information to the stakeholder.
- The pre-valuation agreements, which try to eliminate the legal uncertainty produced when the tax laws employ uncertain notions or terms that originate a different valuation for the taxpayer and the Administration. They shall be issued in writing and be binding, so that, to the extent the legislation remains unchanged or the economic circumstances underlying the valuation do not vary significantly, the Tax Administration that would have determined the agreement is required to apply the values expressed therein during a maximum term of three years, except as otherwise provided for by law.

Along the foregoing lines, we have undertaken a broad array of actions directly tied to the promotion of voluntary compliance with tax obligations as well as another important set of measures that foster and contribute to such end.

In addition to the foregoing, it is worth mentioning a broad series of measures related to the issue, such as those relative to the processing of complaints and suggestions, the relevance of institutions such as the Taxpayer Defense Council, or the internal and external control measures that oversee the Tax Administration performance. Elaborating on the foregoing measures and actions exceeds the scope defined at the beginning of the presentation, but deserve to be summarized given their relevance and significance.

## **CONCLUSION**

The Tax Administrations shall undertake a significant instrumental and vital function to allocate the economic resources that enable to undertake the public policies to serve the general interest. The efficacy in the pursuit of this objective shall ultimately enable more and better services for society.

Therefore, it is necessary to act in a balanced and integral manner on the two great strategic courses for the Tax Administrations: on the one hand, increasing and improving the facilities and assistance offered to those who wish to meet their tax obligations and, on the other, developing and intensifying the instruments that enable to discover the noncompliant taxpayers and make them comply. Tax Administration information and assistance constitutes, in consequence, the right of taxpayers to enable compliance with their obligations, especially if we consider the complexity entailed by the tax system. Additionally, favoring voluntary compliance with tax obligations, information and assistance constitutes a relevant preventive measure against fraud, since it is precisely aimed at avoiding it.

Thus, we are faced with the challenge of consolidating modern Tax Administrations that meet the growing demand for services, sometimes with very short timeframes, and in which the principles of efficacy, efficiency and taxpayer service are articulated as the core axis in addition to leveraging the opportunities offered by the new information and communication technologies in this area.



## THE ELECTRONIC INVOICE

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*CONTENTS: Summary. -1. Overview. -1.1 Background. -1.2 Concepts. -1.3 Electronic Invoice Objectives. -1.4 Grounds for the Project Execution. -1.5 Benefits of the Electronic Invoice. -1.6 Participating Businesses. -2. Electronic Invoice Dynamics. -2.1. Operating Process Description. -2.2. Contingency Strategy. -2.3 Implementation Strategy. -2.4 National Environment. -3. Current Status and Expectations*

### SUMMARY

In August of 2005, in the City of Sao Paulo, the Secretariat of the Receita Federal of Brazil, the Secretariats of Finance of the States and the Federal District and the representatives of the Finance Secretariats of the Municipalities of the capital cities, in order to materialize the trade activities among them, subscribed protocols aimed at developing and implementing the *Sistema Público de Escrituração Digital* (Public Digital Accounting Recording System, Sped, as per the Portuguese acronym) and the Electronic Invoice in Brazil.

The electronic invoice is a document issued and stored electronically, which only exists in the digital format, with the purpose of documenting a transaction involving the trade of goods and services or the rendering of services among the parties. The legal validity of the electronic invoice is guaranteed by the digital signature of the issuer and the reception by the administration, prior to the effectiveness of the generating event.

Presently, the Electronic Tax Invoice Project (NF-e, as per the Portuguese acronym) has been implemented in seven federal States and is in the certification stage in another eight States. Over 50 companies are issuing electronic invoices, from operations with all the States in the Country, which accounts for approximately three

million electronic invoices issued and over R\$ 26 billion in commercial transactions' volume among companies.

This text describes the Brazilian experience with the Electronic Invoice Project, from its creation to the current stage. It seeks to provide an overview of the issue, including the summary of the project background, its objectives, grounds and benefits. Subsequently, it describes the Electronic Invoice operation process as well as the implementation and contingency strategies, in addition to certain relevant data on the operational context.

For the Secretariat of the Receita Federal of Brazil, the Electronic Invoice Project, as an integral part of the Public Digital Accounting Recording System, is of utmost importance. We deem it shall bring about a genuine change in the administration-taxpayer relation and decidedly contribute to enhance the business environment and the Country's growth.

## **1. OVERVIEW**

### **1.1 Background**

In order to meet a provision stemming from Constitutional Amendment No. 42 of December 19<sup>th</sup>, 2003, in section XXII, Article 37 of the Federal Constitution of Brazil, between July 15 and 17 of 2004, in the city of Salvador, capital of the State of Bahía, the first National Tax Administrators Meeting (ENAT, as per the Portuguese acronym) took place, with the participation of the Secretary of the Receita Federal, the Finance Secretaries of the States and the Federal District and the representative of the Finance Secretariats of the Municipalities of the capital cities of the Brazilian States.<sup>1</sup>

The meeting was geared at finding joint solutions among the three levels of government to promote a better administrative integration and standardization and better quality of information; rationalization of costs and the operational workload; improved efficacy in audits; greater possibilities to undertake coordinated and joint tax efforts; greater efforts to exchange tax information among the different levels of government; crossing general data with standardized data and implementing uniform procedures.

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<sup>1</sup> *Brazil is a federal republic made up by 27 States (including the Federal District) and 5,762 Municipalities.*

On the basis of such requirements, in the course of the First ENAT, two technical cooperation protocols were subscribed. The first one, aimed at creating a synchronized registry that served the interests of the tax administrations of the Union, the States, the Federal District and the Municipalities. The second one, of a general scope, sought to facilitate the development of methods and instruments that would serve the interests of the respective tax administrations, prior to the Electronic Invoice project.

In order to align the guidelines of the project initiated by the ENAT, a technical ENAT/ENCAT meeting was held with the discussion fora of the State coordinators and tax administrators (ENCAT, as per the Portuguese acronym), in the city of Sao Paulo, on April 27<sup>th</sup> of 2005, to unify the different projects underway in the area of the tax administrations, especially, the standardization of a national Electronic Invoice model.

In August of 2005, during the II ENAT, held in the city of Sao Paulo, the Secretary of the Receita Federal, the Secretaries of Finance of the States and the Federal District and the representatives of the Secretariats of Finance of the Municipalities of the capital cities, in order to materialize the trade efforts among them, subscribed technical cooperation protocols N° 2/2005 and N° 3/2005, with the purpose of developing and implementing the Public Digital Accounting Recording System (Sped, as per the Portuguese acronym) and the Electronic Invoice.<sup>2</sup>

The Sped as well as the Electronic Invoice were enacted by the Federal Executive Branch by Decree 6.022, of January 22<sup>nd</sup>, of 2007, both under the scope of the Project to Modernize the Tax and Customs Administration (*Projeto de Modernização da Administração Tributária e Aduaneira- PMATA*, as per the Portuguese acronym), which entails the implementation of new processes supported by the information, information technology and logistics' infrastructure systems.

On that same date, the Federal Government announced the implementation of the Public Digital Accounting Recording System (Sped) and the Electronic Invoice over a two-year term, in the context of the Growth Promotion Program 2007-2010 (PAC, as per the Portuguese acronym) – aimed at promoting a faster economic growth

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<sup>2</sup> *In fact, the Electronic Invoice project is part of the Public Digital Accounting Recording System (Sped), which also involves the creation of electronic tax records and accounting books.*

in the Country, increasing employment rates and improving the living conditions of the Brazilian population.

To the present, over 50 companies have issued more than 3 million electronic invoices. The Electronic Invoice project already features the participation of seven Brazilian States and is in the certification stage in eight additional States. Transactions in excess of 26 billion Reales have been conducted with electronic invoices and the project is growing massively.

## 1.2 Concepts

The electronic invoice is a document issued and stored electronically, which only exists in the digital format, with the purpose of documenting a transaction involving the trade of goods and services or the rendering of services among the parties. The legal validity of the electronic invoice is guaranteed by the digital signature of the issuer and the reception by the administration, prior to the effectiveness of the generating event. The Electronic Invoice replaces the printed invoices in business to business transactions (B2B) and business to consumers (B2C) transactions in certain cases.

The Electronic Invoice project is a component of the Public Digital Accounting Recording System (Sped) and groups all the activities required for the implementation of the Electronic Invoice in Brazil.

## 1.3 Electronic Invoice Objectives

The Electronic Invoice<sup>3</sup> project has the following general objectives:

- i. Promoting the integration of Brazilian administrations, by standardizing and sharing accounting and tax information;
- ii. Rationalizing and uniformizing the supplementary obligations for taxpayers;
- iii. Expediting the identification of tax crimes, with improvements in process controls, faster access to information and more effective audits of operations with the crossing of information and electronic audits.

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<sup>3</sup> *It is important to highlight that in Brazil, invoices are issued to control transactions involving the trade of goods and services, which are levied chiefly by the following taxes: tax on the trade of goods and services (ICMS, as per the Portuguese acronym), in the State Jurisdiction; taxes on industrialized products (IPI, as per the Portuguese acronym), in the Federal jurisdiction; and services' tax (ISS, as per the Portuguese acronym), in the Municipal jurisdiction.*

In specific terms, the Electronic Invoice project is geared at the implementation of a national electronic tax document model that replaces the current system based on the issue of tax documents in paper, with the legal validity guaranteed by the digital signature of the sender, simplifying taxpayers' supplementary obligations, while enabling the real time follow-up of the commercial transactions by the administrations.

#### **1.4 Grounds for the Project Execution**

The implementation of the Electronic Invoice constitutes a great advance in the relation between the administration and the taxpayer and its objective is to facilitate compliance with tax obligations, as well as reduce administrative and compliance costs. In order to understand this, it is necessary to provide a context for the Electronic Invoice project<sup>4</sup> in the Brazilian environment, marked by the multiple levels of government (Union, States and Municipalities) and strong tax decentralization. Therefore, the Electronic Invoice project features another essential aspect: the integration among the administrations.

Integration and cooperation among the tax administrations have been issues largely discussed in federal countries, especially those like Brazil, which feature a strong degree of tax decentralization. In such countries, tax autonomy has traditionally generated multiple working routines, bureaucracy, poor information exchange and lack of compatibility among taxpayers' economic-tax data. For citizens, the State is in many respects inefficient and slow. For the government, control is difficult because it lacks the integral vision of taxpayers' actions. For the Country, the public and private cost of compliance with tax obligations has become very high.

With the advent of information society, the economic agents increased their mobility, conducting transactions throughout the national territory and no longer bound by the notion of territorial jurisdiction. Consequently, it is common to find companies who are simultaneous taxpayers in different jurisdictions of the federal, State or municipal administrations. The direct consequence of this model is that taxpayers

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<sup>4</sup> *The pursuit of the integration and modernization of the Brazilian tax administrations is tied to the Federal organization of Brazil. In such context, the Union, the States, the Federal District and the Municipalities are granted political, administrative and financial autonomy. Their powers, limitations and competencies are set forth in the Federal Constitution, which grants each level of government the competency of enforcing and administering the respective taxes.*



have to meet different procedures and regulations in each unit of the federation or municipality, increasing their operating costs.

Therefore, the need arises to allocate a significant number of human and material resources for the purpose of registration, accounting, storage, internal audits and delivery of information in the different levels of government that, in furtherance of their legal powers may require them, usually by way of statements and other supplementary obligations. Undoubtedly, the inherent cost in the large volume of paper documents that circulate and are stored by the tax administration as well as taxpayers is essentially high.

The tax administrations, in particular, face the great challenge of adapting to the globalization and digitization processes of trade and transactions among taxpayers. The volume of transactions performed and the amounts of resources required grow at a fast pace, and, at the same rate, increase the costs inherent in the State's need to detect and prevent tax evasion. Large amounts of resources are required to capture, treat, store and facilitate information on the operations conducted by taxpayers, administering a volume of supplementary obligations that goes hand in hand with the appearance of new tax evasion hypotheses.

Therefore, the Electronic Invoice project foresees the integration of the administrations and sharing information with the purpose of rationalizing and modernizing the Brazilian Tax Administration, reducing costs and bureaucratic hurdles, facilitating compliance with tax obligations and the payment of taxes and service charges, in addition to strengthening control and audits by means of information exchanges.

The project also provides for the investment in technology in order to modernize the existing technology and information systems, broadening the capacity to serve administrative units.

### **1.5 Benefits of the Electronic Invoice**

The convergence in the joint development of projects with related interests enables to plan and identify solutions in advance as regards compliance with supplementary obligations. Given the demands set forth by the tax administrations, joint development enables the contribution of the effective participation of taxpayers in defining the means to serve the supplementary obligations in the improvement of such mechanisms and grants such instruments a greater degree

of social legitimacy, establishing a new type of relation, based on transparency and with positive consequences for society overall.

Also, the Electronic Invoice project is spurring significant changes in the information issuance and management process (and not only tax information), which shall generate productivity and competitiveness improvements for corporations. The use of information technology is in fact what guarantees such difference, since companies shall administrate the tax information in line with the business stages and the remaining obligations, if any, such as those of an accounting and administrative nature. Such offices where organization and tidiness shall be the trend, will replace the large tax departments, full of files and papers difficult to manage. Purchasers shall be able to track the source of the raw materials for their products online, demanding suppliers' commitment to quality.

Just like any sweeping and complex change, this new tax scenario becomes an additional challenge that shall bring about benefits to companies: greater expeditiousness, security and transparency in commercial transactions, simplification of internal processes, and improvement in operating logistics, fostering electronic commerce and the implementation of new technologies, among others.

Hereunder, we present a summary of the main benefits expected:

**Benefits for the Selling Taxpayer (Electronic Invoice Issuer):**

- Productivity increase;
- Reduction of printing and paper acquisition costs;
- Reduction in tax documents' forwarding costs;
- Reduction of tax documents' storage and handling costs;
- Simplification of supplementary obligations, for example, release from the requirement to obtain the authorization to print a tax document (AIDF, as per the Portuguese acronym), which presently contributes to increase the cost of businesses' operations;
- Reduction of waiting and audits' times for trucks and other cargo transportation vehicles in tax control outposts in the borders of the federal States;
- Incentives to the use of electronic customer relations tool (B2B).

**Benefits for the Purchasing Taxpayer (Electronic Invoice Recipient):**

- Productivity increase;
- Possibility to track products and control the quality of suppliers;
- Elimination of invoice typing work upon the reception of goods;
- Reduction of tax documents' storage and handling costs;
- Planning of the delivery logistics by the anticipated reception of the information on the Electronic Invoice;
- Reduction of accounting records' errors owing to invoice typing errors;
- Incentives to the use of electronic relations with vendors (B2B).

**Benefits for Society:**

- Reduction of the cost of complying with supplementary obligations, with a potential impact on the businesses' investment capacity and employment generation;
- Greater efficiency and lower cost for the State;
- Reduction of paper consumption, with a positive environmental impact;
- Incentive to electronic commerce and the use of new technologies;
- Standardization of electronic relations among businesses;
- New business and employment opportunities in the rendering of services related to the Electronic Invoice.

**Benefits for the Tax Administrations:**

- Greater reliability of the Electronic Invoice;
- Reduction of administrative costs;
- Improvement in the tax control process, enabling a better exchange and exchanging information among the administrations;
- Reduction of costs in the control process of the invoices captured by the inspection of goods in transit;
- Reduction of tax evasion and increase in revenue;
- Support to the accounting and tax electronic recording projects of the Public Digital Accounting Recording System – SPED.

## 1.6 Participating Businesses

The fact that the implementation of the Electronic Invoice is mandatory, poses the challenging mission to businesses of adjusting their information systems to meet the legal terms required. For most of them, it constitutes an additional opportunity of reviewing and simplifying their administrative and operating processes, achieving greater internal control and expeditiousness in their business, and reducing tax and operating risks.

After perceiving the potential benefits and the reduction of operating costs, nineteen companies have participated in the Electronic Invoice project from the beginning and currently, close to fifty companies are issuing the Electronic Invoice. This is not a timely opportunity to enumerate them all, but we may say that the majority are large companies from the following sectors:

- Food and beverage;
- Energy (refineries and oil and gas distribution companies, alcohol production and distribution, power generation and distribution);
- Motor vehicles and spare parts;
- Steel and byproducts;
- Tobacco;
- Pharmaceuticals;
- IT and technology;
- Large retail chains;
- Logistics;
- Communications.

## 2. ELECTRONIC INVOICE DYNAMICS

### 2.1. Operating Process Description

The Electronic Invoice process may be described as follows:

#### **Step 1** – Issue of the Electronic Invoice

The company that issues the Electronic Invoice shall generate an electronic file with the tax information of the commercial transaction, which shall be digitally signed, in order to guarantee the integrity of data and the issuer's signature. This electronic file that matches the Electronic Invoice is then forwarded via the Internet to the Secretariat

of Finance of the taxpayer's jurisdiction<sup>5</sup> or, in the absence thereof, an equivalent virtual service<sup>6</sup>.

**Step 2 – Pre-validation of the Electronic Invoice and Use Authorization**

The Secretariat of Finance of the taxpayer's jurisdiction (or virtual service) shall pre-validate the file<sup>7</sup> and return a reception protocol, valid as a use authorization, without which the goods may not be transported.

**Step 3 – Re-transmission of the Electronic Invoice to the Receita Federal**

The Secretariat of Finance of the taxpayer's jurisdiction shall re-transmit the authorized Electronic Invoice to the Receita Federal, which shall be the national holder of all the Electronic Invoices issued, according to the National Electronic Invoice Environment.

In the case of transactions among states, the invoice shall be also re-transmitted to the Secretariat of Finance of the jurisdiction of the transaction's recipient and the Superintendency of the Manaus Free Trade Area (Suframa, as per the Portuguese acronym)<sup>8</sup>, in the case of goods for the tax-free areas of Amazonia.

The Secretariats of Finance and the Receita Federal shall offer Internet-based queries for the recipient and the legitimate stakeholders that have the access key to the electronic document.

**Step 4 – Transportation of Goods accompanied by the Electronic Invoice**

In the case of Electronic Invoices that travel attached to goods in transit, a simplified copy of the Electronic Invoice shall be printed, the Ancillary Document to the Electronic Invoice (DANFE, as per the Portuguese acronym). The DANFE shall be issued on ordinary paper,

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<sup>5</sup> *Body in charge of the tax administration in the respective State of the Federation.*

<sup>6</sup> *The Electronic Invoice may be also sent to the "virtual Secretariat of Finance", as explained in section 2.6.*

<sup>7</sup> *Verification of the digital signature, of the numbering on the Electronic Invoice, the issuer and other requirements.*

<sup>8</sup> *In the case of the goods to be transported to the Free Trade Area of Manaus and tax-free areas of Amazonia.*



## **Step 6 – Subsequent Validation of the Electronic Invoice**

The federal, state and municipal administrations, which store the data in their databases, shall validate the electronic invoices and cross relevant data for the purpose of audits.

### **2.2. Contingency Strategy**

In the cases in which the virtual environment of any of the Secretariats of Finance of the States participating in the Electronic Invoice project, the Receita Federal offers the environment by the name of Sefaz<sup>9</sup> Contingency (SCAN, as per the Portuguese acronym), which enables to replace the Secretariat of Finance as the authority that certifies the electronic invoices. Such interruption, whether by operational issues of the application and network infrastructure, or by scheduled downtime, shall be maintained until the operational environment is recovered.

In case of unavailability of the taxpayer's operating environment, the latter shall issue invoices in print forms to temporarily replace the electronic invoices, until the connection is reestablished.

Among other functionalities, the Sefaz Contingency enables/disables events, generates passwords required to enable/disable contingency, queries the operating status of the contingency service, and synchronizes among the Receita Federal bases (contingency) and those of the source Secretariat of Finance.

Additionally, it enables to maintain the database of the taxpayers authorized to issue the Electronic Invoice in case of contingency; the reception and authorization of the Electronic Invoice; cancellation of the Electronic Invoice and queries to the Electronic Invoice status.

#### **Virtual Sefaz**

The Virtual Sefaz was created by the Receita Federal with the purpose of authorizing in the short-term electronic invoices in the name of the State Secretariats of Finance who choose not to develop their own issuing infrastructure. Just like any other authorizing Secretariat of Finance, the Virtual Sefaz shall store the Electronic Invoices issued in the National Environment and the issuing States and, should the operation be an inter-state operation, in the recipient States as well.

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<sup>9</sup> *Sefaz is the Portuguese acronym for Secretaria de Fazenda (Secretariat of Finance)*

The idea of creating the Virtual Sefaz stemmed from the need to massively disseminate the use of the Electronic Invoice, that is to say, facilitate the participation of a larger number of businesses in the project and enable all the State Secretariats of Finance to authorize its issuance, even with the possibility of becoming a centralizing unit of the Electronic Invoices issued by multi-regional businesses, that is to say, taxpayers who own establishments in more than one federal State.

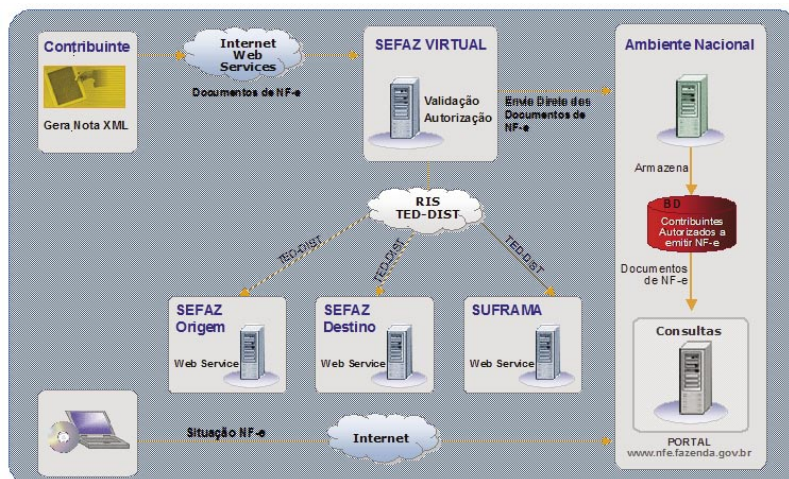


Figure 2 – RFB Virtual Sefaz Environment

In addition to promoting greater performance coverage and dissemination of the project in its technological aspects, the Virtual Sefaz shall enable a secure computer environment, with high availability and processing capacity, high-performance, available 24x7, and create safety copies permanently.

## Redundancy

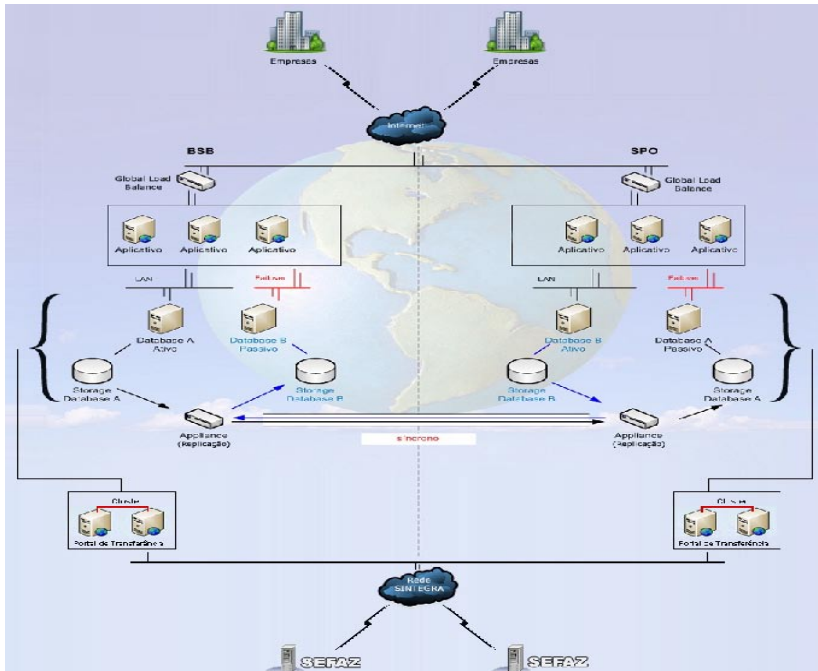
The RFB Virtual Sefaz started operating on January 1<sup>st</sup>, 2008. It features 2 (two) fully redundant sites in all its components and environments. Redundancy applies even at the network level, where transactions shall be carried out in the Sao Paulo or Brasilia environment and vice versa.

The functionalities foreseen are the same ones available in the environment in place in any Secretariat of Finance: to maintain an updated database of the registry of taxpayers authorized to issue Electronic Invoices; cancel authorized Electronic Invoices; annul the



## Topic 2.1 (Brazil)

numbering of the Electronic Invoices; enable queries on the current status of an Electronic Invoice document and provide information on the service status.



*Figure 3 – Technological architecture employed by the Virtual Sefaz of the Receita Federal of Brazil – Geographical cluster outlooks between Sao Paulo and Brasilia*

### 2.3 Implementation Strategy.

The Electronic Invoice implementation strategy may be described as follows:

#### Phase 1 (Pre-operational phase)

In the first phase of the project implementation, between April and July of 2006, nineteen companies issued electronic invoices authorized by the Secretariats of Finance of the States of Bahia, Sao Paulo, Rio Grande do Sul, Santa Catarina, Goi\u00e1s and Maranh\u00e3o. In this phase, electronic invoices were issued simultaneously with the traditional paper invoices. Electronic invoices and their respective DANFES lacked tax validity.

## **Phase 2**

Beginning in August of 2006, we launched the second phase that expanded the number of issuing businesses and authorizing States.

## **Phase 3**

As of April 1<sup>st</sup> of 2008, all the cigarette manufacturers and fuel distribution companies are mandated to issue Electronic Invoices and are no longer allowed to issue paper invoices.

## **Forthcoming phases**

In the forthcoming project stages, the obligation to issue the Electronic Invoice shall be progressively extended to other sectors, including, in the beginning, manufacturers of alcoholic beverages and sodas; metal industry; power utilities; motor vehicle assemblers; pharmaceutical; meat packers and cement manufacturers.

## **2.4 National Environment**

National Environment is the term employed to designate the IT infrastructure managed by the Receita Federal of Brazil (RFB, as per the Portuguese acronym) and shared by the Secretariats of Finance of the States and Federal District to securely receive and store all the electronic invoices and relevant documents.

The system periodically generates synchronization files, automated by the States, with information on the Electronic Invoice documents received in the National Environment.

In November of 2007, the National Environment received approximately 10 thousand electronic invoices daily, that is to say, 300 thousand invoices monthly, issued by taxpayers of the 8 authorizing States.

In the early stages of the implementation of the obligation to use the Electronic Invoice for the manufacturers of cigarettes and liquid fuel distribution companies, we expect to receive close to 1.5 to 2 million invoices monthly as of April 1<sup>st</sup>, 2008.<sup>10</sup>

Interaction with the Citizen.

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<sup>10</sup> Based on the technological model similar to the Electronic Invoice, the project by the name of Electronic Bill of Lading (CT-e, as per the Portuguese acronym) is aimed at implementing electronic documents for cargo transportation and covers all the transportation modalities. Along the same line, as the Electronic Invoice, it creates a supplementary document to the Electronic Bill of Lading (DACTe, as per the Portuguese acronym) and it features the participation of businesses, entities and regulatory agencies. The pilot project and start-up have been foreseen for 2008.

On the National Electronic Invoice Portal (Figure 2), we may find information on legislation and documents; integration and contingency manuals; technical setup, configuration and maintenance information; access to pages of the State Secretariats of Finance; Electronic Invoice background; participating businesses; statistics; FAQs; area from which to download files (downloads, viewer, videos, etc.).

The portal also enables to query the electronic invoices according to two formats: summarized and complete, in addition to enabling the verification of annulled and available invoices.

In the second semester of 2007, the Central Electronic Invoice Telephone Assistance service was launched: 0800-9782338, to assist taxpayers with doubts and questions. It is a toll-free number.



Figure 4 – National Electronic Invoice Portal ([www.nfe.fazenda.gov.br](http://www.nfe.fazenda.gov.br)).

### 3. CURRENT STATUS AND EXPECTATIONS

Currently, the Electronic Invoice Project relies on the effective participation of seven State Secretariats of Finance,<sup>11</sup> which shall receive the Electronic Invoice documents forwarded by authorized taxpayers to the National environment of the Receita Federal, availing themselves of a proprietary hardware and software infrastructure. Eight additional States are under the applications' certification phase.<sup>12</sup>

In order to improve the technological infrastructure of the Secretariats of Finance of the States and the respective audit points, the Ministry

<sup>11</sup> Said States are Bahia, Goiás, Maranhão, Rio Grande do Sul, São Paulo, Minas Gerais and Espírito Santo.

<sup>12</sup> Said States are Ceará, Federal District, Mato Grosso, Pará, Pernambuco, Paraná, Rondônia and Roraima.

of Economy subscribed an agreement with the twenty-seven Brazilian States, releasing R\$ 50 million per loan. Additionally, it is worth highlighting that the Receita Federal has invested close to R\$ 81 million in the Sped project to the present.

The most favored States also contribute to the project success. In order to massively disseminate the use of the Electronic Invoice and minimize the costs for taxpayers, the Secretariat of Finance of the State of Sao Paulo offers a system to issue the Electronic Invoice for small and medium sized businesses for free, with a lower issuance volume. This is justified because the investments for the companies that participated in the pilot project ranged between R\$150 thousand and R\$1.2 million, according to the degree of specialization of the company in the ICT area.

Therefore, the concern of the State is to guarantee that not only large businesses access the system, but also small and medium-sized businesses in the middle-term. Not only the taxpayers based in the wealthiest States of the federation may benefit from the virtues of the Electronic Invoice, but access shall be available to all.

On a different note, in the private sector, it is interesting to observe that certain businesses are already producing solutions to cater to this new market niche, such as the sale of services, data centers, courier, consulting, and collection based on the Electronic Invoice, etc.

Additionally, over fifty companies are issuing Electronic Invoices in operations with all the States of the Country, which results in approximately 3 million Electronic Invoices issued and more than R\$ 26 billion in turnover among companies.

Obviously, the (compliant) taxpayer is interested in adhering to the project, since it obtains a significant cost reduction and also greater security and easier traceability of operations. From another standpoint, we may assert that the Electronic Invoice contributes to increase the value of products and their incorporation in the market.

By virtue of the relevance and potential that the Brazilian Government attaches to the Electronic Invoice, it has been included in the Growth Promotion Program, which foresees infrastructure investments for US\$ 200 billion between 2007 and 2010.

Another example of the project's dimension in the context of the current situation of the Brazilian economy is the future use of the data on the Electronic Invoice to assist in the evaluation of the tax reform bill currently addressed in Parliament.

The idea is that on the basis of the consistent data generated by the Public Digital Accounting Recording System, the federal entities review their revenue projections and improve the reform process, obtaining a better distribution of revenue, allocating resources where they are needed the most. It should be noticed that the guarantee of the Electronic Invoice is vital for the improvement of trust in the negotiations that involve the sensitive tax reform process.

Therefore, the Secretariat of the Receita Federal of Brazil is certain that the Electronic Invoice project is advancing firmly and shall deeply modify the administration-taxpayer relations with advantages for both. Additionally, we are certain that the Public Digital Accounting Recording System and the Electronic Invoice are relevant projects that shall determine the improvement of the technological infrastructure and, thus, contribute significantly to the Country's growth.

## **THE ELECTRONIC INVOICE**

**Ricardo Escobar Calderón**

Director

Internal Tax Service

(Chile)

*CONTENTS: Summary -1. Introduction -2. Project Scope -3. Goals and Objectives -4. Methodology -5. Benefits (Quantitative/qualitative Impacts) -6. Developments with the Electronic Invoice Initiative - Conclusions.*

### **SUMMARY**

The Electronic Invoice in Chile is a system that grants legal validity to the electronic copy of the invoices and the rest of the tax documents related to the Invoices. This modality enables an improvement in the taxpayers' business processes as well as the auditing work of the Internal Revenue Service (SII, as per the Spanish acronym), thus spurring a strong momentum to electronic commerce and the country's modernization.

The use of the digital signature guarantees businesses and the SII that the invoices and other electronic tax documents are not tampered with and that the issuer is not substituted.

The SII receives the largest amount of electronic documentation from taxpayers, which constitutes a large volume of information that enables to enhance controls and reduce tax evasion.

Likewise, the taxpayers included in the system benefit from significant direct savings in the overall process regarding invoicing, distribution and storage of the documents, in addition to enjoying significant improvements in the productivity and competitiveness based on the computerized processing of their tax documents, related to their accounting, supplier and customer systems.

The implementation of the electronic invoice has fostered the development of an electronic multi-service platform for the micro, small and medium-sized businesses (MIPYME, as per the Spanish acronym), which may improve their competitiveness and optimize their tax management by operating via the MIPYME Portal.

## **1. INTRODUCTION**

From the taxpayers' standpoint, the traditional paper invoice system hurdles the improvement of the efficiency and customer-service quality and constitutes a hurdle in materializing the initiative of becoming fully incorporated in the electronic commerce environment, and thus maintaining the competitiveness required by their context.

According to the traditional system (paper-based), the Internal Revenue Service requires taxpayers that their tax documents be registered and authorized by the tax authority, stamping them before their use. For such purpose, the taxpayer is required to regularly visit the SII offices, in order to file the documents he/she wishes to stamp, which shall be previously numbered. The advantage of this procedure is that it prevents the forging of invoices, facilitates audits and assures the recipients thereof, with the disadvantage that it is cumbersome and costly for taxpayers.

Printing requires strict standards of preprinted size and format, on pre-numbered paper with a single national correlative numbering system per company and in quadruplicate, each one stating their purpose. The documents shall be printed with an impact printer, since the numbering must be preserved, which does not allow for the use of modern printing technology.

Also, in order to facilitate audits, the taxpayer shall keep the invoices and other tax documents for six years, for any potential audit. This entails the disadvantage of being costly for taxpayers vis-à-vis administration and storage.

The documents produced according to the traditional system shall be forwarded to their recipients via the post office.

On the other hand, from the standpoint of the audits to be performed by the SII, the traditional invoice system, since it is mostly manual and paper-intensive, does not enable significant improvements in the Value Added Tax (VAT) audits, its objective, since it prevents the

Administration from relying on timely quality data as those obtained via the direct data entry in computer systems.

Replacing the printed tax documents with electronic documents was a vital need, for the SII as well as businesses, in order to achieve significant improvements in the operation of both, given the cost and troubles arising from the document authorization process, with the stamping of the paper copies, against the electronic authorization of the pages in the electronic documents' facilities, in addition to the advantages from the computer processing of information.

The digital signature technology currently enables the exchange of electronic documents with a complete certainty for users as regards the identity of the issuers and the integrity of the data therein. An SII resolution and, thereafter, the enactment of the Digital Signature Act enables the invoice, as well as other documents and contracts signed on the basis of this mechanism, to be deemed legally valid and of the same effect than the paper counterparts, with the additional advantage of the reduction in the cost of the transaction and the assurance of greater efficiency and productivity.

## **2. PROJECT SCOPE**

At the time of evaluating the project, it was determined that the universe of taxpayers who issued tax documents on a regular basis was 300,000, issuing 400,000 million tax documents annually, with a high concentration since the top 1,000 issuers account for 48% of the documents issued.

In the electronic invoice system in Chile, the format specifications required for the taxpayers' documents were delivered, for them to operate and qualify as electronic tax documents. The format specified is XML, digitally signed and including the information contained on the invoices and other tax documents required by the SII and taxpayers. On the basis of such specifications, taxpayers may adjust their invoice systems or purchase an off-the-shelf electronic invoice solution. At the same time, the SII had to develop the software required to include and certify taxpayers, receive and validate information, as well as the queries available on its Web page.

For the Micro and Small businesses (taxpayers who do not exceed \$500 million in annual sales) an electronic invoice system has been



enabled on the SII Web site free of charge, the Electronic Invoice function on the SII MIPYME Portal, through which they may operate only with a digital certificate and an Internet connection.

### **3. GOALS AND OBJECTIVES**

The general objective of the system was to grant the electronic tax documents the same legal and tax validity as the traditional tax documents. This fosters the development of electronic commerce, significantly reduces the invoicing process costs for taxpayers, and enables to incorporate great improvements in their businesses and the services offered to their customers, while simplifying compliance with their tax obligations.

It enables the SII to perform better audits on credits and debits, optimize controls for the movements of assets with valid documents for audits and offer better services with more quality information for taxpayers.

### **4. METHODOLOGY**

In order to operate in the system taxpayers are authorized and registered in the SII as electronic issuers. The designation and certification they shall obtain for the authorization is an Internet-based process that consists mainly in the automated review of electronic documents files similar to the ones that shall be used to operate in the system. Also, they are required to send files with the images of the printed documents, which are reviewed by auditors as regards compliance with the regulations that govern printed documents.

Once authorized, taxpayers are assigned numbers for future documents via the SII Web site, and with such numbers, they may issue, transmit and store their tax documents electronically. The taxpayer shall send each document to the recipient and the SII via the Internet.

The taxpayer who has not been included in the system receives the printed copy of the electronic document and must use it just like a traditional document on paper.

Each document must be generated in the format defined by the SII (XML), with the electronic signature to ensure the identity of the issuer and protect the document's integrity. Additionally, the system attaches an "electronic stamp", in PDF417 format, to the printed copy of the

documents, to certify their validity. Such electronic stamp, materialized on a two-dimension bar code, enables auditors to verify the validity of the printed documents attached to goods offline.

The SII provides a document verification service on its Web site, which allows taxpayers as well as auditors to confirm the validity of a given document.

In addition to forwarding the individual electronic documents to the SII, the taxpayer shall submit the files with the Electronic Information of all the purchases and sales on a monthly basis. The electronic documents already filed with the SII may be excluded from the foregoing files, but the taxpayer must detail all the printed documents issued or received. This is valuable information for Auditing purposes.

In the development of the model as well as the creation of the formats in which the electronic documents are recorded, we worked with a group of companies appointed specifically for such purpose. For 9 months we developed jointly with said companies the rules and formats under which the system would operate. Initially, 9 companies were authorized to operate in a trial run modality to make adjustments and improvements on the system.

The electronic invoice system was enabled for all taxpayers on September 1<sup>st</sup>, 2003, upon publishing SII Special Resolution N° 45 setting forth the regulations on the electronic invoice system.

As a result of the implementation of the electronic invoice, we have launched the “Electronic Factoring” initiative, with the opening of the Public Registry for Credit Transfers that enables to record the transfers of credit included in the electronic invoices, which, according to the enforcement procedures regarding invoices and their transfer suffices as a requirement for the debtor of an electronic invoice to be notified of the transfer thereof.

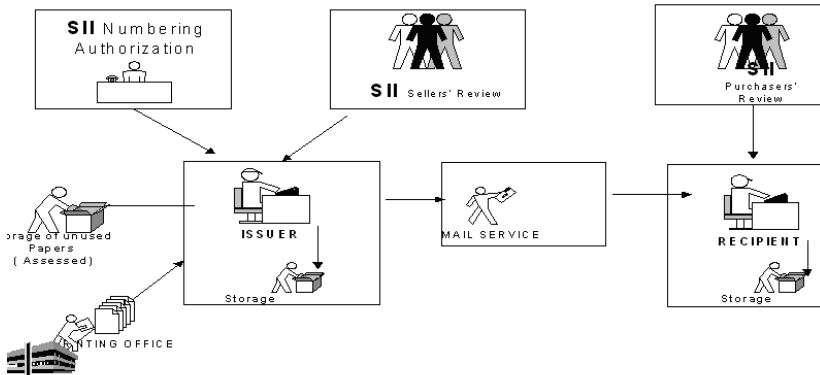
In order to incorporate the Public Sector, we worked jointly on a solution with other entities, which they may employ basically for the reception of electronic invoices (the Public Sector is an infrequent issuer of such documents).

Hereunder, we present the differences between the traditional system and the electronic invoice system.

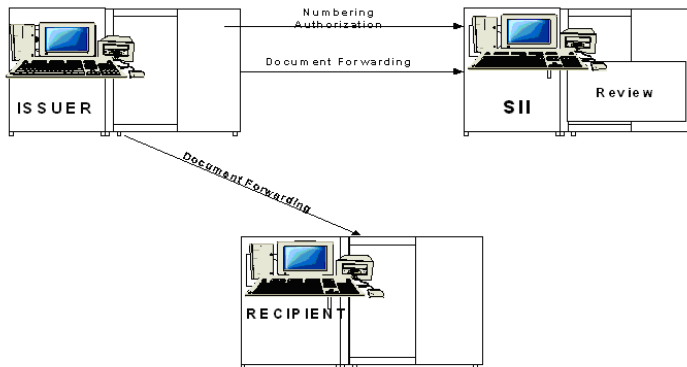
Topic 2.1 (Chile)

FUNCTION	PAPER INVOICE	ELECTRONIC INVOICE
Numbering of documents	Pre-printed on paper sheets.	Authorized by the SII Web site.
Stamping of documents	At the SII offices.	By the taxpayer.
Stamp	Manual.	Electronic.
Storage	Paper. Taxpayers for 6 years.	Electronic. Copy for the SII for tax purposes. Copy for the taxpayer for personal purposes.
Validity verification	Authorization via the SII Web site.	Authorization, reception and validity. On the SII Web site.
Document printing	4 copies, continuous form, Copies, continuous form, pre-numbered, impact printer.	Regular paper, individual sheet of paper.
Presentation of Purchases and Sales' Books	Printed for eventual review.	Electronic. No requirement to keep them in print.

**TRADITIONAL SYSTEM (PAPER)**



**ELECTRONIC INVOICE SYSTEM**



**5. BENEFITS (quantitative/qualitative impacts)**

Among the key benefits reported by the businesses authorized by the SII to operate in the system we may mention:

- Improvements in the business processes,
- Improvements in Productivity and Competitiveness,
- Reduction of invoicing costs,
- Development of electronic commerce,
- Better information quality,
- Better customer services,
- More expeditious invoicing process,
- Visits to the SII to carry out the stamping of documents.

With regards to the reduction of invoicing costs, the studies performed indicate that the cost of the electronic invoice is one third of the traditional invoicing system. In spite of the fact that this figure is relevant, taxpayers have concluded that the most important benefits derive from the greater productivity and competitiveness gained via the system's computerized management of their documents and customers.

From the SII standpoint, it improves the quality of the information since an electronic file is received, which includes the electronic tax documents; traditional documents require digitization (with the implied possibility of error) in order to undertake any formality. More information is gathered, since a copy of each electronic tax document issued is received and on a monthly basis, the authorized taxpayers' purchases and sales information. It improves the auditing processes owing to the existence of more and better information. It reduces manual stamping of documents at the SII offices, which enables a better taxpayer service.

## **6. DEVELOPMENTS WITH THE ELECTRONIC INVOICE INITIATIVE**

We hope to extend the electronic invoice system massively so that, after five years, the great majority of the tax documents issued in the country may be issued electronically. Therefore, the SII must improve its platform in order to strengthen its information processing and storage capacity.

Since all the tax documents for purchase and sales transactions have already been incorporated into the electronic system, including the exports' documents, we are including the accounting books' function in the Electronic Tax Documents' System, which enables taxpayers to avoid keeping the books on paper and having to store them. Initially, we have considered the Journal, General Ledger, Inventory, Balance Sheet, and Accounts' plan. Taxpayers who operate with this function, shall forward the electronic receipts of the annual closing of such books to the SII and, should they be required upon notification, they shall present them with the respective closing information previously forwarded on a form. This option is very attractive for taxpayers, mainly because they avoid carrying printed copies of the documentation required in potential audits, as well as the SII, which may remarkably improve the audits conducted, since it shall rely on the information from such electronic accounting books.

In September 2005 we enabled a portal for the Micro, Small and Medium-sized Companies (Mipymes, as per the Spanish acronym), which includes an Electronic Invoicing system by which said companies may issue and receive their electronic tax documents via the SII Web site as well as carry their purchase and sales' books to be submitted to the SII on a monthly basis, at the month's closing. Additionally, it gives them the possibility of creating the electronic document by which they may record the credit transfer of an invoice in order to access the Electronic Factoring function.

For the users of the MIPYMES electronic invoice system, we have also enabled since March 2007, a Simplified Taxation System geared at simplifying accounting procedures and facilitating tax compliance for small businesses: sole proprietorships or limited liability companies that meet the requirements to qualify for Article 14 (third amendment) of the Income Tax Act of 2007.

Said Article 14 (third amendment) of the Income Tax Act enables to determine the Taxable Income on a simple basis, and releases taxpayers from certain tax obligations (balance sheets, currency adjustment, carrying inventory, Taxable Income record (FUT, as per the Spanish acronym)), in addition to other tax advantages such as the immediate deduction of expenses.

The Simplified Taxation System receives information from the transactions performed by the company via the MIPYME Portal Electronic Invoice function and the eventual transactions on paper that require manual recording with an entry module. With this information, the system automatically produces the following documents:

- The mandatory accounting books (Purchases and Sales' Book, Salaries' Book, Professional Fees' Books and Other Income and Expenses),
- Preliminary monthly Value Added Tax (VAT) statements and annual Income Tax statement,
- Annual statements that must be filed as withholding agents for Salaries and Withholdings (fees),
- Simplified Financial Report, which may be filed with financial institutions as background creditworthiness information.

As regards the Public Registry for Credit Transfers, automated services have been incorporated as required by the businesses that have undertaken Electronic Factoring activities, which enables them to record and query the Registry with automated systems. Additionally, we have discussed with Banking institutions the implementation of a

common electronic payment standard for electronic tax documents, which would render the whole process electronic.

On the other hand, in order to improve audits, we are implementing business intelligence systems that employ the large volume of information available in data crossing, analyses and other processes that enable to optimize the detection of tax evasion targets. Likewise, we are designing a mechanism by which auditors may review and pore through the purchases and sales' books, and subsequently, all the other electronic accounting books filed by taxpayers.

## **CONCLUSIONS**

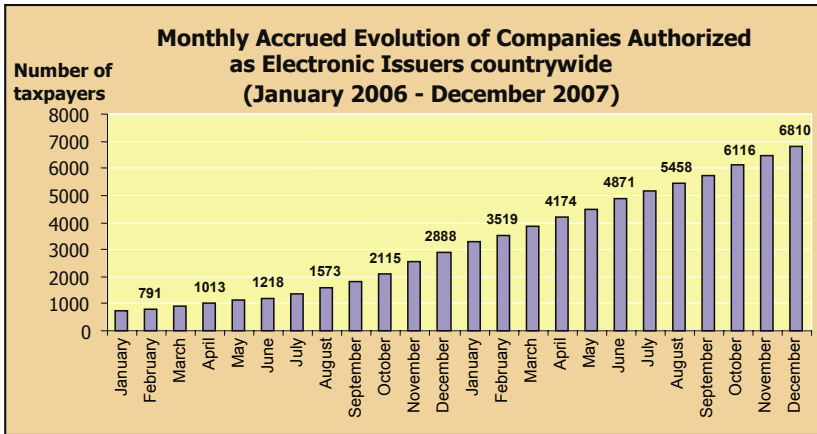
To date, there are almost 7,000 taxpayers authorized to issue electronic invoices, out of which 75% are MIPYMES operating via the SII Web site with the function enabled for them.

The taxpayers who are presently authorized generate over 8 million electronic tax documents on a monthly basis, which accounts for over 25% of the overall tax documents issued in the country.

Almost 500 government offices have been authorized (ministries, city councils, municipalities, utilities) to receive electronic invoices from their private suppliers.

From the implementation of the system to the present, the SII has received approximately 220 million electronic tax documents, which together with the purchases and sales' electronic books that taxpayers who issue electronic invoices are required to file on a monthly basis constitute a valuable source of information, of very good quality, in order to undertake the auditing function.

Hereunder, we present charts with the evolution for the years 2006 and 2007, as regards the reception of electronic documentation as well as the incorporation of taxpayers in the system.



As an evaluation of the process by which this system was developed, it is worth highlighting that the fact that companies were able to participate in the design of the model as well as the documents' formats, through a group especially selected for such purpose. This entailed the incorporation of many elements required by companies on the electronic documentation, for a better and more efficient employment of the information. Additionally, the experience that the Tax Administration developed a system in collaboration with companies according to their interests was very fruitful.



Enabling a platform in the Internal Revenue Service, by which the Micro, Small and Medium-sized taxpayers were incorporated into the system at no cost, only relying on a digital certificate for the electronic signature, enables a relevant penetration of the system among the small-business owners, for whom the manual invoicing process is expensive and cumbersome.

Likewise, should the customers of these small-business owners require that they invoice in the electronic modality because they wish to enjoy the benefits of receiving electronic documents, they may easily do so.

Also, the MIPYME businesses who participate in the Simplified Taxation System may optimize their tax and accounting procedures and reduce tax compliance costs while they increase their competitiveness.

The increasing gradual voluntary incorporation of large taxpayers into the system is also worth highlighting. For most of such taxpayers, becoming part of the system entails the organization of their information and processes, which ultimately, also results in the improvement of their performance.

## **THE EFFICIENCY OF THE TAX ADMINISTRATIONS AND THE REDUCTION OF COMPLIANCE COSTS**

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*CONTENTS: Introduction. -1. Operational Efficiencies, Improved Facilities and Customer Service. -2. Staffing, equipment and training. -3. Flexi-Time. -4. Communication. -5. Technology. -6. Web Page. -7. Diskette Initiative. -8. The New Automated Tax Administration System. -9. The Role of Audit in Reducing Compliance Costs. -10. Innovative Ideas: Direct Deposit. -11. Simplified Return. -12. The Tax Fair. -13. Some Other Matters Related to Efficiency and Cost. -13.1 Legislation. 13.2 Costs of New Provisions. -13.3 Reporting System. -13.4 Cost Benefit Analysis. -13.5 Quantifying Some Costs of Compliance. - Conclusion.*

### **INTRODUCTION**

Compliance is the main goal of tax administrators. It means all taxpayers should pay to their administration the correct amount of taxes for which they are liable at the times specified under the relevant tax legislation.

The true compliance cost for any tax jurisdiction could be said to comprise:

- Total cost of operation of the tax administration
- The cost incurred by stakeholders in collecting revenue in respect of third parties - collection at source
- The cost incurred by taxpayers to enable them to file their returns

A good tax system needs to be robust and efficient in terms of revenue collection yet minimise its compliance costs. To achieve these objectives the tax administration must improve various aspects of its operation. It must also seek to minimise the direct cost of compliance to stakeholders and taxpayers. This paper seeks to outline aspects of Barbados' tax administration system which contribute to the goals of efficiency and the reduction of compliance costs. It will examine specific measures that were undertaken by Inland Revenue Department (IRD) to enhance efficiency and reduce compliance costs. Some of these changes could be considered as traditional while others could be classified as innovative.

### **1. OPERATIONAL EFFICIENCIES IMPROVED FACILITIES AND CUSTOMER SERVICE**

At the operational level adequate staff, equipment and a congenial working environment must be provided to improve the efficiency of the tax administration. Within the last fifteen years Barbados ensured that there was an improvement in the physical surroundings provided for staff and taxpayers. An enhanced customer service area equipped with a television and a spacious waiting area awaits the taxpayer. More telephones lines were added to the area to provide the public with a faster and more efficient service.

Taxpayer are now better able to obtain information and help from officers in a more timely manner. The section of the office dedicated to customer service has brought added benefits to taxpayers and has streamlined the operations of the department by way of quality taxpayers' services.

Other facets of taxpayers' service include an outreach program where officers set up a help-service at strategic locations in shopping malls and other busy shopping areas. This activity is usually done during the month of April prior to filing date.

Generally taxpayers make full use of these services as there are fewer persons at these venues as opposed to those coming to the central office in the capital city.

The services provided by the outreach program has helped to reduce the need for regular employees to work overtime in order to satisfy the high demand in terms of staff resources during the busiest time of the year.

## **2. STAFFING, EQUIPMENT AND TRAINING**

A department is as efficient as its staff and the equipment available for the staff to perform its duties efficiently and effectively. The staff complement at IRD has not increased in many years. It was therefore necessary that management increased the level of training offered to officers to ensure that the limited resources are utilized to the maximum.

Training was provided both locally and internationally. The officers attending these training programs were able to improve their skills in taxation thereby bringing a new and fresh perspective to the task at hand.

Continuous training of officers is an integral part of the trust of the Department to keep them aware of current technologies and provide better services to the taxpayers.

In terms of equipment, more computers are now available for staff to carry out their duties. This ensures that taxpayer matters are responded to quicker than previously.

## **3. FLEXI-TIME**

The IRD recognized that taxpayers often complained about the inability to obtain the services of the department before 8:30 a.m. and after 4:30 p.m. To address this concern the department introduced flexi-time for some members of staff.

This has allowed some officers to determine their work hours in a way that takes into account their domestic responsibilities and the needs of the department.

It means taxpayers have access to the department for an additional two hours per day. The standard hours were 8:15 a.m. to 4:30 p.m. There are now three “work times”

7:15 a.m. - 3:30 p.m.

8:15 a.m. - 4:30 p.m.

9:15 a.m. - 5:30 p.m.

#### **4. COMMUNICATION**

The main objectives of a tax administration is to make it easier for taxpayers to comply with the provisions of the tax code. Therefore, it is necessary for the tax administration to deliver faster, more accurate answers to taxpayers across all communication channels. The department has used the services of the Government Information Service (GIS), a state-funded agency geared towards the dissemination of information via the print and electronic media on behalf of the government and its departments. The GIS is used extensively to sensitive taxpayers of their rights and obligations and what they can do to fulfil their responsibilities, especially during filing time.

#### **5. TECHNOLOGY**

Prior to 1995 the operating system of IRD was essentially manual. Officers were required to transfer manually information from returns submitted by taxpayers to a card recording system in the department. This process was time-consuming and tedious with the refund and assessments for taxpayers taking several months to be completed.

In 1995 IRD with the help of CIAT and a team of consultants drawn mainly from Revenue Canada, introduced a partial computerized system to capture electronically the information previously recorded manually.

This new system allowed the department to complete returns within a six-month period as opposed to a longer period under the former system. The year 1995 was used as a base year and significant information on taxpayers from that year forward was readily available with the click of a mouse.

#### **6. WEB PAGE**

The Department launched its website about three years ago. There were two primary objectives behind this initiative. First, the Department wanted to widen its reach to the taxpaying public in its ongoing effect at informing and educating taxpayers about the Barbados Tax System and the Law and Regulations which govern it. It is believe that the more knowledgeable the public is about the tax laws and their rights, obligations and entitlements under those laws the more likely a higher level of voluntarily compliance would be achieved. The site therefore provides a wealth of information and caters to local taxpayers and

other persons abroad who may have an interest in the Tax System of Barbados.

Secondly, to enable the Department to provide a more effective and efficient service to the taxpaying public. For example, tax return forms, both individuals and corporations, are now available on line. This facility is particularly useful to our non-resident taxpayers. Many other forms required for specific tax obligations are also available on line. The range of services currently being provided will be further expanded as the Department upgrades its Management Information System.

## **7. DISKETTE INITIATIVE**

Tax Administrations must grapple with the need to encourage compliance by creating the enabling environment for taxpayers to fulfil their statutory obligations to the department and simultaneously keeping compliance costs at a reasonable level. The department has allowed the large taxpayers to submit data that was formerly submitted on paper in respect of payroll to be now submitted on diskette. Even this method will undergo some changes with the coming of the New Automated Tax Administration System in 2009. Every effort is being made by the department to use technology to increase its efficiency and to reduce compliance costs.

## **8. THE NEW AUTOMATED TAX ADMINISTRATION SYSTEM**

In May 2007 a Memorandum of Understanding was signed by the Government of Barbados and the Inter-American Center of Tax Administrations (CIAT) for the implementation of a New Automated System for the Inland Revenue Department.

The key components of the system are:

- Electronic Filing
- On Line Transaction Processing
- Document and Workflow Management System
- Decision Support System.

IRD recognized that in order to keep on the cutting edge of technology and to provide taxpayers with improved services, it was necessary to offer taxpayers the opportunity to file their tax returns on line and to

make use of the internet to file documents. The new system will make this possible as well as to enable management to provide specific information on a regular basis.

The project is at the development stage with an actual start date being February 2009. The new automated system will usher in increased benefits to taxpayers and other stakeholders who have to do business with IRD. Information that was submitted manually before will now be sent electronically.

## **9. THE ROLE OF AUDIT IN REDUCING COMPLIANCE COSTS**

Tax compliance is the degree to which a taxpayer complies or fails to comply with the tax laws of his country, for example by declaring income, filing a return and paying the tax due in a timely manner. In Barbados, as in many other tax administrations, the challenge is to increase the number of taxpayers who are on tax roll and to ensure that those who are there report the correct income from all sources. One sector which provides a big challenge to the tax department is the self-employed.

In this category are artisans and professionals including attorneys-at-law and doctors. The audit section therefore has a critical role to play in ensuring self-employed persons and all other taxpayers honour their obligations and file tax returns annually.

The auditing process gives the department the opportunity to verify the accuracy of the data in the returns submitted as well as to identify taxpayers who have not filed returns. Therefore, an aggressive audit programme is essential in any tax administration. The deployment of the resources in the audit division in the critical areas of the self-employed and large businesses forces taxpayers in these areas to comply.

In Barbados, there is a construction boom with an increase in the number of persons finding work in the building industry and related services. The administration is cognizant of the increase in activity in this area and has increased the number of auditors working in the field. Officers involved in payroll activities can now identify new employers and employees while the projects are underway thus ensuring that the necessary deductions are made and are submitted to the department. The presence of officers encourages compliance and reduces the costs to the department when other measures will have to be put in place to recover taxes that are not collected on a timely basis.

Presently, the aim of the audit programme is to detect people who do not comply and to take action against them. Given that only a relatively small percentage of the population can be reviewed each year, the time and personnel available are used wisely and where most benefits will be achieved. It is acknowledged that there is always room for improvement, particularly in terms of the use of technology.

## **10. INNOVATIVE IDEAS DIRECT DEPOSIT**

The improvement of tax services significantly facilitates the taxpayers' voluntary compliance, increasing tax collection, consolidating the institutional image and improving relations between the tax administration and society. One improvement in the department relates to the introduction of the Direct Deposit System. This was introduced in 2003 and it offered taxpayers the opportunity to have their tax refund deposited directly into a bank account of their choice.

The direct deposit system allows the IRD to assign resources which were formerly used to sign cheques to other activities such as auditing. Prior to the direct deposit initiative in 2003, cheques had to be issued to each taxpayer who was in receipt of a tax refund. A significant number of taxpayers welcomed this initiative and requested to have their refund lodge directly into their respective bank account.

## **11. SIMPLIFIED RETURN**

Some measures make income tax returns more complicated, but a lot of taxpayers cannot benefit from them because of their low income. One method which will be introduced to compensate for this challenge is to have a simplified return which can be used by persons who have the minimum deductions and allowances. A return of this kind would allow more taxpayers to complete their returns themselves thereby assisting to keep costs down to the taxpayer and the Department.

## **12. THE TAX FAIR**

Each year in the month of April the IRD host a tax fair in the heart of the capital city. The Tax Fair provides the Department with the opportunity to highlight its role and at the same time makes available informative brochures of various important aspects of the tax system to taxpayers. The Fair also incorporates other collection agencies of government namely the VAT Department and the National Insurance Department.



Persons attending the Fair are also provided with the services of health professionals who conduct blood pressure, blood sugar and cholesterol checks. Senior students in schools are also invited to attend the Fair so that there will be exposed to the importance of paying taxes and the use of taxes to provide the country with the services of education, healthcare and other amenities they enjoy.

In addition a tax specialist from the university or another area delivers a lecture.

The public is given an opportunity to ask questions and make comments.

**The topics for the last four years were:**

- 2004 - Building together especially with our small business and self-employed entrepreneurs.
- 2005 - The tax department as a partner in the social and economic development of Barbados.
- 2006 - The role of the tax department as it relates to the provision of social services.
- 2007 - Building together through youth and sports.

**13. SOME OTHER MATTERS RELATED TO EFFICIENCY AND COST**

**13.1. Legislation**

After the presentation of the Budget each year it is almost certain that some changes are required to the Income Tax Act. Each change must be accompanied by the requisite legislation. The legislation required to effect the changes must be done in a timely manner. Any delay in the completion of the legislation can affect the smooth running of the tax administration and businesses. Also accountants and other persons who represent taxpayers must be able to obtain and interpret the actual legislation.

It cannot be overemphasised how important it is for the taxpayers including businesses to understand the tax laws. The performance of the economy could be affected by the state of such laws. If the lawmakers create tax laws that are terribly complex or laws that change rapidly, taxpayers may not be able to obtain a reasonably certain conclusion about how taxation will affect their business or investment. In addition, cost could be incurred for special advisers. This would increase their compliance costs.

Whenever the tax consequences of various economic activities are unpredictable, then tax policy could impact on the growth of the economy. The laws should be timely, certain and simple. For example the tax changes with specific regards to tax rates and allowances done in 2002 dealt with changes for the next five years, thereby allowing taxpayers the opportunity to do their business planning, taking into consideration any tax liability.

### **13.2. Costs of new provisions**

The introduction of new tax provisions can increase the time it takes to fill out commonly used tax forms for individuals and businesses. In Barbados, the new provisions may have further implications for individual businesses when certain information that now has to be captured was not necessary previously.

For example, from the 2007 income year the allowance taxpayers can claim for shares with a credit union is \$10,000. The amount so claimed must not be withdrawn within five years.

This change in the Income Tax Act forces Credit Unions to monitor deposits and withdrawals to the share accounts of their members and deduct twenty per cent withholding tax of any funds withdrawn within the five year period as stipulated by law.

The tax so withheld must be paid to the Commissioner within seven days. Credit unions in Barbados are not liable to tax on its profits and therefore prior to the change did not have to submit tax returns of any kind to the Commissioner.

Some changes in the Act increase the time each taxpayer takes to complete a tax return. Some changes to the Act may also translate into additional time being spent by officers who have to check these returns. Consequently the overall cost per completed return increases for the department. For 2007 there were nineteen changes to the Income Tax Act. Some of the changes were not significant but others are more detailed and may force some taxpayers to seek professional advice.

### **13.3. Reporting system**

In order to monitor the progress of programmes, it is essential to have a good reporting system that will provide details of the progress, results

and an early warning if things are not going according to plan. The following is a representative list of some of the management reporting requirements from the audit area that are necessary:

- summary of the cases completed to Budget
- summary of time spent on each task
- statistical reporting of assessment, reassessments, reasons for reassessments
- total discrepancies identified
- report of revenues collected versus revenue assessed as a direct result of audit activity
- summary of costs incurred in operating the programme

#### **13.4. Cost benefit analysis**

Any efficiency in a tax administration must take into consideration the costs which are given up and the benefits which results from the giving up of these resources. Activities are done with time considerations. Also regard must be given to the costs and benefits associated with each job.

An example from audit and investigation:

Audit and investigation work is often time consuming and it can be difficult for staff to determine when to finish a case and move on. Smaller audits may not require the same input of time – in these cases the emphasis is on high numbers and wide coverage. Tax administrations must therefore acknowledge that they cannot afford to allow audits or investigations to continue until the last dollar of discrepancy is found. The concept of opportunity cost that was alluded to earlier in this paper must be recognized – chasing the last dollar in tax may be at the expense of starting another more lucrative case or obtaining the desired coverage of taxpayers. It is easy to get bogged down so that discrepancies discovered after a certain point are out- weighed by the cost of continuing with the case (diminishing returns).

With almost all investigations or audit the 80/20 rule applies; that is 80% of the discrepancy is normally detected in the first 20% of the time spent on the job. After that the remaining 80% of the time will only produce the remaining 20% of the discrepancy. As resources are limited, and generally they are, the policy is for auditors to seek out the 80% and then move on to another case to extract another 80% from that one.

### 13.5. Quantifying some costs of compliance

Although it is difficult to measure total compliance cost, an attempt could be made to measure some aspects of such cost. Two general types of cost are: overhead and opportunity cost. Overhead cost can be divided into three activities: tax planning, general compliance and litigation. The first type of overhead, tax planning, refers to all economic decisions that individuals and firms make to maximize their benefits within the tax laws. The second type of overhead, general compliance, refers to the basic actions required to file the income tax return, including record keeping, education, form preparation and packaging/sending. The third type of overhead is tax administration and litigation, referring to the cost of IRD, the Courts (cost associated with tax matters) and the Appeals Board, as well as all costs that taxpayers incur while dealing with these institutions.

Opportunity cost is the result of a less efficient economic activity displacing a more efficient activity. For example, a vendor recognizes that she can sell a special type of apples from one supplier for \$2 and due to their unavailability she is forced to obtain another variety from another supplier which she has to sell for \$1. The loss of \$1 (that is \$2 less \$1) represents the vendor's opportunity cost.

In this example, the determination of the value of the foregone economic activity was easy to identify since the vendor knew how much the apples would sell for. However, measuring the opportunity cost of tax compliance can be more difficult: some parts of it can be quantified but others are more speculative in nature.

As an example of a quantifiable tax opportunity cost, wage-earners are currently required to have their taxes withheld from their pay cheques. In reality, taxpayers are forced to prepay their income taxes. As a result, they lose any economic returns (interest, profit, dividends) that they might have generated with the money between the time of withholding and the time when the taxes are due to be paid. The opportunity costs associated with withholding can be estimated.

## **CONCLUSION**

The Inland Revenue Department enters a new era. Further success in efficiency and the reduction of compliance cost are necessary. The New Tax Automated System will be beneficial to the tax administration, stakeholders and taxpayers which include banks, accounting firms, insurance companies, credit unions and all other taxpayers and organizations doing business with IRD. Certainly, the Department acknowledges the critical role it must play in ensuring the efficiency of the tax system and the reduction of compliance costs.

## **THE EFFICIENCY OF THE TAX ADMINISTRATIONS AND THE REDUCTION OF COMPLIANCE COSTS**

**José María Zubiría**  
Head  
Tax Administration Service  
(Mexico)

*CONTENTS: Introduction. -1. The Platform Project. -2. Services on the new Internet Portal. -3. Statements. -4. Automated Refunds. -5. Electronic Invoice. -6. Personal assistance simplification processes. -7. ISO 9000 certification in the taxpayer service modules. -8. Experiences in foreign trade transactions' improvement projects. -8.1. The Integral Automated Customs System. -8.2. Importers' Registry. - Conclusions*

### **INTRODUCTION**

The ongoing change in the economic, political and social context requires envisioning the tax administration function based on the use of the best planning, prevention, operation, management and control practices for an efficient performance.

On the other hand, evasion, contraband and informality cause inequity and imbalances. Therefore, the Tax Administration shall establish measures to counter such phenomena.

The work of the Tax Administration shall achieve greater and better collection, more efficient controls on the exchange of goods, facilitating services to foreign trade agents and improving the security in their transactions. Such challenges require enhancing the government efficiency and efficacy standards on revenue matters and adjusting its procedures to the new demands of the global economy.

Modern Tax Administrations shall produce new and innovative administrative planning and management processes to ensure operational service continuity and react comprehensively to the challenges posed by collection efficiency.

The change processes shall start by reformulating the way in which the Tax Administration relates to the taxpayer, based on process integration to facilitate compliance with tax obligations and improving its resources and capabilities.

Achieving such results entails addressing different types of issues, which range from employing a complete and reliable taxpayers' registry as a vital condition for an effective and efficient performance to the taxpayers' audits to determine compliance with their obligations.

In order to facilitate compliance, the Tax Administrations shall increasingly facilitate Internet-based transactions (statements and payment). On the other hand, the efficiency in the assessment and payment of refunds shall be enhanced by reviewing procedures and employing information to better manage the risk of fraudulent refunds.

As regards risk management, the improvements in the selection process for taxpayers to be audited and the higher quality of auditing procedures result in higher levels of profitability. Likewise, in legal disputes, the adoption of profitability criteria to assign priorities shall go hand in hand with a more efficient resource allocation.

The short-term challenges involve the following issues: updating and improving the quality of the taxpayers' registry; reducing compliance costs (time and money) for taxpayers; adjusting the complex legal framework; organizing non-integrated information into risk-based auditing structures, and adjusting customs operations to the needs of a very dynamic and global foreign trade.

We wish to share the experiences faced by the Mexican SAT upon addressing some of these challenges. Particularly, we shall comment on the projects in which we have made significant progress vis-à-vis cost reduction and efficiency improvements for taxpayers' services.

## **1. THE PLATFORM PROJECT**

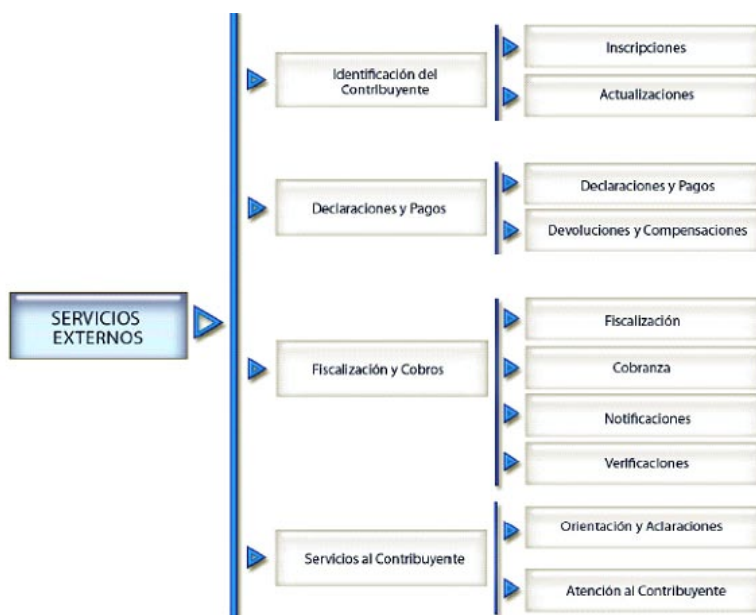
The Integral Solution (SI, as per the Spanish acronym), also called Platform project, is the most ambitious transformation initiative ever undertaken by the SAT in the last few years. It seeks to focus its services by means of simplified business processes, which facilitate compliance with tax obligations and enable to offer services with better functionality and quality, ensuring better administrative efficiency and a reduction in compliance costs, for the taxpayer as well as the Tax Administration.

It entails changes that required redefining regulations, processes, organization, people, information models and the use of available technologies based on an Institutional Architecture principle that seeks to provide consistency and harmony to each element as an interdependent whole, adopting the best international practices and favorable experiences, which require ongoing improvement.

The Integral Solution was structured according to models that make up a complete and articulated vision of processes, technology, regulations, information, security and individuals, which support the day to day performance of the Institution. The main Models are: Institutional Architecture, Tax Cycle, Regulatory Structure, Services' Portfolio, Single Information Model, Risk Management and Change Management.

One of the key models in the SI is the Services' Portfolio: it enables to identify the relation between the services, supporting processes and the tax obligations met through them for the different taxpayers' segments.

**External services** are directly taxpayer-centered:





### **Taxpayer identification**

It enables to rely on a positive identification of the taxpayers' registration in the taxpayers' registry and relate them to their tax obligations by means of the information elements arising from their economic activities, as well as their location. One of the fundamental change elements is the assessment of tax obligations and the deadlines, since it does not stem from the thorough knowledge of the applicable legislation, but from the identification of the activities undertaken by the taxpayer, which derive from the answers to a dynamic questionnaire.

### **Statements and Payments**

It is the key information input of the SAT collection process. It starts when the taxpayer files his/her statement on a dynamic electronic form, making the payments via the banking portals or their physical branches.

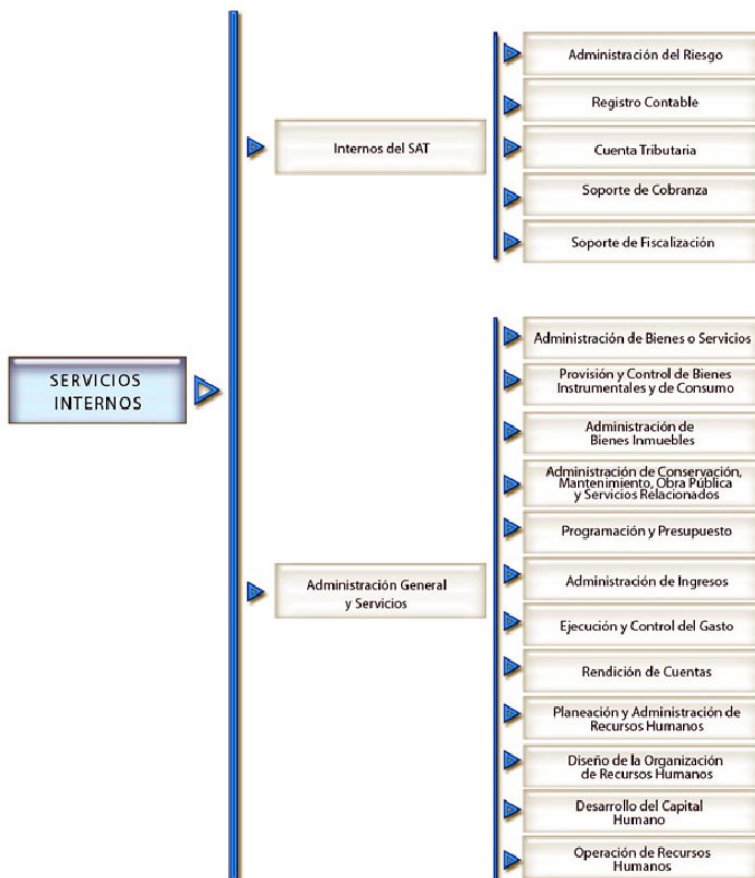
### **Refunds and Setoffs**

It offers an automated structure enabling to decide and control the amounts owed to the taxpayer in the form of a tax refund in the case of a favorable balance.

### **Taxpayer Services**

It constitutes the only assistance facility that includes case resolutions and queries via mechanisms and applications that foster a tax compliance culture: it provides personalized, transparent and expeditious assistance. It enables all the information to be consolidated in a single database, which reflects the interactions by the taxpayer with the SAT.

The **Internal services** supporting the SAT operation:



### Risk Management

It facilitates knowing the taxpayer better and establishes behavioral models according to their risk profile. Depending on each taxpayer's segment, the key identification variables shall be related and supplemented with third-party information to constitute a database that enables to assess risk for decision-making purposes.

### Accounting Entries

It has been defined as an integration process among the different accounting transactions in order to consolidate the federal contributions and their movements into a single flow of information, from taxpayers' payment to their entry on the Federal Public Treasury Account.

## Tax Account

It identifies, classifies and materializes the transactions derived from statements, payments, refunds, credits, self-assessments and different administrative acts on the taxpayer. It provides the elements required by the SAT to conduct a more appropriate control of the process.

## General Administration and Services

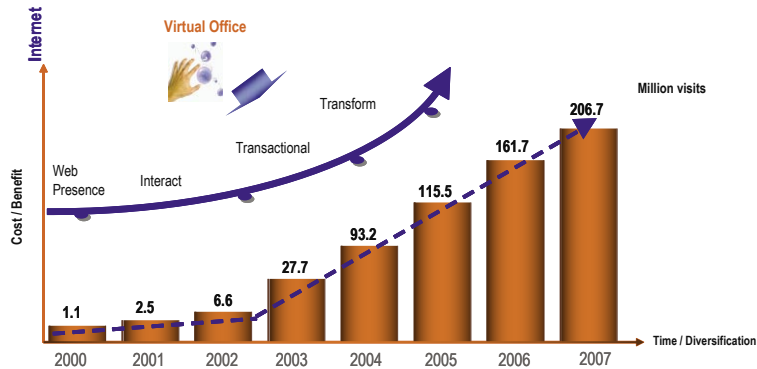
It is geared at enhancing the Tax Administration efficiency and has been developed on the basis of an end-to-end approach that provides for the sequence of activities that enable the SAT to work integrally and more efficiently, by transforming the system inputs into products or services. This has additionally enabled significant changes in the management of SAT internal resources.

In summary, among the main benefits obtained with the Integral Solution, we may mention:

For the taxpayer	For SAT
<ul style="list-style-type: none"><li>• Simplification of procedures and formalities.</li><li>• Increase in the number of tools and assistance and contact points.</li><li>• Security in operations.</li><li>• Expeditious processing of requirements and requests.</li><li>• Rewards for compliance with obligations.</li><li>• Tax obligations identifiable according to economic activity.</li><li>• Ongoing electronic access to services.</li><li>• Single tax account.</li></ul>	<ul style="list-style-type: none"><li>• Integral taxpayer and tax status vision.</li><li>• Portal used as the key point to deliver information and services.</li><li>• Single tax account per taxpayer.</li><li>• Online obligations' control.</li><li>• Information to determine risk profiles.</li><li>• Integral security model.</li><li>• Less use of paper.</li><li>• Online information via all the functional areas of the organization.</li></ul>

## 2. SERVICES ON THE NEW INTERNET PORTAL

### Evolution of the SAT Internet Portal:



#### Statistics of the portal:

- Includes almost 9,000 pages of text
- It is the most visited portal of the three levels of Government in Mexico
- Among the first 190 portals (public and private) of Mexico\*

\* Source: alexa.com - Consultation date: 28-Jan-2008

In August of 2007 a new portal is made available to citizens, which included a broad array of electronic services. The services that the taxpayer could receive upon visiting one of our service offices may be now obtained from the home or office.

- The registration procedure in the Federal Taxpayers' Registry may be started via the Internet and concluded at the service offices.
- Data updates or modifications.
- Request for tax guidance.
- Perform online complaints, suggestions or acknowledgements—including status control—.
- Access to the taxpayer's own portal (private), where he/she may consult the formalities and transactions performed as well as the tax systems and obligations.
- Produce or update the Confidential Electronic Identification Key (CIEC, as per the Spanish acronym) used to access the electronic services.

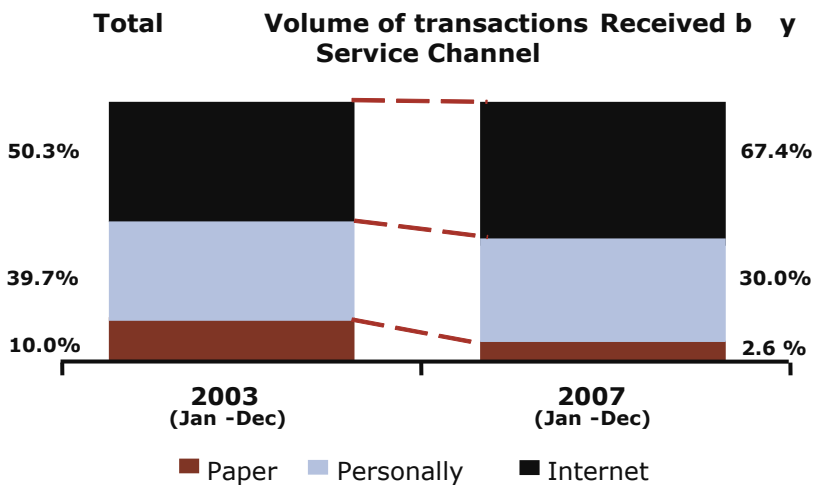
By employing the Advanced Electronic Signature (Fiel, as per the Spanish acronym), taxpayers may digitally sign documents, with high levels of security in their electronic transactions with SAT.

In the private section (My Portal), taxpayers may access the following services in the “Integral Taxpayer Folder”:

- ⇒ Data on the Federal Taxpayer Registry,
- ⇒ Tax systems and obligations,
- ⇒ Annual tax statements,
- ⇒ Electronic payments,
- ⇒ Tax refunds’ status,
- ⇒ Tax rulings,
- ⇒ Permits for imports and exports,
- ⇒ Exports’ permit,
- ⇒ Mail box.

### 3. STATEMENTS

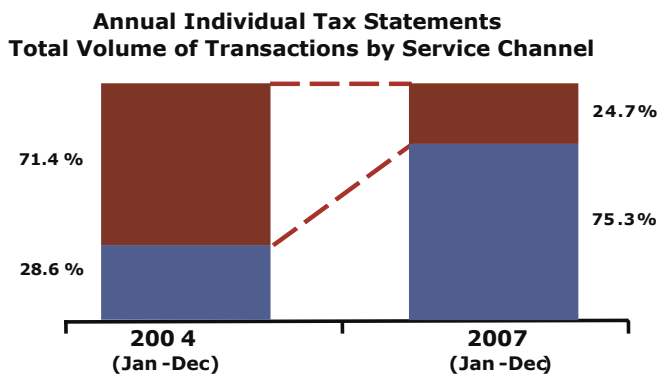
One of the services that reduced compliance costs and improved collection efficiency is undoubtedly the annual statement. The evolution of the Internet-based electronic service has achieved greater penetration than other alternatives for the taxpayer:



Source: SAT. Preliminary information subject to review.

The 17.1 percentage points increase in the share of Internet-based transactions accounts for an additional 10 million transactions conducted via this tool, equally reducing the transactions that required personalized assistance at the offices and on paper.

The preference over the electronic Internet-based service is even more dramatic in capturing the annual Individual Tax Statements. In the comparison of fiscal year 2003 against 2007, Internet featured a 163% variation in 2007 with respect to 2004.

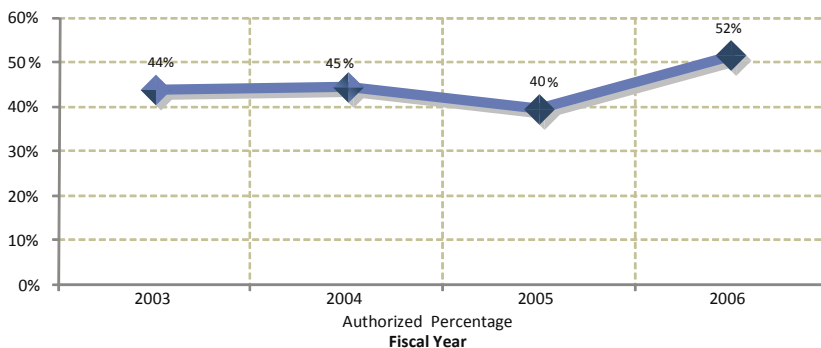


Source: SAT. Preliminary information subject to review.

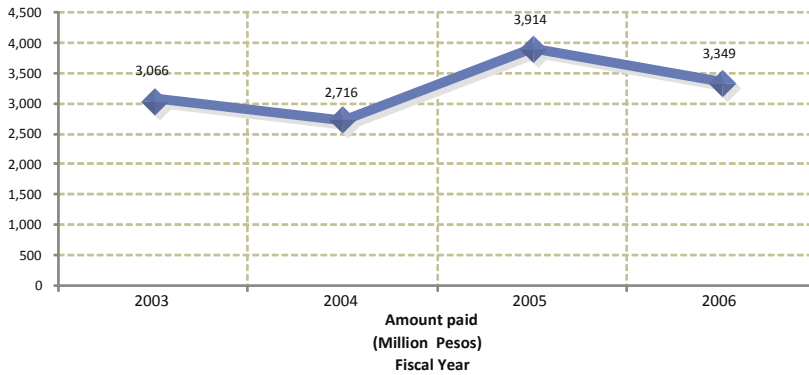
#### 4. AUTOMATED REFUNDS

Automated refunds tied to the Annual Individual Statement Period is one of the areas achieving the greatest efficiency improvements for SAT, as well as the perception of improvement in the quality of service by taxpayers.

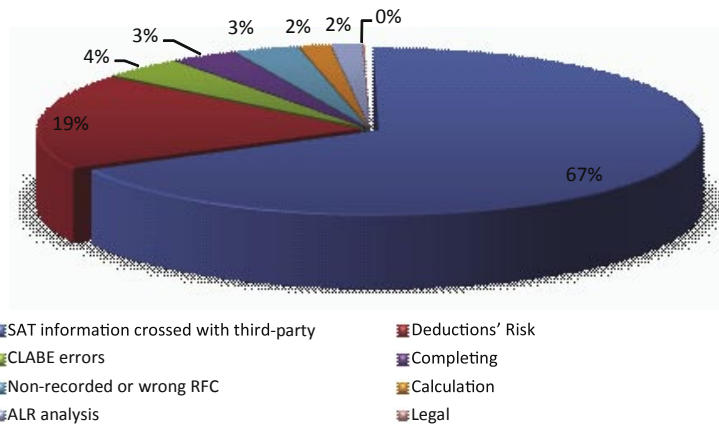
In the period January-December of 2007 (fiscal year 2006), 1,492,372 tax statements with favorable balances were received. Out of the statements filed, those with identification errors or offset by the taxpayer were excluded from the automated process. Therefore, the total forms excluded from the automated process account for 37%, and out of the 917,671 requests eligible for the automated process, 52% were authorized.



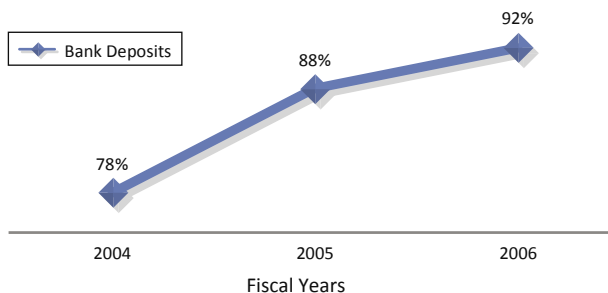
## Topic 2.2 (Mexico)



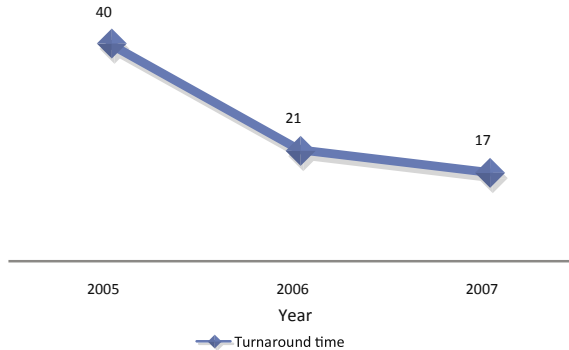
The main cause of rejection (67%) stemmed from crossing the information filed by taxpayers with the one rendered by third-parties. The breakdown is featured hereunder:



A great improvement in facilitating the recovery of the taxpayers' favorable balances has been the direct deposits in their bank accounts, and a growing number of taxpayers receive their refunds according to this modality, as featured hereunder:



On the other hand, the average payment time for the authorized requests was 17 business days, 58% under the average time for refunds' payments two years ago. It is worth highlighting that this year the refunds for fiscal year 2006 were deposited on the business day subsequent to the deadline for the obligation to file the annual statement.



Another benefit of this program is that taxpayers may query the status of their refund via the Internet; that is to say, they may learn whether it has been already authorized, in payment process or, if not authorized under the automated refunds program, learn the reason and differences relative to the information on the annual statement.

In line with such improvements, significant progress has been also made in prevention of tax fraud, stemming from the crossing of information with third-parties and the validations based on statistical and business analysis. In fiscal year 2006, such processes avoided the payment of refunds for an 85% amount of the authorized refunds.

## 5. ELECTRONIC INVOICE

The digital tax invoice is the digital representation of the paper invoice and is fully valid for the Administration. The digital tax invoices (CFD, as per the Spanish acronym) are issued with a digital stamp that identifies them as unique; this enables to verify their content, integrity, uniqueness and authenticity. The SAT Digital Tax Invoice program was launched on January 5<sup>th</sup>, 2005.

The digital tax invoices enable taxpayers to enjoy considerable savings from less printing costs that are tied to the administration and storage of documents, as well as those arising by a faster management of electronic transactions in the client-vendor relation. On the other hand, the Tax Administration achieves higher degrees of security



and integrity of the information that taxpayers employ to support their tax statements while they may validate the transactional information electronically.

The evolution of the CFD system has grown very fast, since according to SAT estimations for 2006, 1,000 taxpayers would be served, but this figure was 40% higher. For 2007, the requests processed increased to 8,155 taxpayers, whether via their own electronic accounting system or from a service provider that generates and forwards digital tax invoices.

As of December of 2007 the following results may be reported:

Record numbers assigned	22,352
CFD reported	14,769,775
Taxpayers to be incorporated in 2008.	62,768

The advantage of this system is that it is available to the majority of taxpayers, regardless of their size or sector. It enables to issue digital tax invoices to all taxpayers whether on their own or via a reliable third-party or Provider of Generation and Forwarding Services, which shall be authorized and listed on the SAT Internet Portal.

The benefits for the issuers and recipients are that this type of tax invoices expedites the reconciliation of the accounting information as well as the reduction of costs and errors in the process of information generation, capture and storage.

It also simplifies the invoice issuing process for taxpayers, offering advantages to the recipients with the automated and secure integration into their accounting systems, based on the digital online Internet-based tax invoice validation services.

## **6. PERSONAL ASSISTANCE SIMPLIFICATION PROCESSES**

The taxpayer assistance model has undergone relevant changes in the last few years, simplifying the interaction with the tax authority significantly.

The purpose of bringing services closer to the taxpayer has positively impacted personal assistance, which went from an isolated function to one that articulates, combines and improves with the remote and virtual assistance channels, offering added value to the taxpayer.

There are many factors influencing the assistance service. We mention some of the most relevant ones hereunder:

**The redesign of taxpayer services' processes** decentralized to a great extent the decisions to the Front Office. This has significantly influenced the expeditious processing of 70% of the formalities, which previously required, on average, four visits for their completion.

**The integration of the assistance channels** in a Taxpayer Interaction Administration Center, which enables to store the contacts of each taxpayer with the tax authority and rely on a 360 degree perspective.

**Strengthening and broadening the remote assistance channels**, by means of a Multi-service Contact Center that provides guidance via Chat sessions, individually as well as in fora, which also includes telephone assistance and online help via cobrowsing.

**The release of new Taxpayer Identification services** that enable to undertake the most recurrent registry update procedures via the Internet, eliminating paper forms. It is worth mentioning that the formality to register in the Federal Taxpayers' registry, which shall be carried out personally, is currently completed in 30 minutes, when it used to require up to 15 days.

**The implementation of an appointments' system** that has enabled to reduce the wait time to be assisted in the service offices from twenty to two minutes, on average, and optimize the distribution of taxpayers' flow in the services' areas.

**Opening free Internet rooms** in the service offices, where taxpayers may perform their formalities by self-service with the assistance of specialized advisors.

**Training workshops for accountants and tax brokers**, the most frequent customers requiring ongoing updates.

**Wait and assistance time control with an automated queue system** that enables to administrate virtual queues, as well as distribute the workloads according to the demand for services and taxpayer needs.

**Digitization of taxpayers documents**, which are actually requested only once and used to be requested for each formality. Under this system, in addition to reducing costs for users, we have been able to initiate the integration of a digital taxpayer record to be queried throughout the organization.

## **7. ISO 9000 certification in the taxpayer service modules**

One of the SAT challenges in the improvement of the levels of efficiency has been to standardize the services rendered in the physical taxpayer service infrastructure. We rely on 67 offices distributed across the country, which concentrate 70% of the demand for services, as well as 137 additional smaller points of contact, where the remaining 30% is served.

Ensuring an optimal performance in each point of service, with the same standards as in the rest, has been undoubtedly a complex task, moreover in an organization like SAT.

In order to certify the services and sustain internationally competitive quality standards, SAT decided to certify the taxpayer service process under ISO 9001-2000.

In each service office we deploy a Quality Committee in charge of administrating its own quality and continuous improvement cycle. Such committees review and analyze the opportunity areas identified in the transaction on a monthly basis, based on satisfaction surveys, claims filed, onsite quality controls and quality reviews conducted by the central level.

All this translates into specific indicators of the service levels provided, which require the committees to establish corrective and preventive actions when the standards are not met, making the whole improvement cycle more dynamic.

In order to reinforce such actions, SAT relies on an infrastructure of video cameras installed in each service office, which enable to oversee their quality and constitute an efficient tool to discover or prevent illegal actions by public servants.

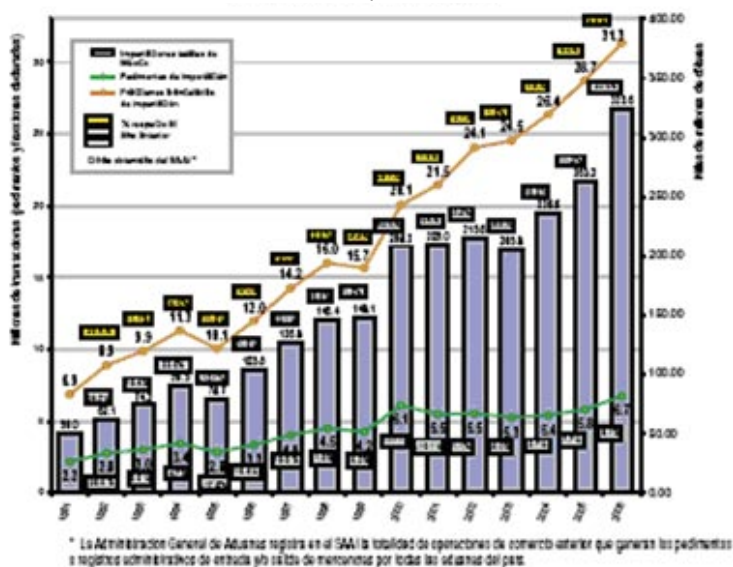
Likewise, wait and assistance times are remotely supervised to enable an appropriate administration of the workloads and the timely reaction to ensure an expeditious service.

After three years from the implementation of this quality assessment system, the results have translated into the regularization of taxpayer service, new practices have been internalized to promote the evolution of the offices' performance and the staff therein has been professionalized.

## 8. EXPERIENCES IN FOREIGN TRADE TRANSACTIONS' IMPROVEMENT PROJECTS

After the implementation of the North American Free Trade Agreement, Mexican foreign trade has grown exponentially, as we render in the following chart:

Gráfica 21  
Movimiento aduanero de importación  
vs. total de importaciones

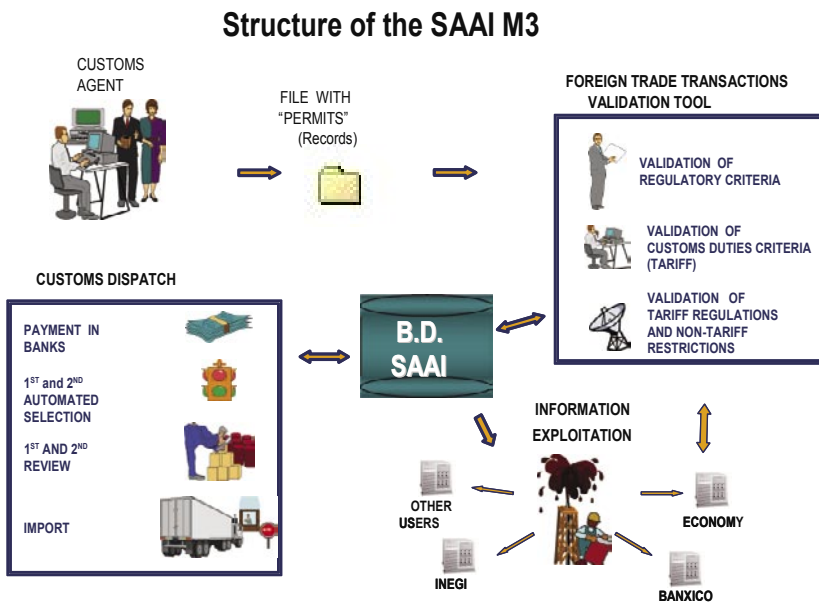


In line with the growth in the number of transactions, the globalization processes have posed a strong demand of the services rendered in customs, which shall balance the fast transit requirements for goods with the control functions and the enforcement of the foreign trade regulations.

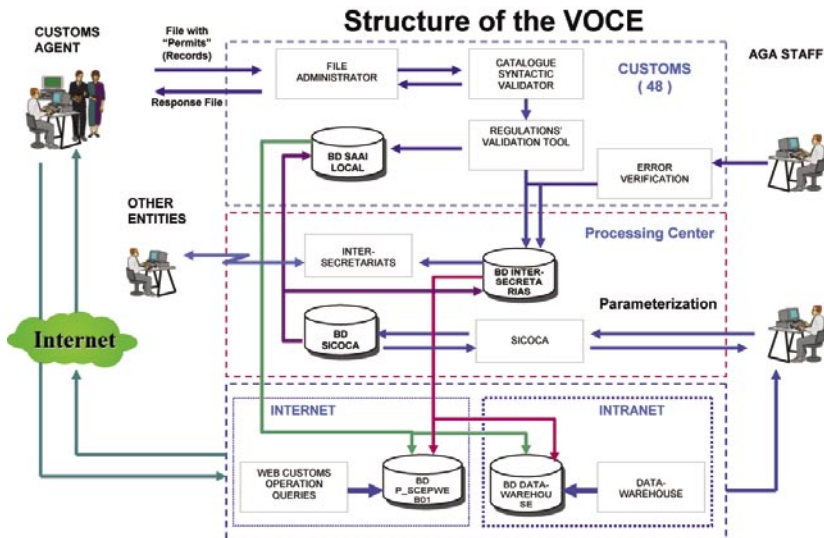
In order to meet such demand, SAT, through the General Customs Administration, has undertaken different initiatives to enhance its levels of efficiency and facilitate the compliance conditions for foreign trade users. Following, we provide two experiences with a significant impact.

## 8.1 The Integral Automated Customs System

In Mexico, we rely on a customs system that enables to carry out foreign trade transactions on a fast, reliable and secure basis, by means of the Integral Automated Customs System (SAAI M3, as per the Spanish acronym), whose main component is the Foreign Transactions' Validation Tool (VOCE, as per the Spanish acronym), which is aimed at verifying that the electronic statement filed by the customs agent or broker meets the legislation in effect.



Innovation was focused on the VOCE and its scope included the modification of communication protocols, modification of the structure of the information forwarded electronically, redesign of the permit form, redesign of the database and redefinition of the regulatory criteria verification processes.



The VOCE has been installed in 48 Customs and serves approximately 13,000 importers and exporters who perform their foreign trade transactions via approximately 1,354 customs agents and customs brokers.

The great number of laws, its complexity and the fact that the VOCE grants electronic authorization for the foreign trade operation to continue, are the reasons why the VOCE is deemed the most important component in the SAAI M3. Additionally, the validation process contributes considerably to achieve the integrity of the foreign trade information, since approximately 90% is generated via the data stated on the permits.

The validation tool has impacted the electronic payment processes of duties, rights and use of permits, issue, bills of lading, sampling and control of incidences, and in areas such as Audits, Revenue, Legal Affairs, and collection, auditing, refunds, and seizure processes, etcetera. Likewise, it also assists in venues such as the Bank of Mexico and the Economy Secretariat in the Balance of Trade generation processes, as well as control and follow-up of development programs.

Such system automates the validation process by 100% and guarantees that all the customs in the country apply the same criteria in the course of the foreign trade transaction, contributing to transparency and limiting the corruption possibilities.

## Topic 2.2 (Mexico)

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The VOCE verifies the appropriate statement of the data for importers, exporters and the tariff classification of the goods; it verifies duties' calculations, ensures compliance with regulations and non-tariff restrictions, etcetera, applying over 2,500 regulations and criteria for each customs system and the specificities thereof.

Approximately 100 indicators are available that are filed on the permits in order to clarify the special features tied to the foreign trade transaction, such as precautionary measures on conventions and exemptions from regulations, which calls for the self-statement to be accurate, and that the VOCE features the necessary elements to undertake the applicable audit.

The VOCE includes sophisticated auditing structures, such as the quota letters, by which in order to conduct a transaction of entry of goods to a warehouse, the system requires the warehouse to issue the applicable quota letter electronically, and filing it on the permit that enables tracking until the warehouse confirms the arrival of the shipment.

The VOCE was built in line with a criteria parameterization structure (forms of payment, indicators, etc.), which enables to add or modify the functionality of the SAAI M3 immediately across the country, and is employed to create control mechanisms in the operation from central areas: special authorizations may be recorded (exceptional transit, exclusive patents, donations), alerts may be sent to users, controls of acceptable errors, tariff updates, etcetera.

The above-mentioned has enabled all the foreign trade transactions in Mexico to be performed 100% electronically, for imports as well as exports.

The impact of this system has contributed in limiting the illegal foreign trade practices as well as increasing the actual revenue from foreign trade transactions.

YEAR	PERMITS	OPERATIONS' AMOUNTS (Billion Pesos)	ACTUAL COLLECTION (Billion Pesos)
2002	7,542,357	4,031.7	126.7
2003	7,100,439	4,541.8	141.2
2004	7,285,982	5,081.7	168.4

By interrupting invalid foreign trade transactions, the costs of review and auditing efforts are reduced, owing to the possibility of working with risk structures. Therefore, approximately 10% of shipments are screened. This accounts for payroll savings amounting to approximately 60 million Dollars annually and enables to support 90 per cent of the customs infrastructure.

Before automation existed, the customs authority had to screen all the shipments and the validations that are currently performed by the VOCE. All the procedures were conducted manually, in the so-called “adjustment tables”, in which in spite of the presence of notaries to attest, the process would entail many corruption issues and the validations performed were extremely basic.

Another example is that controls have been added to the VOCE to ensure that the customs agents and brokers use the system correctly. For example, the VOCE does not let the customs agent or broker to continue with consolidated permit operations if he/she still features an expired one that is still open.

Ongoing updates of the legislation in effect prevents foreign trade users from incurring in delays or interruptions, due to involuntary errors, which may lead to fines, surcharges, seizures and even criminal prosecution.

## **8.2 Importers' Registry**

The Customs Act sets forth that those who import goods shall be registered in the SAT Importers' Registry. The procedure of inclusion in the Registry used to be very complicated, slow and lacking any quality parameter for the applicant, especially, as regards the information of the status of the proceeding and the authorization timeframes. Recently, an improvement process was implemented that significantly reduced the proceedings' processing time.

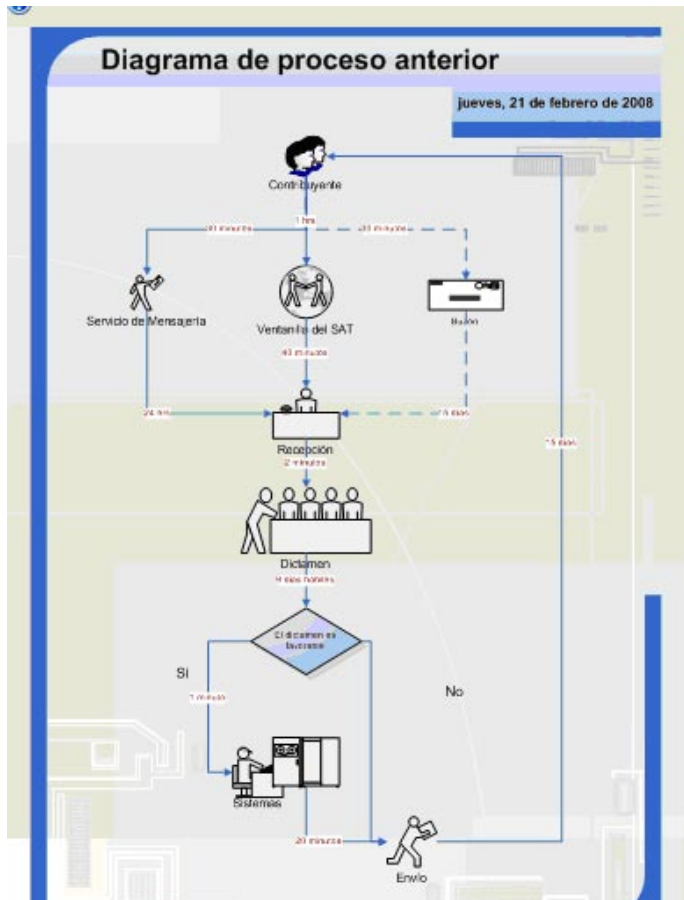
Prior to the adoption of the improvement proceeding, the process required the following:

1. The registration application is received with the supporting documentation.
2. A consecutive record number is assigned to each application, provided by the Importers' Registry System.
3. The numbered applications move to the decision area for review by the analyst assigned.



## Topic 2.2 (Mexico)

4. The queries are made to the National Single Account database, in the taxpayers' registry database (DARIO, as per the Spanish acronym) and in the IT tool *Vista Integral 360* to determine the tax status of the requesting party and the attorney thereof, when applicable.
5. The outcome of the analysis is issued through a Decision, which is sent to the Supervision area to assess the result and, if applicable, duly perform the potential corrections.
6. Once the Decision has been reviewed, the acceptance or rejection result is captured in the Imports' Registry System.
7. The Decision is authorized and signed for delivery to the requesting party.
8. The result is published on the Internet site ([www.aduanas.sat.gob.mx](http://www.aduanas.sat.gob.mx)) and, in the case of rejected requests, the Decision is forwarded to the e-mail address provided by the taxpayer on the application.



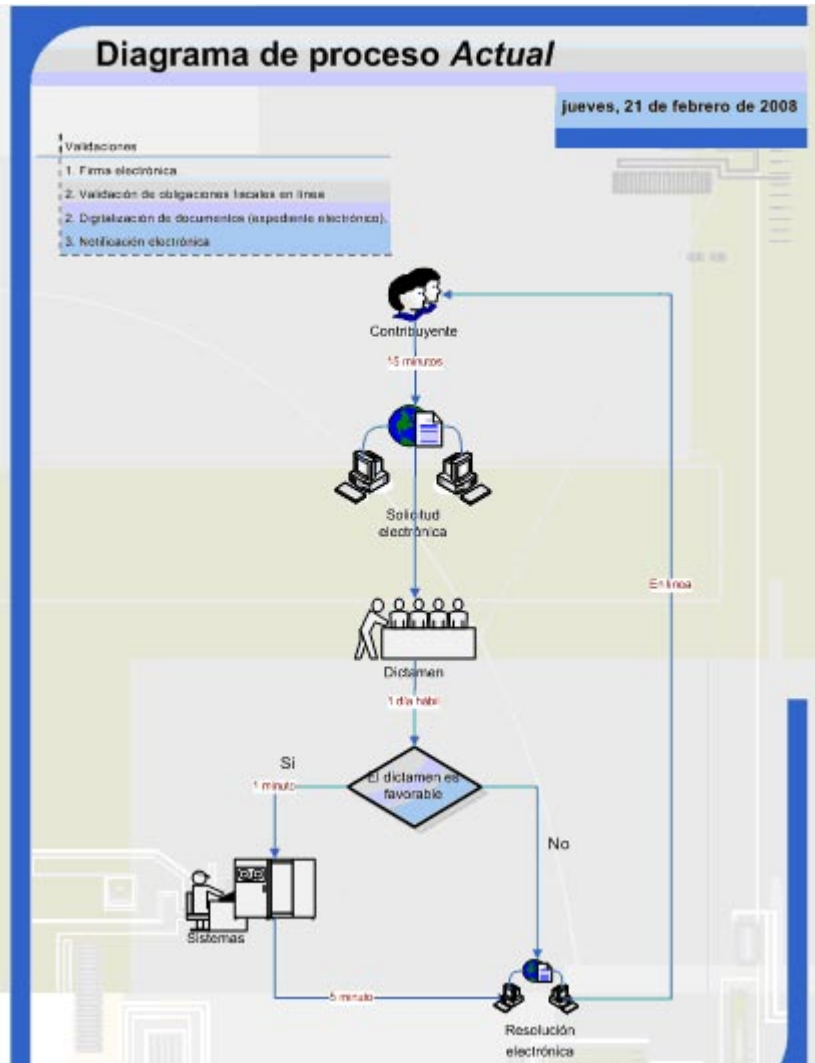
The maximum response time for the tax authority to the requesting taxpayer used to be nine business days, counted from the date of assignment of the internal number by the administration and the validity of the formality was indefinite.

Currently, the requirements and steps to register a taxpayer in the importers' registry, after the adoption of an improvement process and the modification of the legal framework, have been reduced to pursue a more streamlined process. Today, individuals or corporations that wish to register in the importers' registry shall complete the formality via the Internet and fill in the electronic form called "Request for Registration in the Importers' Registry", for which they shall require the Advanced Electronic Signature issued by SAT.

The requesting party shall register the customs agents with whom he/she shall conduct the foreign trade transactions electronically on the electronic forms.

Currently, the steps to register in the importers' registry are the following:

1. The electronic registration application is received.
2. A consecutive record number is assigned to each application, provided by the Importers' Registry System.
3. The numbered applications move to the decision area.
4. Queries are made regarding the taxpayer's primary and secondary tax features, as well as their compliance, in the Integral Solution and Single National Account (DARIO).
5. The Decision is authorized and signed.
6. The result of the analysis is captured in the Importers' Registry System.
7. The result is published on the Internet portal <[www.aduanas.sat.gob.mx](http://www.aduanas.sat.gob.mx)>.



Presently, the maximum response time for the formality is five business days, counted from the date of allocation of the internal number by the authority, with indefinite validity; additionally, it remains free of charge.

If we compare both procedures, the following efficiency improvements may be observed:

TRADITIONAL		INTERNET		DIFFERENCE
The taxpayer fills the application.	Paper	The taxpayer fills the application on the internet	Electronic form	No paper required.
The taxpayer files and SAT receives applications via:	Window and courier	The taxpayer files and SAT receives application via:	The Internet	No courier and visits to the office.
		Reduction of compliance time for the taxpayer who filed via courier.	Significant time reduction from 26 hours to 67 minutes on average. (Includes 24 hour courier).	
The application reception service opens:	From 9 to 14:00. (5 hours)	The application reception service opens 24 x 365		Radical change in coverage.
Error index in SAT decision process is:	10%	Error index in SAT decision process is:	0%	100%
SAT response time for taxpayer decision is:	11 days	SAT response time for taxpayer decision is:	2 days	-8 days
Time to inform decision results via courier:	15 days	Time to inform decision results via e-mail:	5 minutes	-21595
Personal contact		Avoids taxpayers's visits.		
Limited service coverage, focused on correction.	4 persons with 57,600 min.	Increased service coverage.	Increased to 25 persons with 360,000 min. which represents an additional service capacity.	60,480 Additional calls.
		Improves SAT image by making the formality process transparent.		
		Facility to obtain information on the requirements for the formality and its status.	Via the Internet and telephone, at a low cost for SAT as well as the Taxpayer	

## REDUCTION IN SAT COSTS BY REPLACEMENT OF THE REGISTRATION PROCESS IN THE IMPORTERS' REGISTRY \*

INTERNET			TRADITIONAL		DIFFERENCE	
No	ACTIVITY	COST	ACTIVITY	COST	\$	%
			PROVIDES INFORMATION (WINDOW), RECEIVES DOCUMENTS, AND TRANSFERS DOCUMENTS (HIDALGO AND POST BOX)	9,355	- 9,355	100
1	APPLICATION PRINTING	16,994	OPENS AND CLASSIFIES MESSAGES	23,383	- 6,389	27
2	RECORDS APPLICATION REQUESTS	9,269	RECORDS APPLICATION REQUESTS	5,987	3,281	55
3	CLASSIFIES, ASSIGNS NUMBER AND DECISION MAKER	6,204	CLASSIFIES, ASSIGNS NUMBER	11,977	- 5,773	48
4	INTEGRATES ELECTRONIC RECORD	11,486			11,486	100
5	ANALYZES INFORMATION, DECIDES AND INTEGRATES RECORD	48,044	ANALYZES INFORMATION, DECIDES AND INTEGRATES RECORD (INCLUDES RE PROCESSING, 7%)	108,900	- 60,856	56
6	VERIFIES QUALITY AND CORRECTS ERRORS	22,593	VERIFIES QUALITY	43,936	- 21,344	49
			SPECIFIC QUALITY CONTROL	11,511	- 11,511	100
7	CAPTURES DECISION RESULT	6,625	CAPTURES DECISION RESULT	28,701	- 22,076	77
8	AUTHORIZES PRODUCTS	1,731	AUTHORIZES PRODUCTS	11,208	- 9,477	85
9	SAVES FILES	3,111	SAVES FILES	7,384	- 4,273	58
10	TRANSMITS BY E MAIL THE CUSTOMS RESULTS (CUSTOMS COMMUNICATIONS)	2,373	PREPARES AND SENDS PRODUCTS (includes messaging)	54,021	- 51,648	96
11	PUBLISHES RESULTS ON THE INTERNET (CUSTOMS COMMUNICATION)	7.47			7	100
12	GENERAL INFORMATION AND STATUS (1ST level CCM)	140,093			140,093	100
13	PROVIDES GUIDANCE AND CLARIFICATIONS (2ND level PI - CCM)	21,768	PROVIDES GUIDANCE, STATUS AND CLARIFICATION	17,704	4,064	23
	<b>TOTAL</b>	<b>290,299</b>	<b>TOTAL</b>	<b>334,068</b>	<b>- 43,770</b>	<b>13</b>

- Cost Expressed in Monthly Pesos.

The non-monetary benefits for the taxpayer are the creation of new facilities that enable to conduct a formality that used to be complex in the past much faster. We may mention among them: online application reception, online query of the formality status, significant reduction of response times and less compliance requirements. This means that we have migrated from a restrictive policy to one that grants taxpayer confidence, in order to sustain a healthy tax behavior that enables the importation of the goods required in the development of his/her core activity.

With this example, we show that the adoption of new tax collection practices, such as process-based administration instead of function-based, Activity Based Costing, the use of new technological platforms and professional development of human resources, seek to improve the administration of taxes by progressively enhancing taxpayer service in order to promote voluntary compliance over excessive auditing.

## **CONCLUSIONS**

The Tax Administrations shall redefine the form in which they relate to taxpayers, supporting process integration to facilitate compliance with tax obligations and enhancing their resources and capabilities without detriment to the auditing activities; considering that as voluntary compliance is promoted, taxpayer oversight shall be better focused. The objective of improving the Tax Administration's efficiency and reducing compliance costs shall be always part of such initiatives.

In Mexico, the deep transformation that is underway in the Tax Administration, precisely seeks to strengthen taxpayer services, so as to rely on different forms of meeting tax obligations. Additionally, we are focusing on the reduction of monetary and non-monetary costs in the compliance with tax obligations. It is worth stating that it must be an objective, not only from the taxpayer standpoint, but also for the Tax Administration.

The most ambitious project undertaken by SAT along such lines is the Integral Solution, which seeks to focus its services by simplified business processes that facilitate compliance with tax obligations and enable to offer services with greater functionality and quality, ensuring better administrative efficiency and reductions in the compliance cost for the taxpayer as well as the Tax Administration.

This shall enable us to serve the taxpayer with greater efficiency, as the main subject of the tax cycle, while the tax authority identified areas for opportunities and suggests adjustments to the legal framework, based on a vast spectrum of sources of information, arising from new processes and integral systems.



## **TOPIC 3**

# **STRATEGIES FOR THE CONTROL OF TAX COMPLIANCE**





## STRATEGIES FOR THE CONTROL OF TAX COMPLIANCE

**Lyse Ricard**

Assistant Commissioner  
Canada Revenue Agency  
(Canada)

*CONTENTS: 1. Introduction. -1.1. Legislative Authorities. -1.2. Canadian Context for Tax Compliance. -2. Our Approach for Effective Tax Administration. -2.1. Garnering and Maintaining Citizen Support. -2.2. Our Model for Achieving Compliance. -2.2.1. Facilitating Voluntary Compliance. -2.2.2. Enforcing Compliance. -2.2.3. Appeals. -3. Strategies for the Control of Compliance. -a. Noncompliance Prevention and Detection Measures. -b. Compliance Research and Risk Assessment Methods. -c. Formal Compliance Review. -d. Results Measurement and Evaluation. -4. Paying amounts owing when due. -5 Conclusion*

### I. INTRODUCTION

This paper provides a synopsis of the strategies that are utilized by the Canada Revenue Agency (CRA) for controlling tax compliance. To assist in this presentation, the paper opens with a brief overview of CRA's role and responsibilities as Canada's national tax administrator. In Section 2, we examine CRA's compliance philosophy and the basic underpinnings that shape our approach for achieving tax compliance. Section 2 also introduces CRA's compliance model that serves as the overarching framework for its programs and deployment of compliance controls. Section 3 delves more deeply into the four main strategies that the CRA employs for the control of tax compliance. The final section of the report, shares some of the practical challenges and lessons learned in applying CRA's control strategies. This section closes with a review of the directions and initiatives being pursued by the CRA to strengthen its control capacity.

#### 1.1 Legislative Authorities

The CRA is the primary tax collector for the Government of Canada, for most provinces and territories, and for many first nations, and its

predominate responsibility is to protect Canada's revenue base. It is also responsible for distributing benefit payments to millions of Canadians each year. More precisely, the CRA collects:

- All federal income taxes;
- Personal income taxes for all provinces except one (there are ten provinces and three territories that make up the Canadian federation);
- Corporate income taxes for eight of the ten provinces; goods and services tax (GST) in all provinces except one; and
- Harmonized sales tax (HST) in the three provinces where their provincial sales tax has been harmonized with the federal GST; and,
- First Nations Tax and First Nations Goods and Services Tax on behalf of a number of Canadian First Nations.

It also collects commodity taxes; excise duties for certain provinces; employee and employer contributions under the Canada Pension Plan; and employee and employer premiums for Employment Insurance. In addition, the CRA delivers a number of income-based benefits, tax credits, and other services that contribute directly to the economic and social well being of Canadians.

The CRA also administers international tax agreements signed with a large number of countries aimed at promoting the exchange of information between treaty partners and the avoidance of double taxation of foreign-earned income of their respective citizens.

## **1.2 Canadian Context for Tax Compliance**

Canada is a large country that spans some 7,200 kilometre from east to west across 6 time zones. The second largest country in area after Russia, Canada has coastlines on the Atlantic, Arctic, and Pacific oceans, giving it the longest coastline of any country. In area, Canada is slightly larger than the United States, but has only 11 percent as many people. It is one of the least densely inhabited yet one of the most prosperous countries in the world. The Canadian economy is considered to be one of the strongest and healthiest among the G-7 countries.

Compliance with tax laws in Canada typically means registering when required (businesses), filing returns on time, reporting complete and accurate information to determine tax liability, and paying all amounts owing when due. Non-compliance occurs when any of these obligations are not met, for whatever reason.

Achieving total compliance is not a pragmatic expectation. Honest mistakes on forms and differences in interpretation or application of complex laws are to be expected. As well, it is realistic to expect that there will be a small minority within the population who will operate outside the public interest and choose not to comply with the law. Intentional non-compliance involves acts of tax evasion, participation in the underground economy, or participation in illegal tax schemes that are designed solely to circumvent the law.

Non-compliance can have significant effects. Canadians lose public revenues that they need for their social and economic well-being. This, in turn, affects the level and affordability of public programs. Non-compliance erodes the fairness of the tax system, as those who do not pay their correct share shift the burden onto other taxpayers. Similarly, a business that does not pay its share has an unfair competitive advantage over businesses that abide by the law.

#### **CRA Volumes, 2006-2007**

- Just over \$346 billion in revenue collected – averaging \$1.3 billion per working day.
- Almost 25 million income tax returns filed by individuals – 51% filed electronically.
- Over \$15 billion benefit and credit payments distributed to over 11 million Canadians.
- Some 1.6 million employers withheld and remitted over \$192 billion in source deductions – about 56% of all revenues collected.
- Over 1.6 million corporate returns processed – about 14% were filed electronically.
- Almost \$13 billion identified through measures for addressing non-compliance.

Canada enjoys a healthy participation rate in the tax system with some 93% of all adult Canadian taxpayers filing their annual income tax return on time. Obtaining a tax return is the first and most important step in the compliance process. The tax return is the basis for establishing each filer's annual tax liability and provides information that is important to many service and compliance programs.

## **2. OUR APPROACH FOR EFFECTIVE TAX ADMINISTRATION**

Many tax administrations view voluntary compliance and self-assessment as the best, most efficient way to administer a country's

tax system. Taxpayers are expected to determine their own liability under the law and then pay the correct amount of tax. The fundamental approach is to have individuals and businesses comply with their obligations without the tax administration's intervention. High rates of voluntary compliance reduce the costs of administration and lower the burden and intrusiveness of compliance actions.

The underlying belief in voluntary compliance is that most individuals and businesses are willing to comply by correctly self-assessing their tax situation. High levels of participation in a country's tax system often rest on the confidence its citizens have in the fairness, accountability, transparency and integrity of that tax administration.

## **2.1 Garnering and Maintaining Citizen Support**

In Canada, the tax system is the primary basis for funding a wide range of social and economic programs. Taxes pay for education, health care, the security of our nation, and all the public goods and services that together enhance the quality of life of Canadians.

Taxes also provide us with a means of distributing our income to those in need, including children, persons with disabilities, the aged, and the unemployed.

Compliance with tax laws is important to keep the system fair for all and to support the programs and services that enrich our life.

The CRA believes, and is committed to, the principles being advanced at this conference, namely, that societies will show a greater and permanent commitment toward complying with their fiscal duties when they perceive:

- an equitable tax system;
- an efficient and fair tax administration; and
- a State that makes rational and full use of revenues originating from taxes that have been paid.

It is reasonable for all citizens to expect that their tax system is by design equitable, and that taxpayers in like circumstances are treated the same. Tax administrators have a responsibility to be vigilant of situations that give rise to inequitable treatment, such as loopholes in the law that are being unfairly exploited or where some unintended consequences are resulting from some legislative provision.

In Canada, tax policy is established by the Department of Finance and CRA is the administrative arm of government. Maintaining the equity of the tax system requires vigilance in monitoring how the tax legislation is being interpreted and applied by taxpayers and the tax professional community. It also demands that when an anomaly in the tax legislation is discovered, appropriate legislative amendments are developed to correct the issue and restore equity to the tax system. The CRA works closely with Finance to ensure that tax laws are achieving their intended policy aims.

To maintain public trust, an equitable tax system must also be fairly administered. Citizens must be aware of their tax obligations and have adequate information, tools and resources for enabling their compliance. Effective programs and communications aimed at facilitating tax compliance are essential for achieving compliance and for maintaining citizen cooperation and respect. Fairness is also promoted through responsible enforcement where those who do not voluntarily comply are identified and dealt with according to legislative and administrative policies. Maintaining a balance between facilitation and enforcement is essential for preserving public trust and for effective tax administration.

Fairness and efficiency in tax administration also has a more fundamental meaning. Citizens need to be informed of what to expect in their dealings with the tax administration including their basic rights and entitlements.

A recent step taken by the CRA in this area was to release a new Taxpayer Bill of Rights that sets out fifteen rights and confirms the CRA's commitment to serve taxpayers with a high degree of accuracy, professionalism, courteousness, and fairness. The Taxpayer Bill of Rights will make it easier for Canadians to understand what they can expect in their dealings with the CRA; that they will be treated fairly under clear and established rules; and that they can look forward to high standards of service in all their interactions. The Bill contains a reminder of taxpayers' legislative right to a formal impartial review of their file should they believe that the CRA has not applied the law correctly or that they have not received their full entitlements.

### **Taxpayer Bill of Rights**

1. You have the right to receive entitlements and to pay no more and no less than what is required by law.
2. You have the right to service in both official languages.
3. You have the right to privacy and confidentiality.
4. You have the right to a formal review and a subsequent appeal.
5. You have the right to be treated professionally, courteously, and fairly.
6. You have the right to complete, accurate, clear, and timely information.
7. You have the right, as an individual, not to pay income tax amounts in dispute before you have had an impartial review.
8. You have the right to have the law applied consistently.
9. You have the right to lodge a service complaint and to be provided with an explanation of our findings.
10. You have the right to have the costs of compliance taken into account when administering tax legislation.
11. You have the right to expect us to be accountable.
12. You have the right to relief from penalties and interest under tax legislation because of extraordinary circumstances.
13. You have the right to expect us to publish our service standards and report annually.
14. You have the right to expect us to warn you about questionable tax schemes in a timely manner.
15. You have the right to be represented by a person of your choice.

The Taxpayer Bill of Rights includes the CRA's Commitment to Small Business, a five-part statement through which the CRA undertakes to support the competitiveness of the Canadian business community by ensuring that interactions with the CRA are as effective and efficient as possible. These commitments complement the Government of Canada's pledge to create a competitive and dynamic business environment in which Canadian businesses will thrive.

### **The Canada Revenue Agency Commitment to Small Business**

1. The CRA is committed to administering the tax system in a way that minimizes the costs of compliance for small businesses.
2. The CRA is committed to working with all governments to streamline service, minimize cost, and reduce the compliance burden.
3. The CRA is committed to providing service offerings that meet the needs of small businesses.
4. The CRA is committed to conducting outreach activities that help small businesses comply with the legislation we administer.
5. The CRA is committed to explaining how we conduct our business with small businesses.

As a further measure in support of fairness, the Taxpayers' Ombudsman was appointed in February, 2008 to enhance the CRA's accountability and service to the public and to provide Canadians with renewed assurance that they will be treated fairly, equitably, and with respect. The Taxpayers' Ombudsman is charged with reviewing service-related complaints about the CRA and upholding the Taxpayer Bill of Rights with regard to service matters.

### **Taxpayers' Ombudsman**

The Taxpayers' Ombudsman is responsible for ensuring that the CRA respects the following service rights outlined in the Taxpayer Bill of Rights:

- the right to be treated professionally, courteously, and fairly;
- the right to complete, accurate, clear, and timely information from the CRA;
- the right to lodge a service complaint and to be provided with an explanation of the CRA findings;
- the right to have the costs of compliance taken into account when tax legislation is administered;
- the right to expect the CRA to be accountable;
- the right to expect the CRA to publish service standards and report annually;
- the right to expect the CRA to warn you about questionable tax schemes in a timely manner; and
- the right to be represented by a person of your choice.

#### **The Taxpayers' Ombudsman's role is to also:**

conduct impartial and independent reviews of service-related complaints about the Canada Revenue Agency (CRA);  
facilitate taxpayer access to assistance within the CRA;  
identify and review systemic and emerging service-related issues within the CRA that have a negative impact on taxpayers; and  
provide advice to the Minister of National Revenue about service related matters in the CRA.

Important elements of Canada's approach to tax compliance are our outreach and education programs. Outreach activities support voluntary compliance by informing the public about the CRA's programs and services. Education ensures that taxpayers have the knowledge to meet their obligations without our direct intervention.



We have a few notable programs, such as

- The Teaching Taxes program that introduces high school and post-secondary students across Canada to Canada's tax system. It teaches them how to prepare a basic income tax return.
- The Learning About Taxes Program is a free online course that provides basic information on Canada's income tax system, including:
  - o its history and how it works;
  - o why individuals pay taxes, and how those taxes are spent;
  - o why tax returns should be completed;
  - o where to go for help with questions about their return, the taxes they owe, or other related matters; and
  - o how to complete a basic tax return.
- The Community Volunteer Income Tax Program through which trained volunteers work with community organizations to help taxpayers prepare their income tax and benefit returns. Canadians who are unable to complete their returns by themselves and are unable to pay for assistance are eligible for this program.

Under our Voluntary Disclosures Program, taxpayers can come forward and correct inaccurate or incomplete information, or disclose new information, without risk of penalty or prosecution. Provided they make a full disclosure before the CRA starts enforcement action or an investigation against them, they will only have to pay taxes owing plus interest. For a voluntary disclosure to be valid, and penalties to be waived, the disclosure must meet the following four conditions:

1. the disclosure must be voluntary (for example, the disclosure must not be made in response to an audit, investigation, or other enforcement action);
2. the disclosure must be complete;
3. the disclosure must involve a monetary penalty; and
4. the disclosure must involve information that is one year or more overdue.

Lastly, tax administrations must be capable of demonstrating that they are providing citizens with good value for money, and that their budgets are being spent in a fiscally responsible manner. Many administrations, including Canada, produce and publish annual reports of how their budgets were spent and the results that were achieved. These reports are commonly open to public scrutiny and provide a basis for accountability and transparency in administration.

## **2.2 Our Model for Achieving Compliance**

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.

As mentioned above, the CRA has a responsibility to maintain public confidence in the fairness and integrity of the tax system. This means providing ample support to those who wish to comply with the law, while taking appropriate measures to identify and deal with cases of non-compliance.

A primary aim of the CRA is to achieve the highest level of voluntary compliance possible. The Agency works toward this aim by putting into practice its values of integrity, professionalism, respect, and co-operation, and by instilling a client-centred orientation and culture in the delivery of all programs and services. The underlying belief is that most individuals and businesses are honest and, given the right opportunity, information, and tools, will voluntarily comply with the law.

Whether it is a matter of taxpayers who are willing to comply, who cannot manage to comply or decide not to comply, the CRA has a combination of taxation activities and services to ensure compliance with Canada's fiscal right. The success of our programs as regards taxes, depends on two fundamental factors, namely: the capacity to understand which are the factors that influence compliance behavior and the existence of the effective capacity for detecting compliance risks as basis for applying the taxation action. These factors are an integral part of the CRA's strategies for controlling compliance.

High levels of voluntary compliance return dividends to both clients and the CRA by reducing the costs of administration, and the burden and intrusiveness of compliance actions. CRA's approach for achieving compliance recognizes that there are many reasons for noncompliance that, in turn, require tailored programs.

Our programs can be considered as a series of points along a continuum that include facilitated voluntary compliance, and enforced compliance, all supported by an effective appeals capacity.

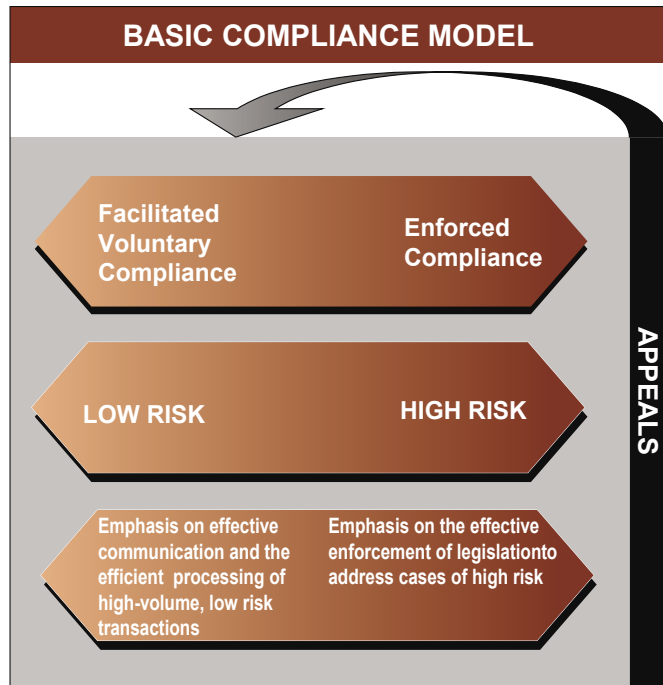
### **2.2.1 Facilitating Voluntary Compliance**

Voluntary compliance requires effort, time, and, sometimes, cost on the part of Canadians. To assist voluntary compliance, our strategy focuses on effective communication to inform and support all clients in meeting their obligations and receiving their entitlements. Our aim is to minimize the compliance burden for individuals and businesses through our continuous actions to streamline processes and provide high-quality service and support. CRA services include telephone and face-to-face communications, Internet-based information, plain language forms, guides, and publications, technical interpretations, rulings, and specialized problem resolution services.

### **2.2.2 Enforcing Compliance**

In addition to our broad-based communication and service activities, the CRA's enforcement activities verify compliance with the law, correct past mistakes, and educate clients on the correct application of the law for the future. Enforcement covers a range of activities that graduate from routine verification procedures (such as the matching of third-party information) to limited examinations and full audits.

For those involved in repeat or deliberate noncompliance, the CRA has a responsibility to take firm corrective action and to provide a deterrent that discourages this form of non-compliance in the future. In the most serious cases, the CRA carries out tax evasion and fraud investigations. The results of these actions can lead to fines and imprisonment. Our enforcement activities provide assurance that the law is properly understood and respected. They are guided by risk management principles and systems that help us in focusing our enforcement actions.



### 2.2.3 Appeals

A central part of the CRA's approach to compliance is the redress system. Occasional disagreements between the CRA and its clients are inevitable. An impartial, fair, and timely dispute resolution process fosters trust in the integrity of our tax system, which helps to promote voluntary compliance.

## 3. STRATEGIES FOR THE CONTROL OF COMPLIANCE

This section of the report describes the strategies that are being applied in the CRA for controlling compliance. These strategies consist of a variety of administrative instruments, management practices and research techniques that work collectively to prevent, detect and address non-compliance in an effective manner. The application of these strategies assists the CRA's verification and enforcement programs in targeting areas of highest risk and in so doing minimizes the compliance burden for compliant individuals and businesses.

The strategies are presented and discussed under four main groupings:

- a. **Noncompliance prevention and detection measures** that proactively limit the scope for non-compliance and aid in the disclosure of cases of non-compliance for verification and enforcement action;
- b. **Compliance research and risk assessment methods** that pursue the discovery of factors, patterns and trends that are indicative of non-compliance behaviour and then apply this knowledge in the development and refinement of our compliance strategies and risk assessment systems;
- c. **Formal compliance review** that involves a comprehensive examination of key compliance issues and the establishment of compliance priorities based on risk. The review also validates the adequacy of existing CRA's compliance strategies for addressing each priority and may realign our level of effort and investment, where warranted.
- d. **Results measurement and evaluation** that are used to measure and monitor progress and to assess the results of our compliance programs and strategies.

Each of the four groupings is elaborated below.

#### **a. Noncompliance Prevention and Detection Measures**

At the most basic level, the CRA has in place a wide variety of prevention and detection measures that function as checks and balances for supporting our achievement of compliance. These measures span from source deductions and information slip matching to test checks, audits, and prosecutions. The CRA's broad range of administrative instruments and programs work together to facilitate and enforce compliance across all taxpayer groups. For example, taxes withheld and remitted by employers on salaries and wages secures some 56% of annual revenue collections. As well, third party reporting by employers of amounts paid and withheld at source provides a data bank for matching income reported by individuals to the amounts declared on their annual income tax returns. These information slips also assist us in identifying late or non-filers for possible enforcement action. As well, computerized crosschecks, document matching, risk assessment systems and various surveys and test checks all support the detection of non-compliance and the establishment of risk profiles to guide our selection of cases for verification, audit and enforcement action.

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## **b. Compliance Research and Risk Assessment Methods**

The choice of compliance tools and measures relies on having sound business intelligence on the compliance risks and their material significance. The selection of compliance tools is informed by compliance research, which explores compliance behaviours and trends and by risk assessment techniques that help determine the materiality of compliance issues and areas of risk exposure.

### **i. Compliance Research**

CRA's compliance research activities are generating empirical information for a better understanding tax compliance behaviours. For example, our research has shown that Canadian taxpayers adopt different behaviours and attitudes when it comes to complying with tax laws. These behaviours range from complete commitment to complying with the tax laws to complete disengagement from the tax system. The drivers behind these different behaviours are varied, sometimes related to economic or business conditions, other times driven by social or psychological factors. Coupled with the increasing complexity of the legislative framework, these drivers could eventually lead to increased levels of non-compliance and ultimately the erosion of the tax base.

Our strategies for promoting tax compliance need to be varied to address the diversity of taxpayer behaviours. The CRA recognizes that traditional deterrent approaches will not always work and that new strategies need to be developed that will help us address these behaviours in more sophisticated ways.

#### **Applying Our Research Findings**

Over the past few years the CRA has conducted research to understand public perceptions on tax compliance issues. The key finding is that the public wants to hear about what the CRA is doing to combat tax crimes and other types of non compliance issues, such as the underground economy. They want to see evidence that the CRA is going after “the big guys.” They also want to see concrete evidence in the media that the CRA is serious about tax compliance.

The CRA also recognizes that communication can be used to affect perceptions of the Agency and Canadians' views of its tax administration, its fairness, and its effectiveness. With a strengthened and integrated compliance communications strategy, we aim to influence both compliance perception and behaviour.

Our Compliance Communications Strategy is comprised of three elements.

1. Research to understand the public's concerns about compliance issues and risks to the tax base and, equally important, how best to communicate our compliance messaging to different members of the target audience.
2. Communicate our compliance activities, their results, and how they contribute to protecting Canada's tax base.
3. Look for opportunities to communicate CRA concerns and views on existing and emerging compliance issues.

## **ii. Risk Identification and Assessment**

Fundamental to managing tax compliance risk is having effective risk assessment processes to identify non-compliance and direct our efforts to address that non-compliance. The extent to which these processes can accurately assess non-compliance, is the extent to which program resources can be applied to areas of highest risk.

National-level risk identification and assessment processes are incorporated into several tax compliance areas at the CRA. They provide case-level analysis of tax revenue risks, and support focusing our compliance efforts in areas where the risk is highest. These include processes:

- At the business registration stage;
- At the stage where taxpayers who are inappropriately outside the tax system are identified;
- At the tax return processing stage;
- At the post-processing or audit stage; and
- At the tax collection stage.

For example, for businesses registering for a goods and services tax account (GST), risk parameters are used to highlight new registrants that may be at risk of committing fraud once in the system. While the process is still in development, a variety of criteria are planned. These include:

- Examining the business' previous compliance history with other CCRA programs such as income tax filing, and ensuring that the taxpayer had not been involved in previous fraudulent activity;

- Ensuring that the identity number being used has not been involved in an identity theft and does not appear anomalous for someone operating a new business (e.g., a child or elderly person);
- Ensuring that contact numbers and addresses are not duplicated in the registry.

National processes and systems are also in place to identify possible non-filers and non-registrants. These systems typically involve matching taxpayer master files to third party slips (e.g., interest income slips obtained from banks, subcontractor payments slips obtained from construction contractors and government departments, etc.). The most important element in this process is cross matching key pieces of data that can be used to identify high-risk Canadian taxpayers that do not appear in our taxpayer master files.

A process also exists, both for income tax and goods and services taxes, to examine risk prior to issuing refunds to taxpayers. These systems typically involve the use of business criteria that trigger a review prior to issuing cheques. The criteria developed highlight situations where the risk of non-compliant reporting is high. Auditors review these high-risk situations and determine whether the refund can proceed as claimed or whether an audit is necessary prior to issuing a cheque.

Similarly, processes and systems exist for focusing our efforts in tax collections and account receivables. Client profiling and the use of business rules are used to prioritize workload for collection action.

### **c. Formal Compliance Review**

Leading our risk management approach is the ongoing Compliance Review. The objective of compliance review is to identify new and/or confirm existing priority compliance risks, and to develop strategies to address them. The Agency believes that conducting compliance reviews puts us in a better position to communicate a common risk picture across the Agency and then focus our resources on addressing the greatest risks.

The first Compliance Review started in 2004. It identified 32 compliance risks and assessed them on their likelihood of occurring, impact on the tax base, and importance to public confidence in the tax system.

The CRA is now conducting a second review of its priorities for compliance, a process that may result in the identification of new



compliance priorities and plans to address them. The objectives of the 2007/2008 Compliance Review are to identify new and/or confirm existing compliance priorities, consider CRA's existing strategies and investments in these priorities, and recommend new or revised strategies for addressing them, where appropriate.

The four key compliance priorities that the Agency is currently working on include:

1. Aggressive Tax Planning;
2. Underground Economy;
3. GST/HST (VAT) High Risk compliance; and
4. Non-Filers/Non-Registrants and Collections.

Strategies for each of the four priorities were subsequently developed with action plans and initiatives.

**i. Aggressive Tax Planning**

Aggressive tax planning involves using tax arrangements that “push the limits” of acceptable tax planning. Such practices undermine the integrity of the tax system and community confidence in the fairness and equity of that system. Abusive tax schemes, such as tax avoidance arrangements through liberal interpretations of Canada's tax laws, can also give the impression that tax avoidance and evasion are pervasive.

An example of aggressive tax planning is the abusive use of tax havens, which are commonly defined as jurisdictions with low or no tax rates and bank secrecy laws. Although tax havens may be used for legitimate reasons, they also provide opportunities for some taxpayers to avoid or evade paying Canadian tax.

Canada has made a significant effort in the last few years to address all aspects of aggressive tax planning. For example, we have established and developed 11 Centres of Expertise across the country, staffed by senior audit professionals and specialists in international tax and tax avoidance. These Centres are identifying and developing new sources of information that can be integrated into the Agency's risk assessment models. As a result of these Centres, there are currently over 50 projects underway, with potential for significant tax recoveries.

Internationally, we have been working with the Seven Country Working Group on Tax Havens to develop an International Compliance Strategy that addresses the risks of non-compliance arising from the growing

number of financial transactions that cross jurisdictional boundaries. We are also strengthening our relationships with foreign tax administrations, both bilaterally and through international organizations such as CIAT.

In 2004, we established the Joint International Tax Shelter Information Center (JITSIC), along with Australia, the United Kingdom and the United States, in order to increase collaboration and coordinate information about abusive tax transactions. In 2007, Japan joined and a second JITSIC office was opened, in London, England (in addition to the one in Washington, D.C.). Our participation in JITSIC enhances our ability to identify and deal with abusive tax schemes and those who promote them. It also provides early insight into schemes that are developed abroad but marketed in Canada.

#### **CRA's International Compliance Strategy**

Parliamentarians and Canadians have become increasingly concerned with aggressive tax planning, tax evasion, and the abusive use of tax havens. The CRA is addressing these concerns in a strategic manner by enhancing our core compliance programs and by increasing the visibility of our compliance activities. The CRA is also playing a strong role internationally, particularly with regard to tax compliance.

Our International Compliance Strategy is built on four pillars:

- Core compliance programs;
- Communications;
- Policy and legislation; and
- International relationship management.

The goal of the International Compliance Strategy is to protect the federal tax base, and that of our provincial/ territorial clients, by:

- Mitigating the risks of non-compliance arising from the growing number of financial transactions that cross jurisdictional boundaries; and
- Strengthening our relationships with foreign tax administrations, both bilaterally and through international organizations.
- In 2004, Canada joined with Australia, the United Kingdom and the United States, to create the Joint International Tax Shelter Information Centre (JITSIC) to collaborate on aggressive tax plans. In May 2007 we welcomed Japan to JITSIC, and announced the opening of a second JITSIC office, in London, England.

The CRA's participation in JITSIC enhances its ability to identify and deal with abusive tax schemes and with those who promote them. It also provides earlier insight into schemes that are developed abroad but marketed in Canada. To date, Canada has had some 350 exchanges of information with JITSIC countries involving issues such as financial products, tax shelters and offshore trusts. As collaboration between member countries continues to grow, more cross-border schemes will be uncovered, shared and addressed.

## **ii. Underground Economy**

The underground economy is generally defined as non-criminal business activity that is unreported or under-reported for tax purposes.

Such activity is present in many industry sectors, primarily where cash is prevalent and where there is an absence of third party reporting or deductions at source. Prime examples of these sectors include construction and home renovations, hospitality, taxi, automotive repairs and sales, tourism, and clothing textiles. The underground economy undermines the public perception of the fairness and integrity of tax laws, and has a major impact on compliant businesses because of their loss of competitiveness.

In Canada, the underground economy can take many forms including:

- Failure to report a business activity;
- Failure to report employment income (for example, gratuities);
- Under reporting of employment income; and
- Failure to file or register.

Discouraging underground economic activities ensures a level playing field for all businesses and taxpayers and promotes the fairness and equity of the tax system.

The CRA has a strategy to address the underground economy, which includes:

- Encouraging voluntary compliance through activities such as community visits to businesses;
- Working co-operatively with provinces, other government authorities and key interest groups to identify opportunities for audit and expand our knowledge of underground economy issues in the provinces and territories;
- Focusing on high non-compliance sectors;
- Publicizing tax evasion convictions as a deterrent to non-compliance; and
- Conducting compliance research to support and analyze the effectiveness of compliance programs.

## **iii. GST/HST (VAT) High Risk Compliance**

An important element of a value-added tax, like the Goods and Services Tax/

Harmonized Sales Tax (GST/HST) is the provision for input tax credits that allow businesses to receive credit, or even refunds, for the amount of GST/HST they pay. While the administration of any tax carries a risk of fraud, it is internationally recognized that this direct payout feature means value-added taxes inherently carry an even higher risk. Millions of daily transactions, and extremely large numbers of registrants requesting refunds, make it very difficult to detect problematic situations within acceptable timeframes.

Our GST/HST High Risk Compliance strategy focuses on:

- Strengthening Agency-wide capacity to horizontally manage high-risk GST/HST files;
- Enhancing enforcement activities through effective targeting of compliance work toward high-risk cases; and
- Improving our ability to identify high-risk registrants and refund claims before refunds are issued.

#### **iv. Non-Filer/Non-Registrant and Collections**

Without a filed return or registration from an individual or business, the CRA cannot analyze the file for audit selection nor collect taxes owing. Part of the Agency's strategy to address this issue is research to better understand taxpayer behaviour as well as identify the specific demographics of this sector and tailor its strategies to stem the increase. Targeting workload aimed at the sectors where high levels of non-compliance are prevalent is another strategy that is being pursued.

Collections are also a key compliance issue as unpaid tax bills and GST/HST remittance requirements steadily increase. The Accounts Receivable Program has implemented and built upon its debt management strategies to address inventory growth and achieve expected performance results of timely reduction in tax debt and maintaining the level of tax debt within targeted levels.

#### **d. Results Measurement and Evaluation**

The CRA has developed a Compliance Measurement Framework (CMF) that is the foundation for monitoring and measuring compliance for the purpose of contributing to compliance strategy development. The CMF lays out the key concepts, constructs and operational definitions for the study of compliance. The application of this framework provides a structured, comprehensive and dynamic approach that enhances our knowledge of program effectiveness.

As a research and communication tool, the CMF:

- Provides a comprehensive and consistent basis for research planning, monitoring and reporting;
- Aids in establishing research priorities and helps ensure coverage across client groups and compliance requirements;
- Contributes to improved coordination with other research and analysis organizations within the CRA; and
- Provides a communication tool that outlines our approach to compliance measurement for greater transparency and improved understanding.

The core of the CMF consists of a set of compliance indicators that have been developed for each of our major taxpayer segments (individuals, self-employed individuals, corporations, GST/HST registrants, and employers). These indicators are populated with data from internal and external sources to provide a basis for establishing compliance behaviour and monitoring changes over time.

The focus for the CMF is on the four main elements of compliance:

1. Registering when required (businesses);
2. Filing returns on time;
3. Reporting complete and accurate information to determine tax liability, and
4. Paying amounts owing when due.

Compliance indicators consist of direct measures, such as compliance estimates derived from random sample reviews, as well as indirect indicators, such as comparisons of tax data with data from external sources.

<b>Filing Compliance - Rates of Filing on Time Without Direct Intervention by the CRA</b>						
<b>Compliance Indicators</b>	<b>Current Target</b>	<b>2002-2003</b>	<b>2003-2004</b>	<b>2004-2005</b>	<b>2005-2006</b>	<b>2006-2007</b>
Individuals who filed a timely return	90%	93.1%	92.6%	92.6%	92.8%	93.0%
Corporations - taxable incorporated businesses that filed their returns on time	90%	87.2%	87.1%	86.0%	85.9%	86.4%
Businesses that filed their GST/HST returns on time	90%	91.6%	92.0%	92.6%	91.8%	91.4%
Employers who filed their T4 returns on time	90%	96.4%	96.5%	94.5%	94.5%	96.0%

In addition to on-going compliance measurement and monitoring, the CRA undertakes periodic studies to examine the effectiveness of its programs and compliance strategies. There are three main types of studies that are performed:

1. Impact studies: The examination of the effects of compliance instruments on compliance behaviour as a basis for validating and refining compliance strategies.
2. Profiling Studies: The profiling of the characteristics of a segment of the taxpayer population or compliance issue to provide program managers with business intelligence that will increase their knowledge of a specific population or issue.
3. Evaluation Studies: The assessment of whether programs and/or strategies are achieving the desired compliance outcome or objectives.

#### **Impacts of Arbitrary Assessments on Filing Behaviour**

A study was completed in 2005 that examined the impacts of "arbitrary assessments" on individuals' filing and payment compliance for the five years following the assessment. Arbitrary assessments are raised under the Income Tax Act as an enforcement action when a non-filer has failed to respond to a demand to file a return. A return is usually prepared as a working paper for supporting the assessment. It does not change the fact that the individual has not filed a return even though a Notice of Assessment has been issued.

The results of this study showed that 63% of the individuals subsequently filed returns in response to the arbitrary assessment. Another 9% did not file a return but paid the tax bill generated by the arbitrary assessment in full. One year following the arbitrary assessment, some 32% of the study group voluntarily filed their tax return. After the fifth year, the rate decreased to 14% of the entire study group who complied every year after the arbitrary assessment.

The findings from this study, in combination with what the research tells us about committed non-compliers, suggest that the full force of enforcement action legislated in the Income Tax Act to address filing compliance should be consistently applied and possibly strengthened.

#### **4. ADVANTAGES AND CHALLENGES TO OUR APPROACH TO TAX COMPLIANCE**

The preceding section provided an overview of the main strategies for the control of non-compliance and several examples of more detailed strategies that in place for promoting compliance. This section explores some of the advantages and challenges that we have noted from our experience.

The CRA believes that there are many advantages to its approach to tax compliance. First, by identifying a limited number of major priority compliance risks, we are in a better position to communicate a common risk picture across the Agency and then focus our various resources towards resolving or mitigating these priority risks. In a time when resources are limited risk management is key. This approach helps us focus our attention on those who are non-compliant and minimizes unwarranted attention on those who are compliant.

Everyday the CRA faces challenges to administering its tax compliance programs and initiatives. One issue that remains a constant challenge is horizontal management of programs and issues across the Agency. Horizontal management is a particularly important value in an organization like ours, where we have shared values, a shared culture and a shared objective that can be summarized as achieving compliance. The challenge; however, is the vastness of our country, and the differences that exist in each region related to tax compliance. The Agency believes that it is imperative that all the regions must work together in the control of tax compliance. Different parts of the organization may interact with the same taxpayer in different ways – but all with the same objective of achieving compliance.

There have been a number of developments and initiatives that have improved the horizontal management of compliance at the CRA. Those most significant include the introduction of Agency committees such as Agency Management Committee (AMC), Resource and Investment Management Committee (RIMC); Operations Committee (OPC); Strategic Direction and Business Development Committee (SDBDC). These committees all provide an opportunity for horizontal discussion of issues and proposals from an Agency perspective.

We also have a Regional Operations Committee (ROC) that meets three to four times a year to discuss important issues with regions, inform them of upcoming changes and obtain their feedback on matters that may impact on their ability to deliver on compliance programs.

We also created a Compliance Strategy Directorate with a mandate to ensure that emerging compliance initiatives and issues are coordinated horizontally across the Branch and Agency. The Directorate also houses the International Relations Coordination Office that provides Agency-wide support, guidance, and direction with regard to many of the Agency's international activities.

Other challenges that we face involve ensuring a diverse, knowledgeable and skilled workforce that can carry out our compliance strategies.

We recognize that the long-term success of the CRA depends on the development and implementation of a structured, strategic approach to succession management to ensure that we continue to have the right people, in the right place, to do the right job. In response, we are developing a workforce development strategy that includes succession management to meet future business and human resource needs. We are also committed to ensuring that our staff receive appropriate training and development to meet their responsibilities.

Lastly, ensuring IT solutions that meet our ever changing needs for promoting tax compliance is always a challenge for the CRA. Currently, we are implementing a project called Compliance Systems Redesign, which is a major initiative to implement a comprehensive suite of IT solutions to enhance the Agency's ability to manage its compliance program in an integrated and efficient manner.

## **5. CONCLUSION**

The CRA plays an important role in contributing to the quality of life of Canadians. Our administration of tax and benefit programs protects the revenue base that enables governments to provide the programs and services that improve Canadians' economic and social well being.

The CRA takes tax compliance very seriously. We know that our self-assessment system of taxation works well and that the vast majority of taxpayers meet their compliance obligations responsibly. However, there are those who do not comply and the Agency works very hard to ensure that they cannot evade their obligations.

Our approach to tax compliance is about finding the right mix of programs and strategies that address the reasons why taxpayers do not comply. Our risk management system ensures that we constantly stay abreast of the most important compliance risks and that our strategies for addressing these risks are timely, effective, and purposeful.

Of course, any approach to tax compliance has its challenges and limitations. In Canada, we remain committed to meeting these challenges of ensuring horizontality, state of the art technology, and a well-developed workforce. In meeting these challenges, we are constantly looking forward to developing new strategies and pursuing alternative avenues in our efforts to promote tax compliance.





## EXAMINATION OF ECONOMIC GROUPS

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*CONTENTS: I. Introduction. - II. Working methodology -2.1 Criteria and mechanisms used for identification. -2.2. Procedure used. -2.3 Considerations taken into account for risk analysis. -2.4 Control procedure developed. -2.5 Case studies - III. Body of Laws - IV. Conclusions. -Annex I: Graph of Economic Group.*

### I. INTRODUCTION

The subject to be discussed is “Examination of Economic Groups”, framed within the main theme of the General Assembly which consists of the design and implementation of “Strategies for the promotion of tax compliance.”

Within the framework indicated in the technical program, an effective control on taxpayers acts as an effective promoter of the latter’s compliance with their tax duties, as a consequence of the generation of subjective risk.

It is undeniable that increasing globalization provides a competitive scenario that forces businesses to undertake transformations of significant impact on productive practices and organizational methods. This is due to the existence of a complex and dynamic business environment.

In the current economy, the existence of economic groups aimed at carrying out different commercial activities is a preponderant phenomenon both at the national as well as international levels.

The productive, marketing and financial activities of these Economic Groups involve geographical diversification strategies with operations at the world level. They act on the basis of centralized and coordinated tax planning, by evaluating alternatives and selecting the adequate legal ways of reducing costs – including taxation costs – and the optimization of their results.

This implies a new challenge for the Tax Administrations, since they must identify the economic group and its members, undertake the study and analysis of their risks and implement changes in the modalities and forms of control; that is, beginning with the investigation and examination sphere, and considering the individual standpoint of each of the components and the group as a whole.

## **II. WORKING METHODOLOGY**

### **2.1 Criteria and mechanisms used for identifying economic groups**

The first step is to determine what is considered or defined as an “Economic Group”.

It must be noted that the Argentine tax legislation lacks a specific definition of the “economic group” concept. Accordingly, it is necessary to further analyze the complementary legislation to compile elements that may contribute to establishing an adequate concept.

In this respect, the commercial legislation, in particular the Law on Commercial Companies (Law N° 19.550), only defines the concepts of controlled companies and related companies.

In fact, article 33 provides that “controlled companies are those wherein another company, directly or through another likewise controlled company, has participation, in any capacity, that may grant the necessary votes for arriving at the corporate will”. It likewise provides that “they are considered related companies, when one has an over 10% participation in the capital of the other”.

Based on that article, the National Statistics and Census Institute created the “Economic Groups Statistics Unit” which defined them – only for statistical purposes – as the series of companies which controlled either directly or indirectly by individuals and/or corporations, resident or nonresident, hold over 50% of the capital stock and/or the necessary votes for achieving the corporate will at corporate meetings or ordinary assemblies.

Likewise, the Law on Profit Tax provides that the relationship will be established when a company – domiciled in the country – and individuals or other type of entities or establishments, domiciled, established or located abroad with whom they carry out transactions, are subject directly or indirectly to the direction or control of the same individuals or corporations, or the latter, due to their participation in the capital, their level of credit, their influences, functional or of some other nature, whether contractual or not, may have decisionmaking power to guide or determine the activity(ies) of the aforementioned companies, establishments or other type of entities. This concept is defined by the legislation in order to make the transfer pricing adjustments.

From the operational standpoint and in order to proceed to the identification of the economic groups for their subsequent analysis, the following definition was used as standard criterion: “Economic Group is a series of companies, regardless of their corporate activity or purpose, where one of them exercises “control” over the others, or where the “control” of the companies comprising them is exercised –either directly or indirectly- by one or a series of individuals or companies.

Such control may be exercised in different manners, through corporate participation, presumption or economic management, namely:

- a) Corporate participation: participation in any capacity which may afford the necessary votes for arriving at the corporate will; that is, substantial or significant influence therein.

Parameter: necessary votes for arriving at the corporate will; that is, over 50% of the capital.

- b) Economic management: when any of the members of the board of directors exercises decisionmaking or technical functions in different companies.
- c) Presumption: when the customers or suppliers of a company have a significant percentage participation in its revenues, expenses, credits or debts.

In both cases, the parties that fulfill those conditions are considered components of the group.

## **2.2 Procedure used**

Before undertaking the analysis of this paragraph, it is worth mentioning that according to Argentine legislation, the assessment and payment of the different taxes is the responsibility of each company or individual forming the economic group, each of which must individually file the corresponding returns, and without there being any integrated filing of information by it.

The situation posed, calls for an exhaustive analysis for determining the composition of the group, which procedure will be described hereafter.

Economic groups are mainly identified through data available in the Tax Administration's bases, originating from systems provided in General Resolutions and third-party information (includes other Tax Administrations and Jurisdictional Control Entities).

The identification process begins with the determination of the economic and fiscal relevance of a company, identification of its stockholders – individuals and/or corporations established in the country or abroad- and their participation according to the number of shares of the company in question.

On the other hand, information is obtained from the companies wherein they participate, such as the data on the number of shares and their appraisal, which is obtained from the Records and Accounting Statements as well as the Profit Tax returns.

The search described in the preceding paragraphs is applicable to each shareholder identified, as well as to all companies wherein he may have investments.

After individually identifying the companies that comprise the group, information is obtained regarding the persons who represent them either as directors trustees, members of the surveillance councils, managers and other positions, to determine their possible participation in other companies, either as representatives or shareholders, taking into account for such purpose the definition that was previously explained.

In accordance with the previously mentioned procedure an analysis is made of information originating from:

- The Profit Tax returns filed by the companies and individuals.
- Information systems (General Res. N° 4120 Shareholders and

representatives - CITI Compras the most important companies of the country report their purchases through the identification of their suppliers).

- Annual Reports and Balance Sheets.
- Studies on Transfer Pricing.
- Other controlling entities such as General Justice Inspection, Trade Exchange of Buenos Aires and National Securities Commission.
- Tax Administrations of Foreign Treasuries (requested within the framework of the Agreements in force).
- Business associations of the activity in question.

As observed, to identify and set up the economic groups, it is necessary to compile and analyze information from different sources, to then establish the relationships of the data collected and then structure a map according to each group to evaluate its risk.

According to the modality described, currently some 83 economic groups, consisting of 1250 members (individuals and corporations) have been identified and their relevant economic data are:

- Total Assets: U\$S 66.000 million.
- Net Worth: U\$S 22.000 million
- Sales: U\$S 27.000 million
- Staff hired: 212.000 persons

By way of example, Annex I includes a model graph on an identified group.

### **2.3 Considerations taken into account for the risk analysis**

After identifying the composition of the economic group, an analysis is made of the corresponding economic and fiscal data, by considering the level of participation in the sphere of the economic sector to which it belongs.

In fact, a good practice at the fiscal control level presupposes the availability of information on the taxpayer universe being examined, with respect to which risk profiles should be developed that may serve to support decisionmaking in a clear, objective and effective manner.

This risk analysis, which involves the examination and comparison of the information known about each taxpayer, allows for identifying the components that may be investigated and/or examined, as well as for establishing the subject matter, concept or operation to be analyzed.

From the study undertaken, the following data, among others, are examined in relation to the members of the group.

- Main activity
- Stockholders
- Number of shares
- Percentage of participation
- Representatives
- External auditor
- Amount of sales
- Amount of exports/imports
- Gross result
- Net result
- Profit Tax determined
- Assets
- Liabilities
- Net Worth
- Credits and debts with related companies
- Number of employees
- Special or promotional systems
- Results of previous investigations or examinations of each member.

This allows for structuring a matrix for each group and to analyze the level of revenues, types of financing, provision of staff, relationship between a specific tax vs. revenue, level of accumulated losses, level of operations as supplier carried out among members, among others.

As a result of this analysis one may obtain specific indicators and establish deviations that may show behavioral patterns that are separated from the mean determined in accordance with the activity, or else indications deserving the analysis of an issue or operation.

#### **2.4 Control procedure developed**

As previously stated, the assessment and payment of the various taxes is the responsibility of every company or individual that is part of the economic group. To this one must add the purely operational aspect in the sense that the examination of each taxpayer is attributable to the regional jurisdiction under which each member is registered, there being at present, an operational map formed by 27 Regional Directorates.

The “traditional” investigation and examination carried out is limited to the verification of a member of the group, which bears with it the difficulty for visualizing and knowing the real “business”, by taking into account the economic group of which it is a part.

The situation described, made it necessary to reconsider the working methodology regarding the procedure for controlling these “business units”, thus establishing the convenience of initiating investigation and examination actions, by applying a unified criterion with respect to the individuals and companies that comprise the pre-selected economic group.

This situation necessarily calls for the centralized coordination of actions within a single sphere, and the subsequent permanent communication and integration of the areas involved in control.

The bases of the new working methodology adopted are:

- knowledge
- strategy
- action

**The knowledge of the group implies:**

- ✓ Analysis of the organized juridical structures to detect undesirable tax effects.
- ✓ Being aware of tax planning in the internal and international market.
- ✓ In-depth analysis of the influence of the action of companies with tax benefits in the operations of the group.
- ✓ Detecting non-formal control relationships with other companies.

**The strategy set for the control of these units involved:**

- ✓ Promoting joint and coordinated action by AFIP on taxpayers organized as Economic Groups.
- ✓ Applying consistent treatment to all members of the group by unifying the criteria.



- ✓ Increasing the perception of risk by analyzing the operations wherein the results are affected by intra-group actions.
- ✓ Improving fiscal control based on the integral vision of the Economic Group.

**The lines of action set in the control procedure are linked to:**

- ✓ Verification of the correct allocation of results among the companies according to their operations and structure.
- ✓ Analysis of the operations which each of the members carry out among themselves, especially their effect on such items as costs, manufacturing expenses, financial expenses and results from special operations.
- ✓ Determination of derivation of results (e.g. Reallocation of expenses).
- ✓ Control of foreign trade operations for detecting situations that may allow for deferring or relocating results.
- ✓ Existence of possible company reorganizations in view of possible transfer of losses or favorable balances.
- ✓ Preventing the dispersion of taxpaying capacity.
- ✓ Analysis of economic operations from the standpoint of both intervening parties – loans/disposal of funds.
- ✓ Verifying the correct application of tax benefits in the intra-group operations, given that they are related.
- ✓ Including particular actions for each group, according to their characteristics.

As observed, the information and coordination of investigation and/or examination tasks are of vital importance for the application of standard criteria by the Tax Administration, in order to improve fiscal control, due to the integral vision of the Economic Group.

**2.5 Case study**

Economic group formed by leading company in the natural juice production and marketing sector

➤ **Economic data:**

Amount of sales: US\$ 110 million.

General result of the group: US\$ 1 million loss.

Without income tax assessed for several periods.

➤ **Characteristics:**

- Companies of the group sell almost all of their production to the related leading company.
- They provide raw material (containers and juice concentrate).
- The company providing the containers is located in a free zone without taxation of Profit Tax.
- The leading company's growth is financed through contributions.

➤ **Actions:**

- Control of operations carried out among the companies in the commercial as well as financial aspect.
- Analysis in the internal market of comparables in identical geographical location which sell to independent third parties.

➤ **Conclusions:**

- The selling price of raw material almost doubles the selling price of a comparable and the market average.
- Consecutive losses are financed by exempt profits of promoted companies (in one case the level of profitability is 150%), through the distribution of dividends and their subsequent contribution in cash to the main company.
- An increase in the tax base of the Profit Tax is determined on considering the cost value of containers at an average market price.

### III. JURISPRUDENCE

Recent jurisprudence is linked to the disposal of money or loans to third parties.

Article 73 of the law on Profit Tax provides that any disposal of funds in favor of third parties by the individuals indicated in article 49 inc. a) – commercial companies – and which does not correspond to operations carried out in favor of the company, will allow for presuming, without admitting proof to the contrary, a taxed profit equivalent to any of the two parameters determined by law.

The majority position of the Government's Fiscal Court in its most recent rulings regarding the application of this presumption, indicates that the fact that the companies intervening in the money loan are related (are members of the same economic group), does not prove that the operation may have been made for the benefit of whoever carried it out, while the organic subordination relationship between the taxpayer and his controller does not suppress his juridical personality nor annuls his taxpaying capacity.

It also adds that it is not logical that loans between related companies do not earn interest, it being necessary to note that in order for those agreements to have tax consequences, the conditions agreed between such companies must be accommodated to those that would have been agreed between independent parties under normal market conditions.

With respect to the position of the National Chamber of Appeals as regards action under Administrative Law, there are different positions and the actions in question are pending, with appeals before the Supreme Court of Justice of the Nation.

There is background (IV Court of the aforementioned Chamber) wherein the presumption of interest is considered appropriate in terms of article 73 of Law 20.628, with respect to loan operations carried out between companies belonging to a same economic group since, the fact that they are related among themselves, is not sufficient to prove that the money loans are for the benefit of whoever made the loan.

Even though the Profit Tax returns filed by the related companies that made loans among themselves were considered jointly, this does not result in a neutralization of the tax to be paid since, on the one hand, the companies filed their returns individually and, on the other, the one receiving the loan cannot deduct the interests which it did not pay.

On the other hand, in the IV Court there is background evidence that the adjustment of Profit Tax made by the General Directorate of Taxation is inappropriate, since the loans made in favor of related companies comprising a same economic group, cannot be considered as disposal of funds in favor of third parties according to the terms of article 73 of the Law dealing with the tax. This is so because even though the funds receiving companies may have their own juridical personality and each of them is a direct taxpayer, the existing relationship between them, since the petitioner holds the majority of shares and the control thereof, prevents them from being considered as third parties.

It must be borne in mind that in this case, the National Chamber of Appeals of action under Administrative Law, considered that the activity corresponded to operations for the benefit of the company that disposed of the funds (condition set in the aforementioned article) since the company purpose indicated the financial operations to be carried out through the contribution of capital to companies or enterprises already established or to be established, financing and credits in general.

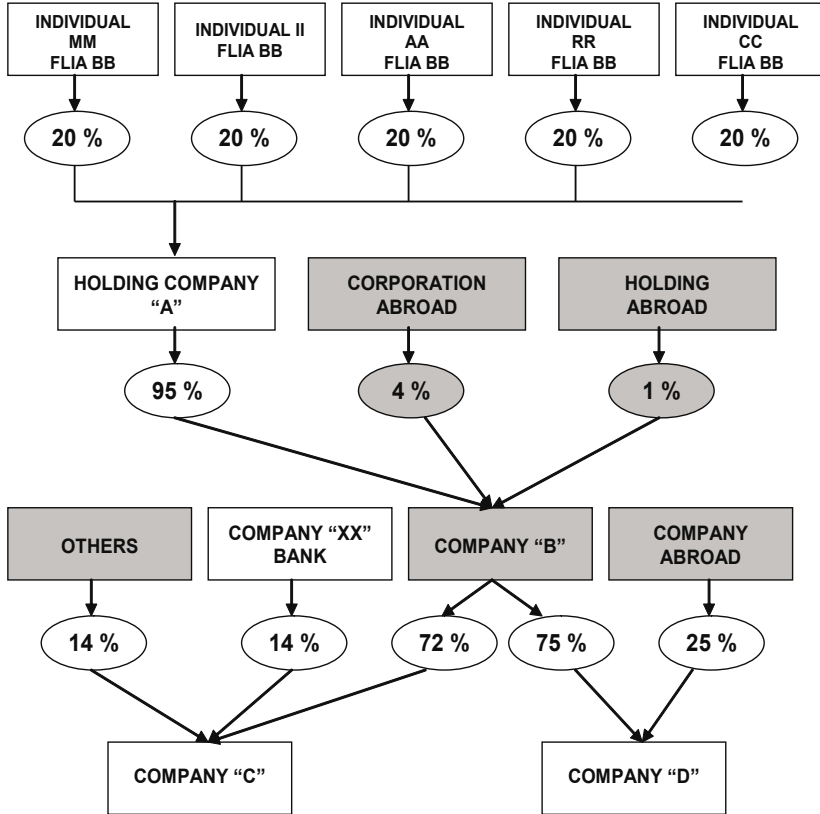
#### **IV. CONCLUSIONS**

The purpose of this paper was to focus on “Economic Groups” from the standpoint of changes in actions and procedures that should have been carried out given the prevalence of their actions in a globalized economy.

This implies a new challenge for the Tax Administrations, since traditionally control was considered from the individual standpoint of the company, while at present it is part of a whole.

In this context, a case study has been used to conceptually describe, first, and then specifically the different tools currently used by the Federal Administration of Public Revenues.

### Annex I Graph on Economic Group



## EXAMINATION OF ECONOMIC GROUPS

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*CONTENTS: Summary. -1. Introduction. -2. Definitions and entities. National and worldwide tax consolidation and international rulings. -3. Italian Tax Administration investigation practices. -3.1 Organizational profile and database. -3.2 Risk assessment methodologies. -3.3 International controls and cooperation. -3.4 IT processes. -4. Construal by the Judiciary. -5. Conclusions*

### SUMMARY

The document sets forth the regulatory and administrative instruments adopted by Italy to face the tax issues regarding the economic groups. Starting by defining the groups, we present the regulatory measures and the practical and organizational solutions determined to date with the purpose of identifying and verifying the appropriate compliance with tax obligations by the taxpayers under study and formulating appropriate strategies to promote tax compliance and the combat of tax evasion phenomena.

In particular, we address the legal entities of the national and worldwide tax consolidation, which purpose is to ensure a single assessment of the tax basis of the economic groups, and international rulings as a tool to favor voluntary tax compliance of international businesses. Subsequently, we analyze the most relevant instruments of the control activity and, specifically, the risk analysis methods, auditing practices and the information technology instruments that support selection and control activities. Lastly, we provide a summary of certain case law decisions on matters regarding the operation of the economic groups.

The general framework outlined sets forth the progressive adoption by the Italian financial administration of strategies that are specifically

geared at the economic groups, and clearly state the relevance of an effective international cooperation among the Tax Administrations in order to combat the aggressive international tax planning phenomena that tend to be a feature in such groups.

## 1. INTRODUCTION

The internationalization of markets has taken a global dimension and multinational corporations constitute one of the most significant expressions of this phenomenon. Economic globalization, on the other hand, is not limited to the economic relations among operators and the consequences on consumers, but it also increasingly impacts the definition of public policies, and among them, the tax policies.

In this context, international tax planning constitutes an essential instrument for the groups that operate on a global scale and permanently pursue global solutions such as acquisitions, mergers, spin-offs, investments, financing, intra-group transfer pricing policies, etc. In such instances we identify the intent to perform such operations with the purpose of avoiding taxes and therefore, the evident interest of the national tax administrations to prevent them and punish them when applicable.

On the other hand, given their nature, the aggressive international tax planning models tend to avoid the control efforts of the national administrations that operate according to the traditional methods. The methods to promote voluntary tax compliance are deemed vital for this purpose.

On the basis of such assumptions, we briefly enumerate the initiatives arising from legislation and the national Administration before the foregoing phenomena, whether in terms of regulations as well as specific control strategies, particularly referred to the operations carried out by the economic groups.

To this end, we have organized the document according to three main sections. Firstly, we shall refer to the notion of economic group and the institutions that govern the most relevant aspects of the activities of such groups according to the Tax Administration. Subsequently, we shall describe the key methods, instruments and organizational and administrative cooperative solutions in the area of risk typology controls. Thirdly, we shall briefly list the most relevant court rulings

regarding the operations of economic groups and lastly, some final remarks.

We shall provide a framework that underlines the clear need to consider the tax aspects related to the large economic groups on an individual basis, and the evidence that certain solutions have been adopted nationally, but in the face of certain increasingly sophisticated tax planning phenomena, the full effectiveness of such solutions largely depends on the administrations' commitment to resort to international cooperation.

## **2. DEFINITIONS AND ENTITIES. NATIONAL AND WORLDWIDE TAX CONSOLIDATION AND INTERNATIONAL RULINGS**

As mentioned before, contemporary economy is increasingly based on business activity forms marked by the interaction among subjects that operate on a national as well international basis. Specifically, we are witnessing the dissemination of "economic groups" that take the form of holdings with a legal structure and nature that varies according to the degree of internal relatedness among the entities that make up the group.

Italian legislation does not provide for a legal definition of economic group in the broad sense. For the purpose of this analysis we shall provide a general definition of such concept.

The classic form of group is marked by the existence of a controlling company and related companies, determined by the direct or indirect ownership thereof and by the exchange of ownership among them, which occurs under the single economic management of a parent company (holding company) from which the related companies remain formally autonomous<sup>(1)</sup>.

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<sup>1</sup> *As regards controlling and related companies, Article 2359 of the Italian Civil Code sets forth: "Controlled companies are deemed to be: 1) companies in which another corporation is the majority shareholder with voting rights in the Shareholder's Meeting; 2) companies in which another corporation owns enough number of shares with voting rights to exert a prevailing influence in the Shareholder's meeting; 3) corporations under the prevailing influence of another corporation by virtue of specific contractual relations therewith. For items 1) and 2) of the first section to apply, the law also counts the votes from controlled companies, trust companies and intermediaries; the votes of third-parties are excluded. Related companies are defined as companies over which another corporation exerts noticeable influence. Such influence is evidenced when at least one-fifth of the votes may be exercised in the Shareholder's Meeting, that is to say, one-tenth if the corporation is a listed company."*



In addition to this form of economic group, we may mention the joint ventures (temporary association of companies), consortia, the European Economic Interest Group (EEIG), which in spite of being different from the foregoing groups of companies, feature strong analogies therewith, and in particular, a source of synergy in order to achieve the common objectives, mostly of a temporary nature.

In the current global economic context, economic groups are increasingly focused on markets that exceed the national borders. Therefore, the foregoing phenomena increasingly take a multinational dimension. While a national economic group may be governed by identical rules to those applicable for each company established in the country, the opposite applies for multinational corporations; this entails evident and relevant tax implications, such as, the risk of detecting irregular behavior by the interested parties in order to obtain tax advantages through transnational transactions.

In such respect, from a regulatory standpoint, Italy has adopted measures geared at activities to prevent and combat tax evasion and tax avoidance. Specifically, and on the basis that the economic power of the multiple subjective structures that make up a group effectively exceeds the one of each component, special attention has been placed on the related tax relevance and the economic dimension of the group overall by introducing the entities of the national and worldwide tax consolidation after the recent tax reform, among others.

In fact, the phenomenon of the economic groups in Italy was firstly governed by provisions of Civil Law, with the introduction of the obligation for equity corporations that control other companies of carrying and publishing the consolidated balance sheet (Act No. 127 of April 9<sup>th</sup>, 1991) including “Measures to enforce Council Directives 78/660/EEC and 83/349/EEC on consolidated accounts”). This type of consolidation has been subsequently accepted as a tax document.

Particularly, Act No. 344 of December 12<sup>th</sup>, 2003, which includes the “Provision to reform the Corporate Income tax”, introduces as an absolute novelty in the realm of taxation of economic groups, the entity of national and worldwide **tax consolidation**. More specifically, the Italian lawmaker has preferred to set forth the “consolidation of the tax base” instead of taxation on the group’s consolidated balance sheet, which would have entailed greater practical difficulties.

With regards to the entity of **national tax consolidation**, it enables to determine a single tax base for the group on the controlling company that shall add its own tax base and the tax bases of the controlled companies to its income tax statement, setting them off in full and regardless of the percentage ownership thereof, thus determining an “overall income”. The entity is governed by the provisions in articles 117-129 of the new Single Income Tax Text (TUIR, as per the Italian acronym) and is defined by Ministerial Decree of June 9<sup>th</sup>, 2004. It is an optional system; the option spans three fiscal years and is irrevocable.

**In order to opt for the national tax consolidation, certain requirements must be met:**

- the equity ownership share of the controlling company shall be over 50%;
- the option shall be jointly exercised by each controlled company and the controlling company;
- the interested companies shall be IRES subjects [who pay taxes on corporate income], residents or permanent establishments.

**Exercising the option entails a number of advantages, among which we may mention:**

- complete exemption on distributed dividends;
- setoff of the positive and negative taxable income in the group;
- implementation of a tax neutrality system for the transfers of non-income producing assets within the group;
- irrelevance of the shares issued by consolidated corporations in the pro-rata equity calculation to deduct the passive interest from financial charges;
- the possibility of maximizing the deductions of amortizations, revaluations and reserves at the group level, even when unrecorded on the balance sheet.

In the case of the **worldwide tax consolidation**, the taxation of the group may also be extended to non-resident corporations. The profits and losses of the foreign controlled companies are applied to the controlling company in Italy, for the purpose of transparency, as a proportion of the overall equity ownership percentage; therefore, the profits and losses of the foreign controlled companies shall be recalculated pursuant to the national tax regulations.

In this case, contrary to the national tax consolidation, the option is exercised only by the national controlling company, and shall apply to all the controlled companies, which, on the other hand, shall not exercise any option. Another difference is that the option is binding for the controlling company for at least five fiscal years; renewals are valid for an additional three fiscal years.

The advantage of enforcing the entities described is the immediate identification of the economic group and the economic and tax variables to examine.

Specific reference shall be made to the introduction in Italian legislation of the **International Rulings**. This relevant discipline has been enforced by Article 8 of Act No. 269 of September 30<sup>th</sup>, 2003 on “Urgent measures to favor the development and correct the evolution of public accounts”, passed by Act No. 326 of November 24<sup>th</sup>, 2003, and enforced by the Decision of the Revenue Service Director on July 23<sup>rd</sup>, 2004, which points out the subjective and objective requirements to enjoy such entity, also establishing the operating modalities to institute proceedings by the taxpayer on the basis of a request to such end.

More specifically, the ruling is a particular method of requesting, by which the company is empowered to know and share the principles adopted by the financial Administration vis-à-vis the tax system, the calculation method for the intra-group transfer pricing of goods and services, interest, dividends and royalties. The proceeding is aimed at reaching an agreement between the taxpayer and the Italian financial Administration without involving the tax authorities of foreign countries. The agreement is binding for both parties for the fiscal year in which it is subscribed and for the subsequent two fiscal years. During such term, a stay prevails over the Administration’s auditing powers as regards the transactions defined in the agreement.

Two specialized Offices of the Financial Administration are in charge of coordinating the relations with the subjects that request access to the proceeding, according to the place of residence of the requesting parties (one for the North of Italy and the other for the mid-Southern area).

### **3. ITALIAN TAX ADMINISTRATION INVESTIGATION PRACTICES**

Therefore, and since certain entities have attached great relevance to the economic groups, in the face of their consolidation, the control strategies adopted by the Italian Tax Administration are developed according to a dynamic ever-evolving methodology, referred to the organizational structure as well as the operating and methodological instruments ancillary to the auditing activity.

#### **3.1 Organizational profile and database**

As regards the organizational profiles, specific structures were developed for the analysis of the accounting and non-accounting data required to detect potential tax risks arising from the activity of the economic groups.

Other structures are in charge of creating control methodologies on which a specific auditing activity has been developed regarding large taxpayers operating in specific sectors, such as banks and insurance companies.

Risk analysis constitutes an essential instrument to plan the control activity. More specifically, and with regards to the databases employed for such purpose, risk indicators are drafted according to the information gathered from:

- the Administration proper, by processing data from the Tax Registry, the information center by which all relevant data to enforce taxes on individuals, corporations and other entities are gathered and processed, from different sources such as income tax statements, VAT payments, results of the control initiatives, commercial exchange with other countries, etc.;
- outside the Administration, from the formalities completed by the taxpayers who interact with the Tax Administrations and the social security and tax offices, pension funds, Chambers of Commerce, Banks, insurance companies and foreign tax authorities, to mention only a few.

In order to guarantee the flow of information to enable to learn about the most relevant economic, financial and accounting events vis-à-vis the taxpayer subject to the control, certain laws enacted in recent years foresee the obligation of the foregoing external parties to file the data relative to the transactions conducted with taxpayers.

To this end, for example, financial operators shall communicate via information technology their relations with taxpayers, stating their personal information, including the Tax Identification Number. On the other hand, the remaining data that are not referred to the account movement but to other relations or operations conducted with the intermediary are compiled and stored to be forwarded via e-mail upon request of the Tax Administration for the purpose of financial investigations.

Naturally, especially in the case of economic groups with an organization established in more than one State, the possibility of gathering and crossing the information mentioned above is vital in order to determine the risk entailed by potential tax evasion or tax avoidance schemes. In such respect, the exchange of tax information constitutes one of the numerous and fundamental international cooperation instruments that we shall refer to later.

### **3.2 Risk assessment methodologies**

On the basis of the data gathered from the above-mentioned sources, the assessment of the degree of risk for the subject to be controlled is articulated in successive phases, going from general monitoring of the economic group to the auditing of the economic transactions carried out.

To this end, we conduct a preliminary analysis of the business transactions and procedures and their compliance with the regulations in effect.

Subsequently, the corporate, organizational and accounting structures are analyzed, according to the features of the group; the forms of control and corporate governance; the degree of integration and specialization of the companies and the equity ownership percentages established.

The balance sheet is analyzed, evaluating the drafting process and the transactions in the light of the national regulations mentioned before and the national and international accounting principles. This analysis may be performed by indices or flows and may entail comparing the result for each company with the overall result.

Additionally, the tax situation is summarized by analyzing the statements filed, including the result of audits already completed.

Other aspects to consider are:

- the tax treatment of intra-group and extraordinary transactions (acquisitions, mergers, spin-offs) and their effects on the economic and equity result overall;
- the tax treatment of the financial instruments employed (differentiating between equity, secured loans, mixed financial instruments, derivatives, etc.);
- losses deducted from the taxable income of future fiscal years, the limitations to the distribution of reserves and eventually deferred taxes.

Another area for analysis relates to the procedures followed in order to meet the VAT obligations. In this case, invoices, transportation documents and other accounting documents are examined. Additionally, we verify the appropriate filing of statements, requests for reimbursements and the eventual opening of a VAT account in States other than the State of residence.

Once all these aspects are examined, the elements detected in the operations conducted by the companies within the groups are analyzed. Special attention is given to the fact that the degree of risk increases where, in the case of fiscal years relative to two or more States, which match the same time period, the international dimension becomes relevant as regards certain specific aspects (such as the distribution of costs according to whether there are agreements in place or not, or the distribution of earnings among taxpayers resident in different tax jurisdictions), paying special attention to the new sectors (for example, financial instruments).

Another element considered for the purpose of detecting eventual international transactions' schemes with a substantial content different from the formal content, are the transfer pricing practices. In such respect, special attention must be given to transactions with low or zero taxation countries.

The commercial practices employed by multinational companies are also examined, paying special attention to the tax obligations of the economic groups.

Additionally, the data referred to eventual failures to file income tax, money laundering of illegitimate proceeds, corruption and under-the-counter financial practices, shall be considered where they may arise and gathered from the multiple sources available to the financial Administration.

### 3.3 International controls and cooperation

Taxpayers to be subject to audits shall be selected on the basis of the elements described above, focusing on the economic groups that are truly likely to perpetrate tax violations. The idea is to maximize the efficacy of controls and make the best use of resources.

As regards the operating profile of the auditing activities, they are coordinated regionally and are specifically focused on the subjects who have opted for the national tax consolidation system. To such end, a detailed control methodology has been created, which is articulated on the basis of a predetermined investigational path, with operating instructions and institutional modules created for each case.

In addition to the internal control activities, international control activities have been also implemented, with **simultaneous audits and multilateral controls** geared at verifying the tax status of the taxpayers who conduct international business activities, generally within the multinational groups.

In particular, the Italian Tax Administration has set forth, as of the '80s, certain administrative technical agreements with the competent tax administrations of foreign jurisdictions in order to undertake **simultaneous audits**. Such agreements foresee that the competent authorities of the two contracting States may consult each other, upon request of the other party, to define contemporary and autonomous

tax audits' modalities in the respective territories, on companies that conduct commercial and/or financial transactions with each other. It is an activity performed autonomously by the respective States on the basis of their own legislation and on the exclusive account of their own officials. The audit stems from a specific request from one the contracting States and shall be geared at subjects selected according to the criteria set forth in the agreement subscribed. Essentially, although not exclusively, the selection criteria are based on the dimension of the transactions performed by the company on a worldwide basis, the volume of intra-group transactions, the existence of compatible fiscal years and when evidence exists of business conducted in countries with preferential tax regimes.

In addition to simultaneous audits, we may mention **multilateral controls**, that is to say, joint tax audits conducted in companies distributed across Europe. In this case, the control effort is organized by two or more countries with common or supplementary interests and shall be coordinated on the basis of the tax status of the related subjects. In the context of the EU in particular, this type of control activity is based on action plans geared at improving the performance of the tax systems in the internal market.

Thus, it is evident that in order to investigate the economic groups, administrative cooperation instruments are vital. The financial Administration seeks to strengthen such instruments, and is committed to the implementation of these cooperation models according to the highest international standards.

### **3.4 IT processes**

Naturally, in order to define the auditing strategies, it is essential to rely on an expeditious access to the information relative to the subjects to be audited and the possibility of processing the information required for the purpose of identifying the risk factors. Therefore, the financial Administration relies on a number of computer programs for taxpayers' selection and control.

In particular, it features a Web portal by the name of Integral Functions to Support Controls, (F.I.S.C.O, as per the Italian acronym), which integrates the data search and management functions in the different phases of the control activity. The themes available on the portal in order to query and process data, in addition to their general functionality are: objectives' planning; selection for audits; controls' programming;



formal and substantive control of tax statuses; auditing tax evasion; payments, records, disputes; follow-up.

Also, for the purpose of planning controls and analyzing the economic groups operating in Italy, certain programs enable to obtain lists of the subjects to be audited, pursuant to certain risk criteria. Specifically:

- the procedure under the name of RADAR, which consists in a database that renders the lists of companies and private business persons on the basis of tax, social security, economic and structural information. The program enables to employ different selection criteria by crossing the data from different sources. Once the lists of subjects to be audited are obtained, other filters may be applied to detect mergers and acquisitions, tax credits, requests for refunds, etc.;
- another database by the name of MERCE contains the data relative to transactions within and outside of the European Community and enables to analyze the flow of trade by Italian operators and select the list of all the operations conducted by a given subject;
- The "Large Taxpayers" software is used to plan the controls on the medium to large taxpayers (that is to say with a turnover of 10 billion or above), with the possibility of monitoring the control activity regularly.

#### **4. CONSTRUAL BY THE JUDICIARY**

The auditing activities described to this point have generated, among others, controversies as regards the construal of regulations and the enforcement thereof in specific cases. In such respect, Italian case law on such matters is abundant, although not unequivocal. This factor, in addition to the fact that Italy is a Civil Law country, prevents us from undertaking a systematic analysis of the case law on the matter. Therefore, we set forth as examples, certain rulings regarding the operation of economic groups from which we may draw the existence of tax evasion or tax avoidance phenomena. For example, reference is made to the reduction of the tax base of the resident companies by commercial and financial transactions, such as intra-group financing, payment of royalties and the application of transfer pricing regulations.

As regards intra-group financing, in the case in which the court ruled in favor of a controlled company in Luxembourg, a decision of the Provincial Tax Committee of Ravenna, confirmed the Administration's challenge that deemed inadmissible the arguments adopted to justify the financing extended, on the basis that it entailed interest-bearing

financing at the fair market value (Decision I, No. 253 of November 15<sup>th</sup>, 2002) <sup>(2)</sup>. It is assumed that, according to this judge, without any evidence to the contrary, a non-interest bearing loan recorded as a credit on the balance sheet is deemed an interest-bearing loan.

In another analogous case, the judge re-qualified a loan as a contribution to the equity account, deeming it an interest-bearing loan. This constitutes the assertion of the principle according to which the financing from a controlling corporation to a 100% controlled company is nothing else but a genuine capital contribution, which, as such, shall not bear interest and is not subject to audits for the greater income that the transaction would have produced for the controlling corporation that provides such financing (C.T.P. Reggio Emilia, Decision VII of March 17<sup>th</sup>, 1997, No. 55).

As regards rights over the payment of royalties among related companies, in a case in which concessionaires from State X (company A) had purchased goods from an Italian company (company B) and paid royalties to another company from State X (company C), the judge considered that the payment of royalties by the concessionaire (A) to the company that owns of the licensed entitlement (C), instead of paying them to the Italian company (B) (related to C) where the goods had been effectively purchased, does not entail a deduction of the tax base in favor of company B (Regional Tax Committee of Tuscany of June 26<sup>th</sup>, 1997 confirmed by the Court of Appeals, Tax Ruling No. 12981 of September 29<sup>th</sup>, 2000<sup>3</sup>).

In another case involving royalties paid to the foreign headquarter, the judge considered that it was actually an anticipated distribution of earnings to the shareholders, on the basis of the criteria employed to calculate the percentages deemed incompatible with the regulations in effect on such matters (C.T.P. Ravenna, Ruling I No. 387 of June 19<sup>th</sup>, 1998).

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<sup>2</sup> According to the Italian system, the Provincial Tax Committees constitute the first instance bodies in the tax proceedings whose rulings may be appealed in the competent Regional Tax Committees, and finally, the third instance for disputes of jurisdiction, competency, breach and unlawful enforcement of regulations, nullity of a sentence or the proceedings on the grounds of omission, inadequacy or contradiction, is the Supreme Court of Appeals.

<sup>3</sup> The ruling from the Court of Appeals has dismissed the motion against the decision, annulled on the grounds of procedural defects.

Vis-à-vis transfer pricing practices, we may refer to a ruling from the Court of Appeals <sup>(4)</sup>, an example of a consolidated opinion, which sets forth that the burden of the proof of the recurrence of tax evasion shall always fall upon the relevant Administration that undertakes the relative transfer pricing modifications (Court of Appeals, Tax Ruling No. 22023 of October 13<sup>th</sup>, 2006). This confirms a consolidated approach under the scope of the OECD, according to which the taxpayer is not bound to prove the applied transfer pricing adjustment until after the Tax Administration determines *prima facie* the breach of the principle of the normal value.

We may also mention a decision by the Provincial Tax Committee of Milan, which, vis-à-vis the income of a parent company and specifically referred to the assessment of general management and administration expenses applied by a foreign controlling company to its affiliate established in Italy, has confirmed the approach set forth in the Resolution of the Ministry of Finance No. 271/E of October 21<sup>st</sup>, 1997, by which the office, in order to annul deductibility in whole or in part of the management expenses on valid grounds, shall undertake all the investigations required in order to detect the certainty and the effective applicability of such expenses incurred by the headquarters to sustain the activity of the Italian affiliate, and subsequently proceed to control the consistency thereof (CTP Milan, Ruling VIII No. 158, of July 29<sup>th</sup>, 2005).

As we have briefly analyzed above, there are different aspects of the activity of the economic groups under the examination of the Judges in tax matters. Although we do not intend to establish unitary approaches, the repeated intervention of the courts confirm the focus placed on the issue and the equally significant contribution thereof in the construal of the national tax regulations on economic groups, setting forth in each case the solutions deemed more useful for tax compliance purposes.

## 5. CONCLUSIONS

The analysis performed to this point has presented the solutions adopted by Italy to face the inherent tax issues in the increasingly greater proliferation of economic groups in the world economy.

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<sup>4</sup> Refer to footnote<sup>2</sup>

On the basis of the growing weight of economic groups, the legislator and the Italian Tax Administration have progressively adopted measures geared at identifying such subjects, verifying the appropriate tax compliance of their activities and developing adequate strategies to counter the phenomenon of tax evasion and, consequently, improve tax compliance.

As we have discussed, after adjusting the regulatory instruments that enable to consider the economic group as a whole (civil law regarding holding companies, tax consolidation, international rulings), the Tax Administration has focused on the performance of audits, adopting appropriate investigation methods and instruments to address such complex economic realities, particularly acting on two fronts: firstly, by gathering and managing the vital information to determine the activities of the economic groups, paying special attention to large taxpayers and secondly, by defining the appropriate control methodologies assisted by increasingly sophisticated intelligent investigation computer tools. The processing of the data obtained in the course of the audits has enabled to develop a wealth of experience that constitutes the basis to develop specific control and anti-tax evasion strategies.

To conclude, the Italian Tax Administration is greatly committed to the efforts to face the emerging phenomenon of economic groups, while Judges in tax matters face the challenge of identifying, defining and describing the complex cases under study. In this context, we highlight the contribution from the progressive consolidation of international cooperation.



## THE CONTROL OF FINANCIAL TRANSACTIONS

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*CONTENTS: 1. The horizontal monitoring programme. -2. Horizontal monitoring.  
-3. Structured finance and compliance. -Conclusion*

### 1. THE HORIZONTAL MONITORING PROGRAMME<sup>1</sup>

In 2002 the Dutch Scientific Council for Government Policy envisaged that the relationship between government and its citizens - individuals as well as corporate taxpayers - would change from a vertical to a (more) horizontal one. In a horizontal relationship there is mutual trust and a model of co-operation between government and its citizens in upholding the laws and regulations. This vision was endorsed by government in its programme 'Andere Overheid' (Whole of Government approach).

In April 2005 the State Secretary of Finance (responsible for the Tax and Customs Administration) wrote to the Dutch Parliament that 'maintaining complex rules in a complex changing society is nearly impossible without information from and co-operation with that society'.

The Netherlands reached the conclusion that the way they were dealing with large corporate taxpayers was not the most efficient and effective one. In the large business area the need to change was also underpinned by feed-back from the organised business community on the policy of the Tax and Customs Administration. Pilots were announced to develop instruments and new forms of co-operation for

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<sup>1</sup> Source: *OECD Study into the Role of Tax Intermediaries*

large businesses, small businesses, individuals, advisers and in the Customs field. International developments like the development of corporate governance codes, the Sarbanes-Oxley-act and IFRS forced large corporate taxpayers to be in control - also on their tax position - to document their tax position and to be increasingly transparent. Those developments appeared to be very important in developing new forms of co-operation in the large businesses segment.

### **Scope, status and duration**

In 2005 the Tax and Customs Administration started a pilot with twenty very large corporate taxpayers in order to conclude supervision agreements. The basic principle of the relationship with the large corporate taxpayers is mutual trust, transparency and understanding. It goes without saying that everything has to take place within the boundaries of laws and regulations of the Netherlands. The supervision agreement does not create any additional rights or obligations, nor does it limit any rights and obligations. The board of the Tax Administration demands from the company at board level (CFO) to commit itself to full transparency on current tax issues. In return the Tax Administration will give its binding opinion on that issue expediently. The advantages for the company are certainty, being in control of its tax position, having a better relationship with the tax administration and meeting less administrative burdens. In order to be able to focus on current issues, it was necessary to solve the issues from the past first. This appeared to be an attractive proposal for the executive board.

Teams started to work out the high level agreement with the tax department of the company. In that process a written document is agreed upon by the parties and signed off by the CFO and the manager of the local tax office responsible for the company in question. The supervision agreement includes a description of the principles and the process agreed upon and is about one and a half pages long (see the draft example agreement at the end of this appendix). In 2006 the Tax Administration expanded the pilot with another twenty large corporate taxpayers. In both pilots were companies that we considered as high-risk taxpayers. With reference to the Sarbanes-Oxley-act and IFRS, in a letter to Parliament in June 2006 it was indicated that in order to enter into the enhanced relationship an adequate tax control framework needs to be developed. The Tax Administration and tax advisers are working on this together.

## **Standards of behaviour**

The Netherlands did not work with a detailed blueprint. A small group of people from the Tax Administration explained their ideas and goals to the other colleagues responsible for dealing with the first twenty large corporate taxpayers in the pilot. During the process the concept developed. The main thing is that there are no definitions of transparency or significant tax risk. This is a key point to be discussed in a bilateral dialogue between the company and the tax team dealing with that company. The expected and shown behaviour should be a topic of ongoing dialogue between the company and the tax administration. It is expected that people from both sides address this.

Early in the process it was understood that Tax Administration staff could not show different behaviour without support. They are expected to build and maintain relationships, to have a problem-solving attitude and understand the different interests of the taxpayer and the tax administration, to have empathic and listening skills and to understand how communication processes work. A masterclass on personal effectiveness and negotiation skills was developed and is mandatory for all the technical staff in the large corporate taxpayers' segment. And, although co-operation is the basic principle an escalation model is always discussed.

## **Monitoring and evaluation**

In 2007 the first part of the pilot was evaluated. A questionnaire was sent to the tax departments of the companies in question and to the staff of the Tax Administration involved. The results are very positive and encourage the Netherlands to move forward along this road. Some of the large corporate taxpayers even mentioned in their public annual accounts the conclusion of a supervision agreement. The results of the evaluation were sent to Parliament in April 2007.

## **Tax advisers (role and response)**

Their first reactions were rather sceptical. Over time this has changed into approval. The role of the tax adviser is still to advise their clients but their work is also shifting to working in real time on current issues. Furthermore we see that tax advisers are developing a business in the tax compliance and tax assurance market.



## **Future**

In 2008 the Netherlands want to make a major step ahead. The form and intensity of supervision of the large corporate taxpayers will be based on the quality of their tax control framework and their level of compliance. In 2008 they aim to have gained a clear insight into the quality of the tax control framework for 60% of the large corporate taxpayers. Our basic values will be trust, transparency and understanding.

This new direction is aimed at more co-operation, less regulations and working in real time.

## **EXAMPLE OF A SUPERVISION AGREEMENT**

### **Preamble**

Parties aim at realising effective and efficient working procedures based on transparency, understanding and trust. They aim at getting lasting insight into current tax risks and at swiftly determining up-to-date standpoints within legal, regulatory and case-law in order to increase legal certainty. This agreement contains the basic principles and the way in which we wish to deal with each other, both with regard to the future and settling the past.

### **1. Basic principles**

- ◆ This agreement concerns Dutch taxation of X (hereafter: X) with regard to all taxes and the tax collection;
- ◆ Legal and regulatory rights and obligations remain applicable without any restrictions;
- ◆ Parties express their intention to base their mutual relationship on transparency, understanding and trust.

### **2. Agreements between the Tax Administration and X**

- (a) With regard to the past:
- (b) With regard to the future:

X:

- ◆ shall actively notify the Tax Administration of any issues with a possible and significant tax risk;
- ◆ shall without any restraint and without any conditions notify the Tax Administration of any relevant facts and circumstances;

- ◆ shall provide the Tax Administration with its view on the legal consequences pertaining to the facts and circumstances and adopted standpoints;
- ◆ shall facilitate that, if required, staff of the Tax Administration may contact staff of the large enterprise of the Tax Administration's choice. The presence of the tax consultant and/or person dealing with tax matters of the large enterprise during the meeting shall not meet with any resistance;
- ◆ shall provide requested information forthwith and as complete as possible;
- ◆ shall submit a tax return concerning an expired period as soon as possible after expiry of that period.

**The Tax Administration:**

- ◆ shall as soon as possible after having been notified of an adopted or to be adopted standpoint state its views concerning any legal consequences, as much as possible in consultation with X;
- ◆ shall when stating its views on the legal consequences take into account real commercial deadlines; if necessary, the procedure shall be expedited;
- ◆ shall assess the corporate tax assessment as soon as possible after submission of the return and as much as possible in consultation with X;
- ◆ shall discuss any fiscal risks it may perceive at (regular) intervals with X;
- ◆ shall provide information at hand on reported tax risks so far as the requirements for confidentiality allow
- ◆ shall and is able to clarify and explain at all times why certain information is requested from X; the time within which a response is required shall be determined in mutual consultation;
- ◆ shall at all times when starting an audit specifically state which tax risks are investigated, unless prevented by the obligation to observe confidentiality.

**3. Duration, regular evaluation and termination**

This agreement shall be evaluated annually by (the management board of) X and the Tax Administration/Office.

If, in the interim, a party objects to this agreement, parties will confer in order to determine the possibilities for adapting the agreement before taking any steps to terminate this agreement.

Both parties may terminate this agreement with immediate effect. However, they shall not do so before having notified the other party of their intention in writing, stating the reasons of their intention. Besides, termination shall not become effective until oral discussion has taken place if at least one of the parties has expressed the wish to that purpose.

#### **4. Entry into force**

This agreement shall enter into force upon signing of both parties.

For the management board of X                      For the Tax Administration

## **2. HORIZONTAL MONITORING<sup>2</sup>**

The Tax Administration intends to continue with horizontal monitoring: to conclude enforcement covenants with large companies and branch organisations and their members. It is of the opinion that the majority of people, businesses and institutions can and wish to be socially responsible. By making a sharp distinction between high risk and less risky businesses and genuine businesses, leaving certain supervision tasks to other parties, there is scope in the organisation's own supervision activities for tackling those who do not adhere to the rules very closely. Horizontal monitoring thus becomes an effective supplement to traditional, vertical supervision, whereby the government checks that the rules are correctly followed, from top down.

In 2007, the pilot on covenants in the very large business segment is being evaluated. Around forty companies, many listed on the stock exchange, are taking part. An individual enforcement covenant has since been concluded with some of them. This approach attempts to increase legal certainty for the businesses. And, with the trust shown by the Tax Administration, avoiding constructions that would normally be dealt with in vertical supervision. The approach is in line with international developments relating to financial reporting that are geared to increasing and compelling transparency. By taking this approach, the Tax Administration intends to positively contribute to creating an attractive (fiscal) climate.

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<sup>2</sup> Source: the NTCA Business Plan 2007-2011

In the (extremely) large businesses segment there are clear opportunities for horizontal monitoring. The Tax Administration intends to step up its partnership with this specific target group by intensifying consultations. Here, the pivotal issue is how the Tax Administration and businesses will work together as two professional bodies. The goal is to base the relationship on transparency, understanding and trust. The intention is that both parties will continue to have a clear idea of the current risks and be abreast of each other's standpoints. Bottlenecks in implementation and the effects of new legislation are the subject of dialogue, too.

Based on a number of pilot projects, we are researching the extent to which the concept of horizontal monitoring also has added value for the SME segment. Research is being done with branch organisations to ascertain whether branch-specific bottlenecks can be resolved on the basis of a covenant to be concluded with the branch. This contains agreements on the way to jointly chart fiscal bottlenecks within the branch thereby resolving them in advance wherever possible. Agreements on the way in which this can be tackled in tandem, and the supervision this involves, are also dealt with. A specific action point is collaboration with intermediaries (accountants and consultants). Research is being done to see if generic agreements can be made with them on the content and quality of their activities so that taxpayers can be offered certainty more rapidly. This may involve types of certification.

Collaboration with intermediaries is being stepped up, based on the conviction that it is better to prevent risks than deal with them later. The Tax Administration is in favour of preventive generic supervision by consulting with intermediaries beforehand on the products intermediaries wish to place on the market. Such as financial services with fiscal aspects like mortgages, annuities and pensions. But there are also consultations on bookkeeping programmes and cash applications that must be fraud-secure, and on offering administrative and bookkeeping services. Fiscally acceptable generic products and services contribute to reducing repressive individual supervision and, with this, to reducing the administrative the burden for businesses.

### **3. STRUCTURED FINANCE AND COMPLIANCE**

#### **Structured Finance approach**

##### **Introduction**

“Complexity does not necessarily indicate tax abuse; nor does the use of SPVs. However, some aggressive arrangements are designed to obscure the real economics of the transaction.”<sup>3</sup>

Structured finance, in principle, relates to the architecture of commercially genuine transactions. This contribution describes the structured finance form that has as its object the generation of a tax benefit somewhere in the world. This can include the architecture of commercially genuine transactions as well as the creation of “non substance transactions”.

As of the early nineties the Netherlands Tax and Customs Administration has been assessing structured transactions of financial institutions together with national and foreign parties in the context of preliminary talks. Around 2005 it became clear that this long-standing market practice had evolved into outcomes that are undesirable and uncontrollable for the Netherlands tax administration. This conclusion led to a tax technical reassessment of the positions taken so far. This reassessment led to a discussion with representatives of a number of important players in the Netherlands structured finance market. These important players didn't have an overwhelming desire to accept our positions. It was agreed, however, to gain experience with the assessment of new transactions along the lines of the discussion and to share these experiences at some point.

In the present context it is emphasized that the banks in general contributed transparently and without restraint to the assessment of the transactions presented. However, the goal of structuring transactions as such is to achieve a fiscal qualification that deviates from the economic reality. At a more abstract level it can be concluded that we were also presented (in all openness) with structures aimed at obscuring the absence of any economic reality. The banks protect their structures out of a strictly legal reality.

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<sup>3</sup> OECD-report “Study into the role of tax intermediaries”

The presented structures were dealt with in a co-ordinated manner. This co-ordination led to a highly improved understanding of the nature and the extent of the transactions and their architecture. It was concluded that most structures consist of similar elements. Positions on the one structure therefore also apply on the others. The co-ordinated approach also led to a perception of the erosion of the Dutch tax assessment base as a result of the structured finance transactions in the financial market.

Many of the assessed transactions boar upon variants of the *sale and repurchase agreement*, in short repo. In this regard it needs to be noted that many of the variants were so-called *Dutch paid repos*. In these cases the assessment base erosion at the lending bank is compensated by the growth of the base within Issuer BV, the collateral for repo transactions. In case of most transactions the assistance from Dutch banks appears to be provided under the condition that the Dutch levy upon the Issuer BV's base must be certain.

### **New approach**

Structured finance transactions consist of mutually coherent legal acts. The approach advocated in the discussions implies that the tax handling of these transactions is geared to the economic reality of the total of these legal acts. In this assessment large significance is attached to the core activity of the traditional banking business: the borrowing and on-lending of money<sup>4</sup>.

Taxing the real economics of the transaction creates the necessity for compulsory analysis of the substance of the transaction. Assuming that the core of the banking business is the borrowing and on-lending of money, it is obvious that the fiscal assessment of structured finance transactions is reduced to that core, where possible. The substance of almost any transaction assessed in 2007 regarded the granting of loans. We did not observe any structure that in fact included more than a bad debt risk<sup>5</sup>. In commercial annual reports such transactions are also included as debts. It is therefore obvious that the final result from the transaction will be regarded as interest on a loan.

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<sup>4</sup> *Starting point is the description of the banking business as included in the OECD report on attribution of profits to permanent establishments (December 2006)*

<sup>5</sup> *Very often the transactions concerned are processed commercially as debts and fiscally re-qualified by the tax payers as participation. The approach we advocate actually is rectification of a re-qualification rather than requalification.*

Expectations are that, within the foreseeable future, a number of structured finance transactions will be submitted to a court for assessment. At present, there is only little case law available in the Netherlands on the processing of similar structured finance transactions. However, there are indications that where structured transactions are involved the Dutch Court seeks to tax the “real economics of the transaction”. It appears that the Court of Justice of the European Communities might also be prepared to re-qualify structured transactions according to the real economics of the transaction<sup>6</sup>.

### **Basic forms**

Many of the structured finance transactions assessed in 2007 focused on transformation of taxed interest in untaxed participation results. We also observed transactions aiming at the use of accumulated losses of other taxpayers through hybrid financing instruments and special purpose vehicles (so-called tax base lending). Plus, we observed tax base lending transactions for optimisation of settlements of taxes on unearned income abroad of the bank itself or of the bank’s clients.

The most distinctive elements of the presented structures were:

- 3.1 repos and repo-lookalikes
- 3.2 tax base lending

### **3.1 Repos and repo-lookalikes**

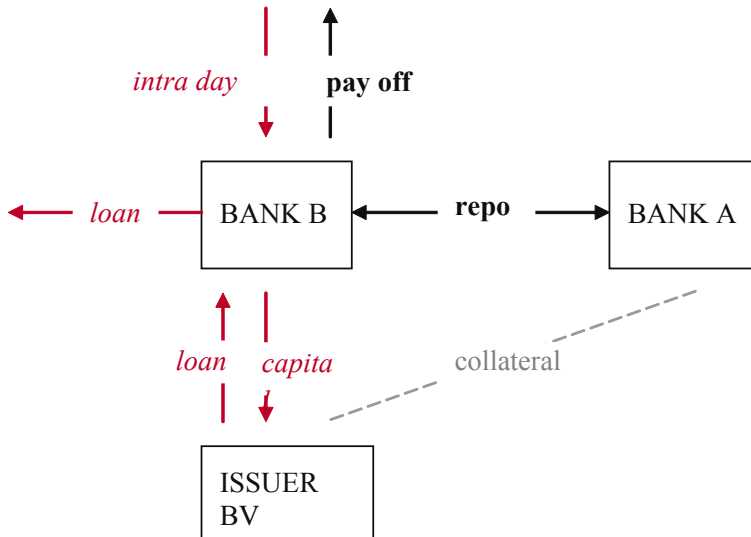
We observed a wide range of transactions based on (variants of) the repo. Repo is the common abbreviation for “sale and repurchase agreement”. A repo can be explained briefly as the selling of shares by party A to party B and agreeing upon the repurchase or resale of the shares at a given date at a given price. In fact, a repo is an interest bearing loan with shares as collateral. The difference between sale and repurchase price (the “repo rate” or “price differential”) indicates the interest agreed on by both parties.

A repo transaction is economically similar to a secured loan and is not substantially different from for instance a mortgage debt. A repo can, just like any other form of financing, be contracted in order to fund an extension of the activities of the borrower or to refinance the business activities of the borrower.

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<sup>6</sup> EC Court of Appeal, case C-255/02, published under Number 2006/C 131/01 (Halifax).

Below you will find a diagram representation of the money flows at the conclusion of a repo-transaction agreement aimed at the extension of the business activities of Bank B. The flow of funds from Bank A is indicated in black (**bold**); they are used by Bank B to pay back its intra day funding. The money flow that is needed to create Issuer BV is indicated in red (*italic*).



Bank B has a double interest burden. One interest burden because of the loan of Issuer BV and one interest burden because of the difference between the sales proceeds and the repurchase price (the repo-rate). The Netherlands Tax and Customs Administration only sees one loan transaction and therefore in principle wishes to consider just one interest income within the Dutch base.

The position that was taken in the past implied that the base of Issuer BV was taxed. For Bank A the proceeds of the resale of the shares to Bank B remained free of tax on the basis of the participation exemption.

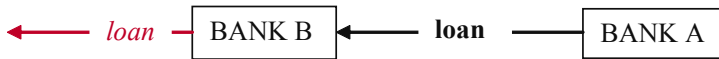
The economic reality of a repo-transaction is that of an interest bearing loan with the shares in Issuer BV as a security<sup>7</sup>. If we eliminate the

<sup>7</sup> In view of the assets of Issuer BV (i.e. Bank B's debts) Issuer BV for that matter is a fairly artificial security for Bank A's receivables from Bank B.



money flows that outweigh each other, this will result in the following picture: Bank A lends Bank B money with which Bank B then funds its business. This is the logic representation of the “real economics of the transaction”.

Diagram representation:

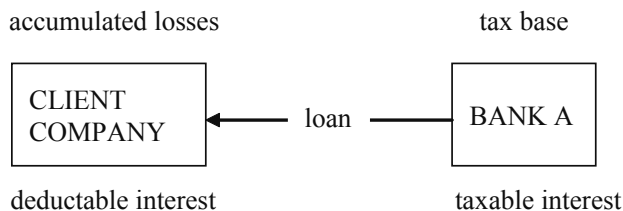


As indicated, a repo-transaction is not materially different from, for instance, a mortgage debt. When granting a mortgage loan, a bank will not include the security right (the property) in the balance sheet but just a debt. We do not see any decisive reasons for accepting the fiscal processing of a repo-transaction other than as a debt with collateral. Bank A therefore receives nothing but taxable interest for a repo-transaction.

### 3.2 Tax base lending

In general, banks have an extensive taxable basis<sup>8</sup>. If a bank grants a loan, the bank receives taxable interest. This interest represents a deductible expense for the debtor. Should this debtor already have considerable accumulated losses, he will not be interested in tax-deductible expenses.

Diagram representation:



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<sup>8</sup> At the time this memorandum was written the consequences of the international credit crisis for the tax base of financial institutions and their role in the structured finance market could not be assessed yet .

Bank and debtor then have a common interest to conclude a loan agreement transforming the interest in non taxable or non deductible dividend, respectively<sup>9</sup>.

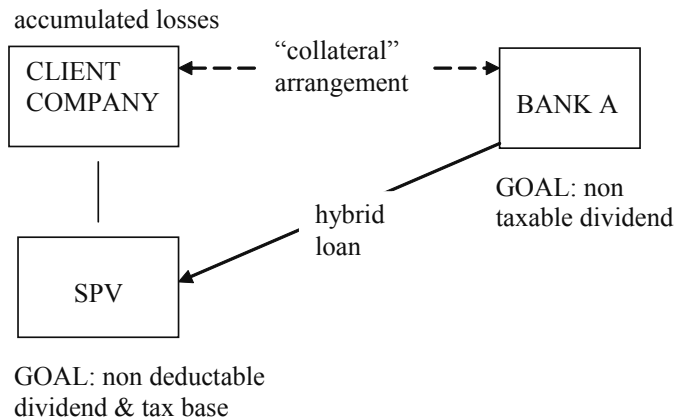
On the basis of case law a loan can in the Netherlands be fiscally handled as capital provided that three cumulative requirements are met. In that case the compensation might be regarded as non taxable or non deductible dividend, respectively:

The requirements are:

- the loan term shall be more than 50 years;
- the lender (the bank) must be subordinated to all other creditors;
- the compensation shall be profit-dependent.

A loan that meets the three requirements will, under normal circumstances, never be granted by a bank. The fact of the matter is that these kind of conditions will not be agreed with debtors. Such conditions may, however, be agreed upon in a structured environment. For that purpose the Client Company sets up a special purpose vehicle (SPV) that raises the loan with the bank. In the relationship between the SPV and the bank the above conditions may be agreed upon. Through the SPV a tax base is thus created which under the Dutch regulations can be weighed against the Client Company's losses. Bank A and Client Company subsequently make agreements on all securities required by Bank A for the conclusion of a loan agreement.

Diagram representation:



<sup>9</sup> Similar structures were instituted to optimise the possibilities of balancing taxes on un-earned income abroad, both for the clients and for the bank itself.

In a loan agreement with an SPV in principle everything can be agreed on, for instance subordination to all other creditors of the SPV (who will not exist), the loan term of more than 50 years (deviating from the intent of Client Company and Bank A) and profit dependency (in fact, the interest that Client Company owes Bank A).

In line with the assessment of the repos the Netherlands Tax and Customs Administration has taken the position that the relationship between Client Company and Bank A is determined by the whole that is agreed upon between these parties. As a matter of fact, the features of the hybrid loan are therefore also typified by what is agreed between Client Company and Bank A. The compensation that Client Company pays Bank A is regarded by both parties as interest and not as dividend.

### **CONCLUSION**

For the fiscal interpretation of structured finance transactions the Netherlands Tax and Customs Administration wishes to embrace the real economics of the transaction. In that context, knowledge of the banking industry is at least as important as the fiscal analysis of the different elements of structured finance transactions.

## **THE CONTROL OF ELECTRONIC COMMERCE**

**David Holmes**

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(OECD)

*CONTENTS: Introduction. -1. Electronic commerce. -2. Development of OECD guidelines. -3. Value added taxes. -4. Direct taxes and tax treaties. -5. Trends in taxpayer service delivery using new technologies -6. Electronic commerce -Threat or opportunity?. -7. Conclusion. -8. Annex*

### **INTRODUCTION**

This paper reviews the rapid rise of electronic commerce and the related tax issues. It recalls the OECD's work with business and non-OECD economies in order to ensure that early predictions of significant revenue losses were not fulfilled. Following on from the development of the OECD's 1998 Ottawa Taxation Framework Conditions for electronic commerce it looks at how OECD work on consumption taxes led to developments in the EU that enables a levelling of the playing field for European businesses and how the technology itself has been used to raise revenues from Internet trading. The paper also considers the impacts on international taxation and on how tax administrations have been able to use the power of information and communication technologies to provide taxpayers with improved services, thus enabling improved compliance. It concludes that the developments in electronic commerce, allied with the underlying technologies, have provided more opportunities than threats. Further, it notes that business has integrated e-commerce into its mainstream activities meaning that, for tax administration, it is difficult to treat electronic commerce as being distinct from mainstream commerce.

### **1. ELECTRONIC COMMERCE**

As information and communication technologies developed rapidly in the early 1990s so the expression, "electronic commerce" began to emerge. The development of the Internet, originally seen as a tool

primarily for military and academic purposes, was quickly recognised as a potential tool for commercial exploitation. By 1996 concerns were beginning to be raised in finance ministries, particularly in more developed countries, that this new phenomenon of international trading might expose tax revenues to excessive risk. A headline in the Financial Times in 1997 quoted one expert as forecasting that “billions” of tax revenues would be lost in cyberspace. In the light of such alarmist talk the OECD quickly formed working groups to look at the potential threats and to consider ways in which these challenges might be successfully met.

Before going on to consider these challenges, and their reactions, in more depth, it is helpful to try and define, for taxation purposes only, what is meant by “electronic commerce”. It also might be useful to bear in mind that at that time a small company in the north-west of the United States, Amazon, was only just beginning to be established as an Internet retailer whilst other names such as “eBay” and “You Tube” were unknown. Therefore, there was no readily available agreed definition of “electronic commerce” and what follows is very much a description of electronic commerce as we know it today.

The Internet is the primary vehicle for e-commerce although inevitably developments in mobile telephony also contribute. Its growth continues apace –see Annex 1 for developments in four OECD countries in recent years. For the purposes of this paper, I shall focus on the Internet as that is by far the biggest e-commerce medium. Any Internet user will be familiar with websites that offer products for sale. What is less clear is the distinction between such sites and the equivalent of “catalogue” (or mail-order) companies. Ordering from a catalogue entails reading through the catalogue, selecting purchases, completing the order form and sending it through the mail together with a cheque or credit card number. The goods are then despatched by the mail order company and delivered through a carrier. Compare this with an Internet site, such as Amazon, that offers an electronic catalogue, together with a “shopping basket” (equivalent to an order form). In order to complete the order it is necessary to complete the electronic order form (although through the use of cookies this may be pre-filled, including the credit card details) and click a button to complete the order. The goods are then shipped by the on-line retailer to the delivery address using a carrier.

Therefore, the question arises as to how far this is different from the mail order model. The goods are still delivered physically and the buyer’s credit card account is debited in much the same way. The main difference lies in the ordering process; but viewed objectively

there is little difference between the Internet model and that of the mail order model. Thus the question arises – is this electronic commerce?

Similarly take the example of purchasing travel tickets on-line. How different is this from ordering by telephone or through a travel agent? The actual service being purchased is the flight or the rail journey. All that the Internet provides is a means of ordering tickets in a way that many people prefer. Even Microsoft have yet to find a way of flying from Paris to Guatemala through Internet wiring! So again - is this e-commerce?

The answer that most people would give to these questions would probably be yes. A good website enables the ordering and payment process to be relatively simple and convenient. It often empowers choice and therefore the buyer feels in greater control, particularly as the vast array of websites means that price comparisons are made much easier.

But to what extent is this e-commerce in the tax world – and to what extent does this provide a risk to tax administrations?

## **2. DEVELOPMENT OF OECD GUIDELINES**

The OECD reacted as early as 1996 to developments in e-commerce. This reaction covered both income taxes and consumption taxes, particularly value added taxes as these appeared at first sight to be the most vulnerable as the Internet allowed for much easier cross-border trading. This cross-border element meant that no one government could tackle the issues alone; the response had to be international and the OECD's long experience in global tax matters made it the most obvious organisation to tackle this emerging priority. However, it recognised that it was dealing with a global phenomenon so it also worked with non-OECD countries, often through organisations such as CIAT, IOTA, CATA and CREDAF. The Organisation worked closely with business as it was also clear to our governments that there was much to learn about the technology, emerging business models and the potential for future developments.

A major conference was held in Finland towards the end of 1997 at which representatives from governments and business met to discuss the issues. As a result of this, and other, meetings a major OECD Ministerial Conference on the broad set of issues raised by e-commerce and information and communication technologies took place in Ottawa in 1998. This was attended by the 30 OECD member countries, nine non-OECD countries as well as tax organisations such

as CIAT, CREDAF, IOTA and CATA. Taxation was a significant issue for this event and one of the major outputs from the conference was as a result the OECD Ottawa Taxation Framework Conditions (see Annex 2).

These Framework Conditions set out principles to apply to taxation of e-commerce:

- Neutrality
- Efficiency
- Certainty and Simplicity
- Effectiveness and fairness
- Flexibility

The OECD's Committee on Fiscal Affairs (CFA) drew the following conclusions from these principles, as reflected in the taxation Framework Conditions;

- Taxation principles that guide governments in relation to conventional commerce should also guide them in relation to e-commerce.
- Existing taxation rules can implement these principles although this does not preclude new administrative or legislative measures, or changes to existing measures provided that these are not intended to impose a discriminatory tax treatment of e-commerce transactions.
- Fiscal sovereignty of countries should be maintained in order to achieve a fair sharing of the tax base, to avoid double taxation and to avoid erosion of the tax base.
- Successful implementation of these principles would require an on-going dialogue with business and an engagement with non-member economies.
- For consumption taxes such as value added taxes the core elements of the taxation Framework Conditions were developed as follows:
  - Taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place.
  - The supply of digitised products should not be treated as a supply of goods.
  - The use of the reverse charge should be examined for business-to-business supplies of services and intangible property.
  - Appropriate systems should be developed to ensure that such revenue collection systems do not impede the delivery of products to consumers and that revenue collection is not unduly impeded.

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### 3. VALUE ADDED TAXES

Subsequent work by the Committee on Fiscal Affairs led to the publication in 2001 of Guidelines on the Definition of the Place of Consumption (reproduced at Annex 3). These Guidelines essentially led to taxation of business-to-consumer supplies being subject to the rules of the jurisdiction in which the customer has his usual residence. For business-to-business supplies the place of taxation would be the jurisdiction in which the recipient has located its business presence.

#### **Practical Application of Guidelines**

##### ***Physical Goods***

As noted above, the Internet is used primarily as an ordering and payment mechanism for the purchase of physical goods. Thus if a customer in Argentina wishes to buy a book or a CD from an on-line retailer based in Spain the order can be placed on-line along with the payment by credit card. The vendor in Spain will then despatch the goods to the customer to the customer's address in Argentina using a carrier service. Under the Taxation Framework Conditions, this is an import of physical goods and so will be liable to tax in Argentina. As these are physical goods they will have to pass through Customs controls, at which point the revenue can be assessed. This revenue may, of course, include both customs duties and value added tax. In many countries the goods will be despatched from Customs to the customer with the carrier – which may be the postal authorities – and delivered only upon payment of the necessary revenue.

Many countries employ a *de minimis* value of the goods below which they do not enforce revenue collection, given that the amounts are too small to justify the administrative resources required to collect.

Assuming that the vendor has made a valid and accurate description of the goods on the customs documentation affixed to the package there would appear to be little concerns for revenue bodies. The goods cannot be released to the customer until such time as the revenue required has been paid; failure to pay the revenue results in non-delivery of the goods to the customer. Thus the revenue body is in a strong position to control the importation of physical goods ordered through e-commerce mechanisms.

Problems over the control of e-commerce trade in goods may arise in customs unions where a number of countries come together to form a single customs union with no customs frontiers between those



individual countries. Under such an arrangement the absence of customs controls at the borders will make collection of revenue that more difficult. Within the European Union (EU) a system of “distance selling” is in place to counter this situation. Under this arrangement a company based in an EU Member State supplying goods to consumers in another Member State is required to register for VAT in that second country if sales of goods to consumers exceeds a certain threshold. However, enforcing this arrangement is fraught with difficulties as the country requiring the registration (and thus the tax) has no legal jurisdictional power over a company in another Member State. Further, the “home” Member State tax administration is unlikely to be too concerned if one of its companies is abiding by its domestic legislation but not adhering to requirements outside the jurisdiction. One way of breaking out of this would be multilateral agreements that allow for assistance in tax collection, such as that provided for in the Joint OECD/Council of Europe Multilateral Assistance Convention, but this would still require significant administrative resources.

### ***On-line Auctions***

The growth of on-line auctions, such as e-bay, has allowed many people to set up small businesses under which they sell goods through internet auction sites. Again, this model should not give tax administrations too much cause for concern as far as cross-border trading is concerned because the customs model described above will still capture revenue at importation. However, there may well be problems as a result of many small businesses operating within these sites failing to notify the tax administration once they have reached, or expect to reach, the relevant threshold that would require registration for VAT and subsequent collection of taxes from sales made. These sites therefore do lend themselves to be part of the “hidden economy” although examination of the content of sites may help administrators identify possible registrants. Most sites keep, and publish, records of the number of sales made by vendors (usually to demonstrate the reliability and honesty of vendors insofar as supplying goods as described and within quick timescales) and whilst these details may not include values any vendor with a high number of sales may be worthy of further investigation. In many countries, data protection laws may prevent the tax administration from obtaining vendor details directly from on-line auction sites; and, of course, the site may be located in another jurisdiction to which the tax administration has no access.

It is unlikely that revenue losses from on-line auctions are currently high but as the popularity of trading in this way grows they may present greater problems in the future.

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***Intangible Property***

Within the world of e-commerce perhaps the major innovation as far as consumers are concerned has been the ability to download items such as music, film and software. It is here that the real taxation issues arise insofar as e-commerce is concerned. Again, however, the problem is primarily one in the business-to-consumer areas rather than business-to-business. For the latter, the application of the reverse charge, as recommended in the Ottawa Taxation Framework Conditions, allows the “exporting” supplier to sell without the addition of any VAT (as in an export of goods). At the same time the “importing” customer is required to apply the reverse charge through declaring the purchase on its VAT return and applying the local VAT rate as output tax. It can, of course, subject to national tax rules, also deduct this as input tax. The fact that the tax administration in the country of taxation has jurisdictional power over the taxpayer helps ensure the application of VAT to business-to-business e-commerce.

The situation for business-to-consumer e-commerce in supplies of digital products is less simple and has been the principle cause for concern for governments. The great weakness for governments is the absence of a customs barrier in cyber-space. It is a relatively simple and common task to purchase a digital product over the Internet from one country and have it delivered to a computer in another country. Music and software (such as anti-virus software) are commonly supplied in this way and recent industry developments strongly suggest that film will follow suit in the near future.

Under the Ottawa Taxation Framework Conditions and the 2001 OECD report on implementing these, the place of taxation is the jurisdiction in which the customer has usual residence. The EU’s legislation prior to 2002 allowed for the place of supply (and thus taxation) to be the country in which the supplier was established. Therefore a supply of software from an EU-based business to a customer resident in, say, Brazil would have been subject to the VAT rate of the EU Member State. Bearing in mind that the United States does not have a VAT this put EU companies at a significant advantage. This was compounded by the effects of this legislation which ensured that a supply of a digital product from the US to an EU country would result, under the EU’s laws, in taxation in the US. In other words imports were free of tax whilst exports were taxed – the exact opposite of the normal rules of a destination VAT and highly distortive in terms of competition.

The EU therefore undertook to amend its legislation in line with the Taxation Framework Conditions so that exports of digitised products

(“electronic services” in the language of the legislation) were “zero-rated” and imports were made liable to VAT according to the rate in the country where the customer was resident.

The absence of customs barriers to such products immediately begged the question as to how this VAT would be collected. A company outside the EU and with no establishment in the EU was beyond the reach of EU tax administrations. The answer was found in the OECD’s work on the Consumption Tax Guidelines, issued in 2001. Working closely with business and non-OECD economies, the OECD recommended that in order to encourage compliance in these circumstances the processes of registration, filing returns and making payments should be automated through using the Internet technology that gave rise to the problem.

Under this scheme, businesses outside the EU can select an EU Member State in which to register. They are then required to account for VAT according to the Member State in which their customers are resident. Therefore, a business based in Brazil may opt to register in Portugal but it is required to account for French VAT when a customer is resident in France and for Swedish VAT when the customer is a resident of Sweden. The supplier then completes a VAT return detailing the amounts of VAT due in each country and submits one return and payment to the Portuguese administration using an electronic portal. The Portuguese authorities are then responsible for ensuring that each Member State receives the VAT due according to the return.

It should be borne in mind that the change to EU legislation was primarily to level the playing field for EU e-commerce businesses, removing the competitive distortion that the old legislation created. A by-product of this legislative move to a destination system is the requirement for non-EU businesses to register and account for sales into the EU but the amounts of revenue are not that great when compared to total VAT revenues. This should not be surprising as trade in business-to-consumer e-services is still relatively very low compared with other forms of commerce. Therefore, it can be seen that this was not so much a revenue-raising move by EU legislators but primarily one to address competition issues.

Given that there is an element of revenue-raising involved in this arrangement the obvious question is how successful has this been in capturing revenue. Under the legislation adopted by the EU countries, any internal business-to-consumer trade is liable to tax in the Member State of the supplier. Therefore, there is an advantage to be established (and registered) in a low-tax State. Currently the Member State with the

lowest standard rate is Luxembourg (15%). This is why several of the larger non-EU companies have established in Luxembourg as it allows them to sell their products throughout the EU at the lowest rate. This option of establishing within the EU may well be attractive to the larger companies in e-commerce whilst it is likely that smaller businesses wishing to comply will adopt the special e-scheme described above.

The reality must be, however, that a large number of businesses – primarily small and medium-sized enterprises - outside the EU who should register have not done so. This may be through ignorance of the requirement (not unreasonable for small businesses) or through an approach of accepting that they are beyond the jurisdictional reach of EU administrators. Nevertheless the number of registrations that have been enacted (over 1000) and the revenue being collected between €150 and €200 million) does suggest that there is a reasonable degree of compliance, given the issues of jurisdictional powers.

#### **4. DIRECT TAXES AND TAX TREATIES**

In the tax treaty area (excluding transfer pricing), the OECD dealt with four different issues that had been identified as issues that could arise from e-commerce:

- Can a web site or a server be a permanent establishment?
- What is the treaty characterization of various e-commerce payments?
- Are the current treaty rules for taxing business profits appropriate for e-commerce?
- Does the treaty concept of place of effective management need to be revised or changed?

Can a web site or a server be a permanent establishment?

The first treaty issue that was dealt with was the clarification of the application of the treaty definition of permanent establishment in relation to e-commerce.

A discussion draft on this subject was released by Working Party 1 in October 1999. Comments received from the public were discussed and a revised draft was released on 3 March 2000. Based on the additional comments received, Working Party 1 finalised its discussions in September 2000 and the Committee on Fiscal Affairs adopted consequential changes to the OECD Model in December 2000.

These changes were incorporated in paragraphs 42.1 to 42.10 of the commentary on article 5, which were included in the OECD Model Tax Convention in 2003.

The changes do not deal with allocation of profit issues nor with whether the existing treaty rules should be changed (that last question was to be addressed separately; see below). The main conclusions reflected in the changes are:

- A web site alone cannot be a permanent establishment;
- Hosting of a web site by an Internet Service provider does not constitute a Permanent Establishment since the server is not “at the disposal” of the enterprise that owns the web site;
- The place where a server is operated can, in some limited circumstances, constitute a permanent establishment. It should be noted, however, that it is unlikely that much tax revenue will depend on the issue. The reality is that if a taxpayer does not want a permanent establishment, it is relatively easy to move the server or move some of the functions of the server. If the taxpayer does, however, want a permanent establishment, a similar result can be achieved by setting up a subsidiary that will own and operate the server.

### **What is the treaty characterization of various e-commerce payments?**

A Technical Advisory Group (TAG) on Treaty Characterization of E-Commerce Payments was set up in 1999 with the general mandate to examine the following issues:

- What are the treaty characterisation issues that arise from electronic commerce?
- How should these issues be solved?
- What clarifications should be made?

The Group was composed of representatives of OECD countries, non-OECD countries, business and academics.

The Treaty Characterisation TAG issued two drafts for comments in March 2000 and its final report was presented in February 2001. A slightly amended version of the report was subsequently adopted by the OECD Committee on Fiscal Affairs and its conclusions were incorporated in the 2003 update.

The report deals with the following treaty characterisation issues in relation to a broad range of payments that can be made in relation to e-commerce:

- Business profits or copyright royalties
- Business profits or know-how
- Business profits or rental payments
- Provision of services and transfer of property
- Whether payments qualify as technical fees
- Treatment of mixed payments

By way of illustration, the report included a list of specific transactions to which its conclusions were applied. One conclusion of the report is that most downloads of digital products made for the purpose of using the product itself should be characterised as business profits. However, there may be exceptions, such as downloads that give the customer the right to exploit or to display the copyrighted product, downloads of technical information and similar items. Although not all the countries agreed with this conclusion, it represented a broad international consensus.

Are the current treaty rules for taxing business profits appropriate for e-commerce?

A Technical Advisory Group (TAG) on Monitoring the Application of Existing Treaty Norms for Taxing Business Profits was set up in January 1999, with the general mandate to “examine how the current treaty rules for the taxation of business profits apply in the context of electronic commerce and examine proposals for alternative rules”. The Group was composed of representatives of OECD countries, non-OECD countries, business and academics.

The process followed by the Business Profits TAG was as follows:

- To consider how the current treaty rules for the taxation of business profits applied in the context of electronic commerce. This led the TAG to analyse new business models that emerged as a consequence of IT developments.
- To consider the pros and cons of applying the existing treaty rules taking into account anticipated developments in electronic commerce.
- To develop a set of criteria to facilitate the evaluation of existing treaty rules in the context of electronic commerce.
- To assess whether and, if so, how the current treaty rules should be clarified in the light of electronic commerce.

The TAG final report examined in detail the pros and cons of a number of possible alternatives and amendments to the existing rules. The overall conclusion of the TAG was that there was no immediate need

to change the existing treaty rules. The TAG noted, however, that it would be important to continue to monitor the effect of the new business models on tax revenues and that the interpretation and application of the some of the existing rules should be clarified.

Does the treaty concept of place of effective management need to be revised or changed?

As part of its work, the Technical Advisory Group on Monitoring the Application of Existing Treaty Norms for the Taxation of Business Profits also examined the treaty concept of place of effective management to see whether it needed to be revised or changed in light of IT that allows management functions to take place simultaneously in different places.

In 2001, the TAG released for comments a first discussion draft entitled "The impact of the Communications Revolution on the Application of 'Place of Effective Management' as a Tie Breaker Rule". The TAG subsequently examined the comments received on that draft and concluded that they supported the alternative options of providing clarification of the place of effective management concept as a tie-breaker rule and developing a hierarchy of different approaches (which could be based on factors similar to those used as a tie-breaker for individuals) that would constitute a new tie-breaker rule.

The TAG accordingly released, in 2003, another discussion draft entitled "Place of effective management concept: suggestions for changes to the OECD Model Tax Convention". The TAG also recommended to the OECD to examine the various alternative proposals discussed in that draft in light of the comments to be received with a view to decide whether and how the OECD Model Tax Convention should be amended. With that recommendation, the TAG concluded its work on this issue.

## **5. TRENDS IN TAXPAYER SERVICE DELIVERY USING NEW TECHNOLOGIES**

The Ottawa Taxation Framework Conditions also noted that there was an opportunity for tax administrations to use news technologies to improve services to taxpayers. In 2005 the OECD's Forum on Tax Administration published a report on how member countries were using these technologies to improve such services. The key findings in this report were as follows:

- There was substantial progress since 2000 in the *scope and*

*nature* of electronic services offered to taxpayers and their agents by virtually all national revenue bodies in OECD countries.

- Notwithstanding this progress, considerable potential existed for many national revenue bodies to increase substantially the take-up rates for the various services offered, especially by businesses.
- Substantial progress was made in the use of electronic filing by taxpayers and their agents for *personal income tax administration* purposes; indicative of this progress is the fact that in 2003, the take-up rate for these services exceeded 50% in five revenue authorities, with four achieving 80% or more (3 without mandatory requirements); progress in other areas (e.g. *VAT, corporate income tax*), largely covering businesses, is considerably less advanced, although a small number of countries have demonstrated that very high overall take-up rates (i.e. over 50%) can be achieved.
- The Internet has become a significant tool for the delivery of services to taxpayers; generally speaking, revenue bodies have substantially increased the information content, functionality, and “user-friendliness” of their websites since the last survey; over half of the revenue authorities in member countries offered transaction services via their Internet sites in 2004.
- Customer segmentation approaches to the delivery of services to taxpayers had become increasingly significant (e.g. website information groupings, dedicated portals, account managers for large taxpayers, specialist inquiry and consultative services for tax professionals) in line with modern management and marketing approaches to service delivery.
- The significant role played by tax professionals in day-to-day tax administration in many countries received increasing recognition; over one half of revenue authorities identified tax professionals as a critical service delivery stakeholder and provided a range of tailored services (e.g. dedicated call centre phone services, dedicated internet portals with transaction capabilities) in recognition of this factor.
- There was considerable growth in the provision of electronic payment facilities; notwithstanding this development, the take-up of these services was slow, most likely due to taxpayers’ concerns around security and fears of fraud.
- There was a clear trend of revenue authorities devoting an increasing share of their administrative budgets to IT investments; however, the survey revealed a substantial variation in the levels of the IT investments across member revenue authorities (from 5-25%), pointing to the need for some authorities to review the extent of their investments in line with prevailing trends.



- There was a substantial increase in the number of revenue bodies using e-mail (either in free or constrained form) for taxpayer interactions (mainly for taxpayers' inquiries); however, reported volumes were generally quite small and survey responses revealed a number of concerns regarding effective management of e-mail services.
- Call centre phone operations, supported by modern phone technology, are becoming an increasingly significant element of the service delivery strategy of many revenue authorities in OECD countries, reflecting drives for increased efficiency and accessibility for taxpayers to the information they require to meet their tax obligations.

In addition to these trends, the use of electronic information from third parties (mainly employers and banks) has led to the development of pre-populated tax returns for personal incomes taxes in a number of OECD countries – and such trends have also been noted in a number of non-OECD countries. This uses the technology to make for a much easier procedure for taxpayers with few, or no, complex tax return issues to complete their tax returns in a couple of clicks.

## **6. ELECTRONIC COMMERCE - THREAT OR OPPORTUNITY?**

When the Ottawa Taxation Framework Conditions were drawn up they acknowledged that whatever actions that were taken to protect tax revenues should not be such that they unduly harmed the development of e-commerce. They also recognised that new technologies had a major role to play in the promotion of tax compliance. To a large extent, the developments in e-commerce have probably been to the advantage of tax administrations. Commercial websites are public and in most cases businesses are likely to be reasonably compliant. In the “hidden economy” where cash plays a significant role, publicity is not sought by those who seek to evade taxes. And the use of accountable payment mechanisms, such as credit cards, makes it more difficult for firms to hide sales.

Websites have also proved to be excellent sources of information for tax auditors. Firms usually provide extensive details of what they do on their site and an auditor can now carry out an audit knowing a lot more about the business than would have been the case pre-Internet. The Internet also contains a huge amount of information about how business sectors work including technical detail that allows for expertise in sectors to be developed within tax administrations. Of course, one of the problems with this information is sorting through what is reliable and what is not. In general tax administrations do not

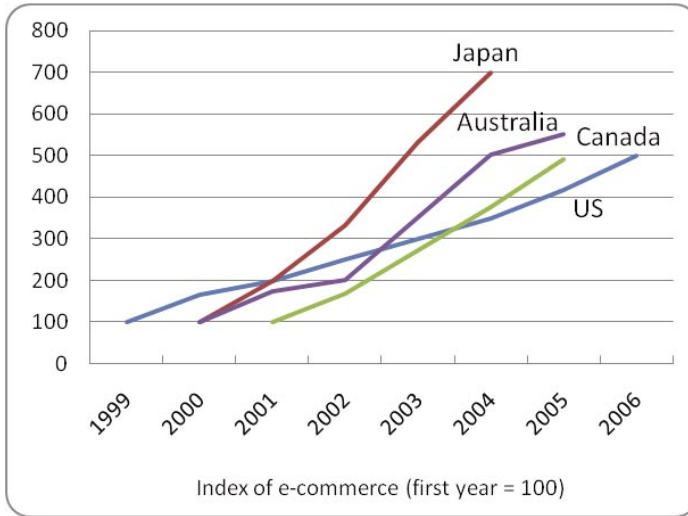
have sufficient resources to have staff reviewing Internet sites all day but some administrations have been successful in profiling business sectors in order to better inform tax auditors as to what they should expect to see in terms of profit margins and performance.

## **7. CONCLUSIONS**

It is almost certainly true that the threats to revenues that were envisaged back in the mid-1990s have failed to materialise. Quick action by the OECD, working closely with the business sectors concerned and with non-OECD countries, has gone a long way to helping. The ways in which the Internet and e-commerce have developed have also helped. In terms of sale volumes, the Internet is dominated by a comparatively small number of very large businesses. These businesses are, in general, compliant and wish to remain on the right side of the law given that public perception of commercial and taxation behaviour is very high.

E-commerce developments are such that at the OECD there is no longer pressure to treat the issue as a stand-alone. Monitoring of developments continues but the reality is that e-commerce is now just another form of doing business. Ten years ago it was the “electronic” in “electronic commerce” that was important. Today the important word is “commerce” because all businesses have, to a greater or lesser degree, integrated the Internet into their business. And in the OECD, we have integrated it into our mainstream work, on both direct and indirect taxes.

**Annex 1 - Growth in e-commerce in four selected OECD countries**



Australian business income from orders received via the Internet, 5 1999-2000 to 2004-05 Percentage of total business income

Canadian business sales conducted over the Internet, 2001-05 Percentage of total business operating revenue

Business-to-consumer electronic commerce in Japan, 1998-2004 Percentage of total B2C sales Quarterly US e-commerce retail sales 4th quarter 1999 to 4th quarter 2006 Percentage of total retail sales

**Annex 2****Centre for Tax Policy and Administration****Consumption Tax Guidance Series**

Electronic Commerce - Ottawa Taxation Framework Conditions

**Ottawa Taxation Framework Conditions****Caveat**

Each Revenue authority faces a varied environment within which they administer their taxation system. Jurisdictions differ in respect of their policy and legislative environment and their administrative practices and culture. As such, a standard approach to tax policy may be neither practical nor desirable in a particular instance. The documents forming the OECD Consumption Tax Guidelines need to be interpreted with this in mind. Care should always be taken when considering a Country's practices to fully appreciate the complex factors that have shaped a particular approach.

**Ottawa Taxation Framework Conditions**

The application of consumption taxes such as Value Added Tax and Goods and Services Tax to electronic commerce presents specific problems for both revenue administrations and for business. The intangible nature of many of the supplies presents challenges in terms of identification of the some of the essential elements necessary to accurately tax the transaction. As e-commerce developed during the 1990s the OECD reacted to suggestions that the very nature of this new way of doing business posed significant threats to tax revenues. Working with business interests a number of principles were distilled and these were welcomed at an OECD Ministerial Conference held in Ottawa in 1998. These principles, known as the *Ottawa Taxation Framework Conditions*, have provided the basis for the OECD's work on taxation and e-commerce. The Ottawa Taxation Framework Conditions are reproduced on the following pages.

## **The Ministerial Report**

### **Preface**

This Report has been prepared by the Committee on Fiscal Affairs of the OECD. The Report has benefited from inputs by the European Commission and the World Customs Organisation in the area of indirect taxes and from an exchange of views with the business community.

## **ELECTRONIC COMMERCE: TAXATION FRAMEWORK CONDITIONS**

A Report by the Committee on Fiscal Affairs

### **I. Introduction**

Electronic commerce has the potential to be one of the great economic developments of the 21st Century. The information and communication technologies which underlie this new way of doing business open up opportunities to improve global quality of life and economic well being. Electronic commerce has the potential to spur growth and employment in industrialised, emerging and developing countries.

Revenue authorities have a role to play in realising this potential. Governments must provide a fiscal climate within which electronic commerce can flourish, weighed against the obligation to operate a fair and predictable taxation system that provides the revenue required to meet the legitimate expectations of citizens for publicly provided services. Striking the right balance between these objectives is the aim of this Report.

### **II. Main Conclusions**

The Committee on Fiscal Affairs (CFA) recognises that the technologies which underlie electronic commerce offer Revenue authorities significant new opportunities to improve taxpayer service and Member countries are committed to exploiting fully these opportunities (see Section III).

The taxation principles which guide governments in relation to conventional commerce should also guide them in relation to electronic commerce. The CFA believes that at this stage of development in the technological and commercial environment, existing taxation rules can implement these principles.

This approach does not preclude new administrative or legislative measures, or changes to existing measures, relating to electronic commerce, provided that those measures are intended to assist in the application of the existing taxation principles, and are not intended to impose a discriminatory tax treatment of electronic commerce transactions.

Any arrangements for the application of these principles to electronic commerce adopted domestically and any adaptation of existing international taxation principles should be structured to maintain the fiscal sovereignty of countries, to achieve a fair sharing of the tax base from electronic commerce between countries and to avoid double taxation and unintentional non taxation (see Section IV). Revenue authorities acting within the OECD or other fora, must take an active role in encouraging protocols and standards for electronic commerce which are compatible with these principles.

The CFA has been able to reach conclusions on conditions for a taxation framework needed to implement these principles (see Section V). Intensified co-operation and consultation with business will be an important part of the process of implementing these principles (see Section VI).

### III. Taxpayer service opportunities

Revenue authorities recognise that electronic commerce technologies will open up new ways by which they can undertake their business of administering tax law and collecting tax revenues and new ways by which they interact with the wider community.

#### **Box 1**

#### **Taxpayer service opportunities offered by new technologies**

##### ***Improving service standards***

- (i) Communications facilities and access to information can be enhanced to assist taxpayers and to improve response times.

##### ***Minimising business compliance costs***

- (ii) Tax registration and filing requirements could be simplified and norms promoted for the acceptance of electronic material.

##### ***Enhance voluntary compliance***

- (iii) Electronic assessment and collection of tax could be encouraged. Easier, quicker and more secure ways of paying taxes and obtaining tax refunds could be facilitated.

#### **IV. The broad taxation principles which should apply to electronic commerce**

Box 2 sets out the widely accepted general tax principles that should apply to electronic commerce.

**Box 2**

**Broad Taxation Principles which should apply to Electronic Commerce**

***Neutrality***

(i) Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

***Efficiency***

(ii) Compliance costs for taxpayers and administrative costs for the tax authorities should be minimised as far as possible.

***Certainty and simplicity***

(iii) The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted.

***Effectiveness and Fairness***

(iv) Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimised while keeping counter-acting measures proportionate to the risks involved.

***Flexibility***

(v) The systems for the taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.

The full application of the principles set out in Box 2 will require further work after the Ottawa Ministerial meeting.

#### **V. The challenge of implementing these broad principles**

The challenge facing Revenue authorities is how to implement the broad taxation principles identified in Box 2 in a rapidly changing

environment. In a number of areas the CFA has been able to reach conclusions on the elements of a taxation framework that will incorporate these principles. These are summarised in Box 3.

### **Box 3**

#### **Electronic Commerce: Elements of a taxation framework**

##### ***Taxpayer Service***

- (i) Revenue authorities should make use of the available technology and harness commercial developments in administering their tax system to continuously improve taxpayer service.

##### ***Tax administration, identification and information needs***

- (ii) Revenue authorities should maintain their ability to secure access to reliable and verifiable information in order to identify taxpayers and obtain the information necessary to administer their tax system.

##### ***Tax collection and control***

- (iii) Countries should ensure that appropriate systems are in place to control and collect taxes.
- (iv) International mechanisms for assistance in the collection of tax should be developed, including proposals for an insert of language in the OECD Model Tax Convention.

##### ***Consumption taxes***

- (v) Rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place and an international consensus should be sought on the circumstances under which supplies are held to be consumed in a jurisdiction.
- (vi) For the purpose of consumption taxes, the supply of digitised products should not be treated as a supply of goods.
- (vii) Where business and other organisations within a country acquire services and intangible property from suppliers outside the country, countries should examine the use of reverse charge, self-assessment or other equivalent mechanisms where this would give immediate protection of their revenue base and of the competitiveness of domestic suppliers.
- (viii) Countries should ensure that appropriate systems are developed in co-operation with the WCO and in consultation with carriers and other interested parties to collect tax on the importation of physical goods, and that such systems do not unduly impede revenue collection and the efficient delivery of products to consumers.



***International tax arrangements and co-operation***

- (ix) While the OECD believes that the principles which underlie the international norms that it has developed in the area of tax treaties and transfer pricing (through the Model Tax Convention and the Transfer Pricing Guidelines) are capable of being applied to electronic commerce, there should be a clarification of how the Model Tax Convention applies with respect to some aspects of electronic commerce.

The CFA also recognises that there are ongoing developments in areas such as establishing electronic trading, payment, certification and technical standards and protocols and in the reform of Internet governance where Revenue authorities both individually and in such international fora as the OECD may need to play a role if they are to succeed in implementing the tax principles set out in Box 2. In addition, Revenue authorities in co-operation with other appropriate authorities, will closely monitor developments in electronic means of payment, particularly unaccounted systems.

Recognising the global nature of electronic commerce, Revenue Authorities will intensify their use of existing co-operative arrangements, explore options for multilateral administrative assistance and examine the application of the recommendations relating to geographically mobile activities contained in the OECD Report *Harmful Tax Competition* to the electronic commerce environment.<sup>1</sup>

The CFA believes that an implementation of the framework conditions set out in Box 3 will enable Governments to harness the opportunities and to respond to the challenges of electronic commerce and thereby lead to an internationally consistent taxation approach to electronic commerce.

## **VI. The post-Ottawa Agenda and Process**

The Turku conference of November 1997 initiated work on developing taxation framework conditions for electronic commerce. The Ottawa Ministerial meeting of October 1998 will take this process further. However, much remains to be done. This Report has identified the broad taxation principles which should apply to electronic commerce and identified implementation issues, including how these new technologies offer Revenue authorities the opportunity to improve the service they provide to taxpayers.

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<sup>1</sup> Luxembourg and Switzerland abstained from the Council recommendation which accompanied this report.

## Box 4

## The Post-Ottawa Agenda

Revenue authorities will work through the OECD and in consultation with business to identify concrete substantive steps that can help implement and extend the taxation framework conditions described in Box 3, and to consider the feasibility and practicality of those steps, including the following:

***Taxpayer service***

- (i) Developing an international consensus on ways to simplify taxation systems to minimise the cost of tax compliance, particularly for small- to medium-sized enterprises.

***Tax administration, identification and information needs***

- (ii) Adopting conventional identification practices for businesses engaged in electronic commerce.
- (iii) Developing internationally acceptable guidelines on the levels of identification sufficient to allow digital signatures to be considered acceptable evidence of identity in tax matters.
- (iv) Developing internationally compatible information requirements, such as acceptance of electronic records, format of records, access to third party information and other access arrangements and periods of retention and tax collection arrangements.

***Tax collection and control***

- (v) Designing appropriate strategies and measures to improve tax compliance with regard to electronic commerce transactions, including measures to improve voluntary compliance.

***Consumption taxes***

- (vi) Reaching agreement on, inter alia, defining place of consumption, on place of taxation rules and on internationally compatible definitions of services and intangible property.
- (vii) Developing options for ensuring the continued effective administration and collection of consumption taxes as electronic commerce develops.

***International tax arrangements and co-operation***

- (viii) With regard to the OECD Model Tax Convention, clarifying how the concepts used in the Convention apply to electronic commerce, in particular:
  - (a) To determine taxing rights, such as the concepts of “permanent establishment” and the attribution of income and;

- (b) To classify income for purposes of taxation, such as the concepts of intangible property, royalties, and services, and in particular as regards digitised information.
- (ix) Monitoring of developments in, and tax administration challenges presented by, electronic commerce, in the application of the OECD Transfer Pricing Guidelines.
- (x) Improving the use of existing bilateral and multilateral agreements for administrative assistance.
- (xi) Considering how harmful tax competition for electronic commerce is to be avoided, in the context of the Recommendations on geographically mobile activities accompanying the OECD Report *Harmful Tax Competition*.

The Committee on Fiscal Affairs further recognises that the full application of the principles which underlie these arrangements will require further work after the Ottawa Ministerial meeting. It also accepts that any taxation arrangements put in place must be capable of developing as the technological and commercial environment changes. The Committee welcomes the willingness of business to work with Government in developing further approaches for the implementation of these principles and looks forward to working with business at both the technological and policy level. This further dialogue entails a recognition of the place of Revenue authorities as stake holders in electronic commerce and the validity of their involvement in the development of the standards and protocols which are now emerging.

#### **Box 5**

##### **The Post-Ottawa Process**

To pursue the post Ottawa agenda, Revenue Authorities will continue to:

- (i) Carry forward the work programme in the Committee on Fiscal Affairs including monitoring developments in, and tax administration challenges presented by, electronic commerce and continuing its close relationship with the EC and WCO.
- (ii) Intensify co-operation and regular consultation with the business community.
- (iii) Develop its contacts with interested non-member economies.
- (iv) Report back periodically to the OECD Council and, if appropriate, to Ministers.

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**Annex 3**

<b>Consumption Taxation of Cross-Border Services and Intangible Property in the Context of E-Commerce</b>
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**A. Guidelines on the Definition of the Place of Consumption****Introduction**

In 1998, OECD Ministers welcomed a number of Taxation Framework Conditions relating to the consumption taxation of electronic commerce in a cross-border trade environment, including:

- In order to prevent double taxation, or unintentional non-taxation, rules for the consumption taxation of cross-border trade should result in taxation in the jurisdiction where consumption takes place.
- For the purpose of consumption taxes, the supply of digitised products should not be treated as a supply of goods.
- Where businesses acquire services and intangible property from a non-resident vendor, consideration should be given to the use of reverse charge, self-assessment or other equivalent mechanism.

The Guidelines below are intended to achieve the practical application of the Taxation Framework Conditions in order to prevent double taxation or unintentional non-taxation, particularly in the context of international cross-border electronic commerce. Member countries are encouraged to review existing national legislation to determine its compatibility with these Guidelines and to consider any legislative changes necessary to align such legislation with the objectives of the Guidelines. At the same time, Member countries should consider any control and enforcement measures necessary for their implementation.

**Business-to-business transactions**

The place of consumption for cross-border supplies of services and intangible property that are capable of delivery from a remote location made to a non-resident business recipient<sup>2</sup> should be the jurisdiction in which the recipient has located its business presence<sup>3</sup>.

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<sup>2</sup> This will normally include a "taxable person" or an entity who is registered or is obliged to register and account for tax. This may also include another entity that is identified for tax purposes.

<sup>3</sup> The "business presence" is, in principle, the establishment (for example, headquarters, registered office, or a branch of the business) of the recipient to which the supply is made.

In certain circumstances, countries may, however, use a different criterion to determine the actual place of consumption, where the application of the approach in paragraph 3 would lead to a distortion of competition or avoidance of tax.<sup>4</sup>

### **Business-to-private consumer transactions**

The place of consumption for cross-border supplies of services and intangible property that are capable of delivery from a remote location made to a non-resident private recipient<sup>5</sup> should be the jurisdiction in which the recipient has their usual residence.<sup>6</sup>

### **Application<sup>7</sup>**

In the context of value-added or other general consumption tax systems, these Guidelines are intended to define the place of consumption (and so the place of taxation) for the international cross-border supply of services and intangible property by non-resident vendors/suppliers that are not otherwise registered and are not required to register in the destination jurisdiction under existing mechanisms.<sup>8,9</sup>

These Guidelines apply to the cross-border supply of services and intangible property, particularly in the context of international cross-border electronic commerce, that are capable of delivery from a remote location.

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<sup>4</sup> Such an approach should normally be applied only in the context of a reverse charge or self assessment mechanism.

<sup>5</sup> In other words, a “non-taxable person” or an entity not registered and **not** obliged to register and account for tax.

<sup>6</sup> It is recognised that implementing this Guideline will not always result in taxation in the actual place of consumption. Under a “pure” place of consumption test, intangible services are consumed in the place where the customer actually uses the services. However, the mobility of communications is such that to apply a pure place of consumption test would lead to a significant compliance burden for vendors.

<sup>7</sup> In accordance with the Ottawa Taxation Framework Conditions, specific measures adopted in relation to the place of taxation by a group of countries that is bound by a common legal framework for their consumption tax systems may, of course, apply to transactions between those countries.

<sup>8</sup> While these Guidelines are not intended to apply to sub-national value-added and general consumption taxes, attention should be given to the issues presented, in the international context, relating to these taxes.

<sup>9</sup> The objective is to ensure certainty and simplicity for businesses and tax administrations, as well as neutrality via equivalent tax implications for the same products in the same market (i.e. avoiding competitive distortions through unintentional non-taxation).

The Guidelines do *not*, therefore, apply to services which are not capable of direct delivery from a remote location (for example, hotel accommodation, transportation or vehicle rental). Nor are they applicable in circumstances where the place of consumption may be readily ascertained, as is the case where a service is performed in the physical presence of both the service provider and the customer (for example, hairdressing), or when the place of consumption can more appropriately be determined by reference to a particular criterion (for example, services related to particular immovable property or goods). Finally, it is recognised that specific types of services, for example, some telecommunications services, may require more specific approaches to determine their place of consumption.<sup>10</sup>

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<sup>10</sup> *When such specific approaches are used, the Working Party recognises the need for further work and for international co-ordination of such arrangements to avoid double or unintentional non-taxation.*



## **FINAL CONSIDERATIONS**





## FINAL CONSIDERATIONS

**Horacio Castagnola**  
General Director  
General Directorate of Taxes  
Federal Administration of Public Revenues  
(Argentina)



**Mr. Horacio Castagnola**  
*General Director  
General Directorate of Taxes  
Federal Administration of  
Public Revenues*

During the past days different aspects and strategies on the promotion of tax compliance were analyzed.

Issues of great importance and interest to us were discussed, such as:

- **Building tax culture.**
- **facilitate compliance.**
- **and control strategies.**

- **Tax culture** was analyzed taking into consideration the need for its legitimization, communications policies that must be implemented and the administration's ethical and corporate responsibility issues.

- **Facilitate compliance** was covered through electronic invoicing, the efficiency of the administrations and the decline in compliance costs.

- **Control strategies** were reflected in issues such as the examination of economic groups, the control of financial transactions and electronic commerce.

For some time now, all these issues form part of the agenda of our Administrations as well as CIAT's.

## FINAL CONSIDERATIONS

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Therefore, when preparing these reflections, I was thinking that maybe as a starting point we should ask ourselves, why are we examining these issues again?

One of the reasons is that we live in a dynamic world, even a spiraling one in some aspects, which is increasingly becoming more complex. Hence the need to continuously examine becomes visible, and we must apply strategies to reach the results we seek.

TAs are at the center of change processes having to operate recognizing the complexities, assuming that this implies more activity with better results and less costs. At the same time, they proactively participate as the engines of change and directly influence the development of economies and societies.

Therefore, the TAs that were historically created to perform in a territorial environment, recognize that they currently interact in a framework and context where globalization potentiates commercial operations and flows, multiplies the market's and society's external factors, allows new forms of communications, gives pace to new forms of regional citizenship and causes fiscal sovereignty transfers.

Complementarily, complexity has generated the conceptual expansion of the scope of intervention of the TAs, transcending from the basic idea of an organization exclusively dedicated to tax collection and examination.

Considering these issues and this dynamic, understanding that the formulation of strategies of the TAs should not only consider traditional aspects, those that we have been examining since we tax administrators began meeting in this scope, but others that stem from a broader point of view and which may exceed what we should strictly consider to carry out our competencies.

This idea is implicit, somewhat in the broad scope being given to the "promotion of voluntary compliance" concept and the multidimensional approach of the different types of strategies that were proposed in the Assembly's program.

In this regard, the topics covered in the past days are the core of the "key issues" that the TAs must consider.

Therefore, I would like to say that to me some of these issues are important to analyze in the context in which we must act and that we must take into consideration when planning our strategies.

## 1. FISCAL CITIZENRY

Life in society presupposes a *social contract* establishing certain distribution of the loads among the different players that form and face the same.

This *social contract* implies in any organized state, a *fiscal compact* in response to the necessary financing of the social order.

In this scope, it is therefore necessary to reflect on how we can improve from our role as tax administrators the interaction among the different players of the *social contract* and *fiscal compact*.

Bearing in mind that the social contract and fiscal compact are the same insoluble thing, citizen and taxpayer are also of one same identity. This idea is accented in the concept of *fiscal citizenship* as the best image for this comprehensiveness, because when we talk about a taxpayer we almost exclusively think about obligations, whilst when we refer to citizens we are taking into consideration an player that is not only the bearer of the duties but also of the rights that must be overseen.

Under this scope we must overcome the traditional vision of the taxpayer and consolidate the idea that we are dealing with citizens that have individual and collective rights that must be fully recognized, and we all know that in order for rights be in effect, we must work towards their fair and equitable financing.

With this approach in mind, the paths covered relating to the development of the tax culture such as compliance control is relevant.

In my country's tax administration, the tax education program has two large lines. One is of internal nature, where the objective is to modify the asymmetrical approach of the treasury department-taxpayer relation for a more horizontal line that is public-citizen. The other is addressed to produce a cultural change in citizens which favors the practice of responsible citizenry based values and solidarity.

## 2. THE DEMANDS OF THE CITIZENRY

In Latin American countries and societies the cultural phenomena resulting from the different crisis that have occurred in their recent history is increasing, and is characterized by recent demands made by citizens of greater efficiency in public management.

Society demands State organizations adequate attention of the rights and needs through specific Solutions and similarly require that these solutions be met with quality and efficiency.

This demand impacts at all government levels and scopes and is essentially felt in the TAs given the multiplicity of the relations they manage, as well as the ramifications that it creates.

Hence, our challenge is to make the services provided by the TAs attain this expected level and that the same be perceived as such and are reached by each citizen.

Therefore we must consider the citizen's vision as the main theme; to make an effort and know the reality of the persons, the companies, the variables characterizing their behavior and its specific requirements on the issue of assistance and services.

This approach from the side of the demand allows us to define objectives, policies and procedures that are in agreement and which highlight our condition as public servants.

Therefore, the adoption of strategies aimed at building customized services for citizens is fitting; to be closer to citizens and, reduce compliance costs as well as the state's operational costs. In this manner we will be working on the pillars of fiscal citizenry, promoting in citizens a sense of "fidelity" which translates into greater voluntary compliance.

### **3. SOCIAL INCLUSION**

Some of our countries present alarming signs of social exclusion social. In this regard, the IADB in its annual report considered social exclusion in Latin America as one of the most concerning issues and defined it as "the most dangerous threat faced by democracy in Latin America and the Caribbean".

Exclusion has become more urban and visible; covering people that are not "outside" but which exclusion is a consequence of disadvantageous interactions with institutions and resources that are the ones who allow those who are integrated to develop and prosper in the market economy.

What I mean is that exclusion in one dimension leads to exclusion in others, for example, precarious labor situations push these people towards exclusion in banking, credit, social coverage, health, etc.

Regarding such realities, all countries and state entities must further efforts towards social inclusion, linking insertion, integration and wellbeing mechanisms with the full sense of belonging from the members of society, considering the different strata that separate individuals.

I believe that from the TAs we must pay attention to this problem by supporting developments that tend to revert this situation, not only through the review of traditional process but also considering the forms adopted by the market in the different activities, to facilitate the inclusion of the sectors that are at the edge of marginalization.

From the perspective of social cohesion, our TAs can do much more and many of the lines of action that we were discussing during the last days are steered in this direction.

We must contribute towards educating citizens to promote their formal registry, understand their needs and look for ways to come closer to them to pave the road towards social inclusion.

We know that often projects of this nature do not generate a substantive and immediate impact, but we are sure that from the standpoint of conviction, persuasion and service, we can achieve changes.

This is the road that in the long-term will give us the most important results on the subject of fiscal citizenship.

#### **4. CORPORATE RESPONSIBILITY**

A topic of increasing concern for those of us managing our tax administrations is social responsibility or corporate responsibility, and the complexity of this topic from the standpoint of the public bodies.

In this regard, I would like to state a characterization that divides this concept into exactable social responsibility and transcending social responsibility.

The first of these, exactable social responsibility, is to abide pursuant to the law, and comply with the standard. It is the product of an obligation that comes from outside and therefore, demandable, because it is about meeting the demand of the social contract of which I form a part of as a society.

Transcending social responsibility goes beyond the standard, it implies to do something more than what the system established is

requesting. I consider that this is what we are really talking about when we are talking about social responsibility, when we transcend mere demandable responsibility and go on to give more than what the law asks us to, and this 'give more' becomes 'corporate' when undertaken as a project owned by the organization.

This distinction seems to be appropriate because today you expect, demand that organizations perform actions transcending their strict scope of competition. This can be achieved from the TAs by developing activities that promote civil values, changing undesirable cultural parameters, opening organizations to society, generating public communications spaces.

Therefore, more and more the administrations are working on tax education projects, social inclusion, electronic government, supporting the growth of entrepreneurs and give greater competitiveness to companies operating internationally.

In this manner we relate with the environment, by expanding the traditional role of the TAs linking control and collection, generating in this manner the tools that allow changing the culture of informality, creating more responsible and participative fiscal citizenship.

### **5. TRANSPARENCY IN MANAGEMENT**

It is imperative for public servants to act with transparency.

All our Tax Administrations are concerned about clearly stating to our taxpayers what we do, to provide citizens the possibility of knowing our activity, from the disseminating of statistical data at an aggregate level, up to those that have to do with the control or the examination that is being carried out.

Furthermore, in the quest to make management transparent and further communication with taxpayers, we must be accountable for our activities, as broadest as possible, with budgetary information, on the use of public resources and management – amount of examinations, status of actions or services rendered.

From the internal perspective, the need to establish principles that form the behavior that the Administration wants from its employees persists. Organizations must establish the guidelines and the conditions on which they will be subject to their structure and personnel management.

The establishment of ethical standards must be complemented with periodical training, with the commitment of high officials in the promotion of responsibilities and values, in the supervision of activities for the detection of potential deviations and abuses of its officials.

## **6. THE MULTIPLE DIMENSIONS OF THE INFORMAL ECONOMY**

The informal economy has gained a multidimensional character with different degrees of complexity and spread.

Hence we can consider the different *generations* of the informal economy.

Traditional: characterized by the absence of invoices and bills, “ant” contraband and unregistered employment.

Specialized: where unverified invoices, ghost companies, over and under billing, among others are prevalent.

The broad spectrum of the informal economy is a serious problem for the TAs specifically for the States in general since the maneuvers that are not exclusively developed in their borders: the informal economy has gone global, and this is evidenced in the use of tax havens, financial derivatives, offshore corporations and brand counterfeiting.

Furthermore, the scenario of the TA becomes more complex if we take into consideration the liberalization of financial markets, the elimination of change control mechanisms and the advance of electronic commerce, dematerializing operations, minimization of economic intermediation and making difficult traceability due to the use of electronic money.

Regarding this situation, the TAs must be prepared to respond to strategies that are in agreement to each type of informal economy.

From the collection viewpoint it is more effective to put our efforts on fighting informality linked to more complex maneuvers involving more important operations, from a more ample perspective as the ones we have mentioned previously, we must ask ourselves what we can do about the informal economy to build a more fair society.

The broad range of strategies discussed during the Assembly to promote voluntary compliance is related to this extended view of the phenomena of informal economy. All topics discussed, from the promotion of tax culture to financial transactions influence some form of informal economy.



## **7. RISK MANAGEMENT**

During this week we have been analyzing different aspects that evidence the complexity of the transactions in our current work and the need to potentiate risk management as the guiding principle for the running of the Tax Administrations.

We can agree that risk management is a systematic process that allows the identification of segments on which to apply specific actions leading to increase voluntary compliance and the detection and prevention of evasive and avoidance maneuvers, as well as criminal activities which in some cases may be related to money laundering and corruption practices.

These maneuvers translate into a diverse complexity of operations that may be related to the transfer of funds to tax havens or the creation of offshore corporations with the purpose of concealing assets and income, just to mention some cross border operations, and even those that we live daily in each of our countries from unverified billing, carrying forward losses in time up to unregistered employment, to name a few.

In this regard the benefit of developing studies and research on tax behavior of individuals and companies, their obligations and the complexity of their operations, their zones of activities and their network of relations. In this manner risk management extends to activities that cover registry, filing, collection and control of tax obligations, determination of audits, rendering of services, enforced collection.

Similarly, it is disseminating the use of risk profiles in order to orient control activities. In parallel, to promote transparency in management the development of activities leading to inform taxpayers the assigned category and the reasons why they have this evaluation to promote improvements in the behaviors of those that depart from the standard.

## **8. INFORMATION TECHNOLOGIES**

For many years now, the TA has been participating in the development of modernization of the public sector management leveraged in information and communication technologies.

In this item we must underscore the political decision and the leadership profile of the administrators to overcome the natural difficulties that any process entails.

I think that we all coincide with the validity and importance of the effort that the TAs are carrying out supported on the potentiality of the technologies, to improve:

- the products and services for citizens,
- the links with other services rendering services,
- the efficacy and the efficiency of the services,
- the transparency of public acts
- citizen participation and commitment

In this context, the application of the electronic government concept offers large potentialities originated in the synergy among processes and the use of information produced by more efficient services and by more precise controls.

From the TAs we can contribute to build scenarios where the opportunities offered by information technologies are used by all stakeholders to improve their efficiency and their competitiveness. Every opportunity entails an implicit challenge for all of us. Clear examples of this are electronic invoicing and electronic commerce.

## **9. GROWTH OF INTANGIBLES**

The new information technologies and the development of a knowledge-based economy lead TAs to act proactively to control the new transactions modalities.

Technological development applied in function of growth has generated in companies comparative advantages because of the possibility of incorporating intangible assets such as patents and brands, technology, human capital, management, incorporation of knowledge, services and low cost remote communications.

This incorporation may take place through the generation of intangible assets or due to the different business reorganization modalities internationally, where in a globalized world it is used to position itself in different and new markets.

The challenge on which the TA's should focus on comes here, and this is the valuation of intangibles and their relation with transfer pricing. How can TAs face the exchange of intangibles between linked or related companies, knowing that the valuation of intangibles is complex for an independent company? These are issues that the TAs should anticipate.

In parallel to the intangibles' growth and strong technological innovation, electronic commerce arises as one of the modalities which growth has been exponential during the past decade generating in the TA's a dilemma in taxation concerning the elimination of geographic or national barriers.

These situations and others that are constantly generated, we must face with an open mind that allows appreciating its dynamics and its complexity. To anticipate and follow-up changes will allow us to create conditions to generate better compliance with taxpayers' obligations.

### **10. INFORMATION NETWORKS**

The TA is an organization that permanently interacts with the context, setting up multiple mutual influence relations.

In this manner, as mentioned in many presentations, the traditional point of view of management by collection, control and service processes is no longer enough to achieve the final objectives of promoting voluntary compliance.

A way to expand this concept is to form alliances with key organizations, by creating favorable scenarios for the actions of the tax administration in a strategic complementation scheme.

This advance in the building of networks is one of the instruments that have allowed us to integrate the TAs into the national and international scope, by improving the conditions of the environment where they must develop their tasks.

A good experience that the building of alliances has given us, is materialized through the exchange of information between the many TAs present here, and that has nurtured us with the knowledge - data, experiences, capacities – necessary to understand the complexity of citizens and companies in this globalized world and that has enabled to improve management.

I also think that it is important to mention again another positive aspect produced by information networks, such as the improvement of the quality and the extension of the services offered. For example, speeding-up foreign trade operations, anticipating delivery or dispatch data, qualify operators in the Framework of a determinate logistics change, etc.

Since the trend in the TAs is to increase data and information exchange as a facilitating element for the effective and efficient Management of the tax system, I want to stress that its support starts from the soundness of each of our internal and control registry systems and the quality of the data that we manage.

In this manner, all the alliances that we can build, nationally and internationally, gives us great benefits to be able to construe the complexity and interact with the environment.

We cannot end without mentioning that this is sensible information, therefore we must take the necessary precautions to use it by protecting the rights of our taxpayer citizens.

The link with the private sphere is conceived from the standpoint of communications and facilitation. In this regard, the need to potentiate the interaction with the different players to exchange knowledge and experience, the conception of friendlier and more efficient procedures and the approach of high-impact critical issues in society, to improve the relationship with professionals, business chambers, professional councils and associations.

## **FINAL THOUGHTS**

We can surely have different opinions and appreciations on the “key issues” discussed and how they influence the formulation of the strategy processes of the TAs.

Also, it is likely that we can add other issues to those already discussed.

But I think that we all coincide that it is by the nature of their functions that the TAs must develop their capacities to know and understand the main phenomena happening in today’s world and in each of our countries.

We must assimilate the complexity were we have to act and be proactive to operate.

Therefore the TAs must develop a 360° vision.

It is unimaginable to think about effectively reformulating the strategies if we do not know the phenomena going on in the world and how they impact the realities of our countries.

## FINAL CONSIDERATIONS

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As from the development of this expanded vision, perhaps we should modify the positioning of our TAs maintaining as a horizon to lead them to be institutions of excellence, committed with the economic-social development of our countries, with clear values and ready to fully assume their responsibilities as the drivers of change.

To me it is highly enriching to know the ideas and experiences developed in these scopes.

This is the reason why I would like to thank CIAT for the work it carries out in making possible through events of this nature the sharing of experiences, to approach a 360° vision that I understand we must develop.

**RESOLUTION OF THE 42<sup>ND</sup> CIAT GENERAL ASSEMBLY  
“STRATEGIES FOR THE PROMOTION  
OF VOLUNTARY COMPLIANCE”**





Resolution of the 42<sup>nd</sup> CIAT General Assembly

**“STRATEGIES FOR THE PROMOTION OF VOLUNTARY COMPLIANCE”**

**The tax administrations of the member countries and associate member countries of CIAT present in the 42<sup>nd</sup> CIAT General Assembly in Antigua, Guatemala,**

**Whereas,**

The Tax Administrations have understood the need to design and implement mechanisms that may motivate and facilitate spontaneous taxpayer compliance, not merely through the application of coercive measures which, in addition to demanding a significant effort in terms of use of human, technological and financial resources, have not always proven to be the most effective means for ensuring a generalized and sustainable fiscal discipline in society.

The tax culture is an issue that acquires ever greater relevance among the tax administrations, not only because it constitutes an important element within the State-society and specifically the tax administration-taxpayer relationship, but rather because it discloses the ever greater need to make the citizen aware of his civic-tax duties, thus becoming one of the ways of creating and promoting the citizens' knowledge about tax policy and its execution or management, the role it fulfills, the need and social justification it entails and the citizen's role and responsibility for complying therewith.

The Tax Administrations are responsible for establishing mechanisms that may promote ethics not only within the organization (codes of conduct, promulgation of values, etc.) but also in the procedures and actions carried out in its relationship with society (rendering public the information on tax administration expenses, the declaration of properties by the officials, etc.). Therefore, accountability mechanisms are an important and necessary means for making citizens aware of those actions.



Counting on mechanisms that may allow the taxpayer timely and correct compliance are an essential condition for increasing voluntary compliance.

The tax administration has understood that the relationship with society and assistance in complying with tax duties is one of the basic functions it should carry out at present.

Considering the opportunities and services currently afforded by technology and the greater access thereto, not only by the tax administrations, but also, the taxpayers, the facilitation of these services to them is of great relevance for achieving greater efficiency and lower compliance costs.

Among the achievements provided by technology, the electronic invoice represents a significant step within the options of simplification of processes that facilitate compliance by the taxpayers, as well as control by the tax administration, by having promptly and readily available relevant information for carrying out its functions.

The Tax Administrations, vis-a-vis such challenges as economic globalization that has resulted in operations that go beyond the countries' own borders, must analyze all aspects of compliance (filing, payment and reporting) including for combating potential tax fraud, evasion and avoidance, by establishing more effective control strategies for identifying the nature of operations, the taxpayers, etc. and which may be done, among other things, through effective management of information obtained through external or internal exchange.

## THE GENERAL ASSEMBLY

### RESOLVES:

**To recommend the tax administrations of its member countries to permanently strengthen mutual cooperation and undertake actions for promoting voluntary compliance, to which end they must:**

**FIRST:** develop and implement strategies for structuring a tax culture by:

1. Promoting a citizenship culture in society, among individuals and business, at large to favor compliance with tax obligations.
2. Implementing operating guidelines that stress the importance of ethical behavior by government officials in tax administration, and by improving the taxpayer's understanding of their role and responsibility in promoting ethics in the tax administrations.
3. Identifying and applying tools and means that may improve effective communication between the tax administration and society, through the use of innovative and emerging communication technologies.

**SECOND:** implement mechanisms that may motivate and facilitate spontaneous taxpayer voluntary compliance by:

1. Improving and expanding the coverage of services currently available to the taxpayers and implementing new ones through the use of tools afforded by technology, such as electronic invoicing in VAT regimes, Internet access to forms and publications, electronic filing of tax returns, and posting frequently asked questions and their answers.
2. Increasing the efficiency and effectiveness of tax administrations through: the reduction of compliance costs, reducing or eliminating unnecessary and/or complex procedures, improving the tax culture awareness of employees, and better use of information and information technology to avoid unnecessary contacts with taxpayers.

**THIRD:** Establish strategies for improving tax compliance control that may be innovative and in keeping with the complexity and diversity of operations currently carried out by:

1. Identifying and seeking to understand the economic relationships that exist between companies (taxpayers) and enterprises within

which they operate, by effective use of information, obtained externally and internally, and by improving the tax administration's awareness of the taxpayer's commercial operating environment (commercial awareness).

2. Identifying and seeking to understand the role and effectiveness of financial institutions in the taxpayer's business operating environment.
3. Identifying taxpayers engaged in electronic commerce and seeking to determine the nature, scope and value they derive from e-commerce, and seeking to understand the cross-border implications of e-commerce and the use of international administrative assistance and cooperation.

## **TECHNICAL PROGRAM**



**42nd. GENERAL ASSEMBLY**  
**Antigua Guatemala, Guatemala**  
**April 21-24, 2008**

**DAILY SCHEDULE OF ACTIVITIES**

**Main Topic: STRATEGIES FOR THE PROMOTION OF VOLUNTARY COMPLIANCE**

**MONDAY, APRIL 21**

**Morning**

09:00 - 09:30 Inaugural ceremony (30')  
09:30-10:00 Official photograph and Coffee Break

**TOPIC 1**

**Topic 1: Strategies for the development of the tax culture**

**Moderator:** William Layne, Permanent Secretary, Ministry of Finance of Barbados.

10:00-10:35 **Speaker:** Carolina Roca, Superintendent of Tax Administration of Guatemala. (35')

10:35-10:45 **Commentator:** Juan Toro, Head of Tax Administration Division, IMF. (10')

10:45-11:15 **Debate (30')**

**Topic 1.1: Social legitimization of the tax policy and culture.**

**Moderator:** Nelson Hernández, General Director of Revenue, Uruguay.

## Technical Program

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11:15-11:35 **Speaker:** Clara Rossana Urteaga, Legislation Intendent, National Superintendence of Tax Administration, Peru (20')

11:35-11:55 **Speaker:** Alberto Barreix, Regional Economist, IDB (20')

11:55-12:25 **Debate** (30')

12:25-14:00 **Lunch**

### Afternoon

**Topic 1.2: Policies for communicating with society and new methods for rendering them more efficient.**

**Moderator:** Armando Sarmiento, Executive Director of Revenues Honduras

14:00-14:20 **Speaker:** Edward Kieswetter, Chief Operations Officer, SARS- South Africa (20')

14:20-14:40 **Speaker:** José Antonio de Azevedo Pereira, General Director of Taxes of Portugal (20')

14:40-15:10 **Debate** (30')

15:10-15:30 **Recess**

**Topic 1.3: Ethics and Corporate Responsibility in the tax administrations**

**Moderator:** María Raquel Ayala Doval, Tax Studies Director - CIAT

15:30-15:50 **Speaker:** Linda Stiff, Acting Commissioner – IRS, United States (20')

15:50-16:10 **Speaker:** Olivier Siviéude, Human Resources Director of the General Directorate of Taxes of France (20')

16:10-16:40 **Debate** (30')

16:40-17:15 **Eurosocial Project:** Presentation and advances

<b>TUESDAY APRIL 22</b>
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**TOPIC 2**

**Morning**

**Topic 2: Strategies for facilitating Tax Compliance**

**Moderator:** Claudino Pita, Executive Secretary, CIAT

09:00-09:35 **Speaker:** Luis Pedroche, General Director of the State Agency of Tax Administration of Spain (35')

09:35-09:45 **Commentator:** Soraya Nivar, Deputy General Director of Taxes of the Dominican Republic (10')

09:45-10:15 **Debate** (30')

10:25-10:35 **Recess**

**Topic 2.1: The electronic invoice**

**Moderator:** Oscar Franco, General Director of Taxes and National Customs of Colombia

10:35-10:55 **Speaker:** Ricardo Escobar Calderón, Director of the Internal Tax Service of Chile (20')

11:55-11:15 **Speaker:** Marcelo Fisch, General Coordinator of Examination, Federal Revenues of Brazil, (20')



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- 11:15-11:45     **Debate (30')**
- Topic 2.2:**     **The efficiency of the tax administrations and the reduction of compliance costs.**
- Moderator:**     Carlos M. Carrasco, Director of Internal Revenues Service of Ecuador.
- 12:45-12:05     **Speaker:**     Sabina Walcott-Denny, Commissioner of Internal Revenues Department, Ministry of Finance, Barbados (20')
- 12:05-12:25     **Speaker:**     José María Zubiría, Head of the Tax Administration Service of Mexico (20')
- 12:25- 12:55     **Debate (30')**
- 12:55-14:15     **Lunch**
- Afternoon**
- 14:30-17:00     **Administrative Session**

**WEDNESDAY APRIL 23**

**Integration activity**

THURSDAY APRIL 24

**TOPIC 3**

**Morning**

	<b>Topic 3:</b>	<b>Strategies for the control of tax compliance</b>
	<b>Moderator:</b>	Carolina Roca, Superintendent of Tax Administration of Guatemala
09:00-09:35	<b>Speaker:</b>	Lyse Ricard, Assistant Commissioner, of Canada Revenue Agency (35')
09:35-09:45	<b>Commentator:</b>	Deborah Nolan, former Commissioner of Large and Mid-Size Business Division (10')
09:45-10:15	<b>Debate</b>	(30')
10:15-10:30	<b>Recess</b>	
	<b>Topic 3.1:</b>	<b>Examination of economic groups</b>
	<b>Moderator:</b>	Errol Goeloe, Head of tax Collection Office of the Netherlands Antilles
10:30-11:50	<b>Speaker:</b>	Enrico Martino, Director of Economy Relations Office, Ministry of Finance, Italy (20')
10:50-11:10	<b>Speaker:</b>	Luz Elvira Rey, Head of Investigation Department, Directorate of Large Taxpayers Examination of AFIP, Argentina (20')
11:10-11:40	<b>Debate</b>	(30')

	<b>Topic 3.2:</b>	<b>The control of financial transactions</b>
	<b>Moderator:</b>	Francisco Fonseca, General Director of Taxation of Costa Rica
11:40-12:00	<b>Speaker:</b>	Frans Buikema, Expert Incorporate Income Tax. The Netherlands (20')
12:00-12:20	<b>Speaker:</b>	Donato Raponi, Head of Tax Administration, Department, European Commission: (20')
12:20-12:50	<b>Debate</b> (30')	
12:50-14:15	<b>Lunch</b>	
<b>Afternoon</b>		
	<b>Topic 3.3:</b>	<b>The control of electronic commerce</b>
	<b>Moderator:</b>	Walter Porras, General Director of Revenue, Nicaragua
14:15-14:35	<b>Speaker:</b>	David Holmes, OECD (30')
14:35-14:55	<b>Debate</b> (20')	
15:45-16:00	<b>Recess</b>	
16:00-16:15	<b>Evaluation of the event</b>	
16:15-16:40	<b>Final considerations:</b>	Horacio Castagnola, General Director of Tax Administration – AFIP, Argentina.
16:40-17:00	<b>Closing ceremony</b>	

## **LIST OF PARTICIPANTS**



**42nd CIAT General Assembly  
Antigua, Guatemala  
April 21-24, 2008**

**LIST OF PARTICIPANTS**

**ARGENTINA**

**Horacio Castagnola**

Director General - Dirección General  
Impositiva  
Administración Federal de Ingresos  
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